



June 9, 2004

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Subject: Proposed Rule on Short Sales
File No. S7-23-03

Dear Mr. Katz,

Pink Sheets LLC ("Pink Sheets") provides the following comments on proposed new Regulation SHO under the Securities Exchange Act of 1934 (the "Exchange Act"), which would replace Rules 3b-3, 10a-1, and 10a-2. Pink Sheets is the leading provider of pricing and financial information for the over-the-counter (OTC) securities markets and, among other things, operates an Internet-based, real-time quotation service for OTC equities and bonds for market makers and other broker-dealers registered under the Exchange Act.

We applaud the Commission's efforts to revise its existing short-sales rules in light of modern trading practices. We are particularly encouraged by the Commission's focus on the problem of naked short selling, which from time to time raises serious issues with respect to settlement and clearing of certain relatively illiquid securities quoted in the Pink Sheets and on the OTCBB.

Our comments on proposed Regulation SHO concern four important issues: (1) short interest disclosure, (2) bona fide market making activities (3) uniform reporting and trading rules and (4) increased regulatory and enforcement focus on actions that dilute shareholders.



Short Interest Disclosure. Proposed Regulation SHO derives much of its solution to naked short selling from NASD Rule 3370, which generally requires broker-dealers to make an “affirmative determination” that stock can be borrowed or that other arrangements can be made to deliver the stock prior to settlement before it can be sold short. We believe that prompt and consistent enforcement of the proposed rule would in most cases alleviate current clearing and settlement problems resulting from naked shorts.

Effective enforcement is frequently the handmaiden of good disclosure. It should be noted that NASD Rule 3360 requires monthly reporting of short positions in securities traded in The NASDAQ Stock Market or on any registered securities exchange. Unfortunately, this rule does not extend to stocks quoted on the OTCBB or the Pink Sheets. We believe that the salutary effects of proposed Regulation SHO, and the Commission’s efforts to enforce the new rule, would be greatly enhanced by extending this disclosure requirement to all equity securities, wherever traded. We also might for regulatory purposes enhance disclosure to the NASD so member short position reporting is categorized as proprietary, proprietary under the market maker exemption and customer accounts.

One of the most frustrating symptoms of having no transparency in OTC equity short positions is that investors are easily misled that any selling in a stock is from “Naked Shorts”. This creates a perception that the seller will need to return to the market to buy any shares that are for sale, instead of the fact that it could be a disgruntled shareholder or worse an insider selling shares they own. Pink Sheets believes that monthly short position reporting and disclosure by NASD member firms is the most important change that is needed to enhance transparency and protect investors from being victimized by supposed short selling.

Market Maker Delivery Requirements. We concur with the Commission’s view that there should be an exemption for naked short selling by bona fide market makers. We also believe that this exemption should be limited to bona fide market makers.

On the other hand, we respectfully disagree with the Commission’s view that a failure to deliver a security within 5 days indicates that a market maker is engaged in an investment or trading strategy, rather than market making. Many of the stocks traded in the Pink Sheets are quite illiquid and trade infrequently. Stock lending programs rarely include such issues. Under the



proposal, bona fide market makers required to clear and settle short sales in such securities within 5 days would be unwilling to make a two-sided market unless they held a long position.

It is our experience that bona fide market makers without a long position from time to time may sell stock to a customer, or offer to sell stock in a quotation medium, when that stock cannot be borrowed, and it may be some time before the stock can be purchased to cover. The unintended consequences of the rule would be to eliminate a market in many smaller, illiquid issues, a result that would be contrary to the interests of the investing public and frustrate the successful capitalization of smaller companies.

A determination of “bona fide market making” status is necessarily a facts and circumstances test where the nature of the market is a highly relevant factor. In liquid markets with active borrowing programs, a failure to deliver promptly might well indicate that a firm is not operating as a bona fide market maker. In less liquid markets, an extended failure to deliver may be a necessary component of bona fide market making.

We would suggest that the Commission look at an alternative of developing guidelines of what is “bona fide market making” such as continuously publishing two sided quotations in a Quotation System and provide a safe harbor for short sales are made in relation to market makers published quotations.

Uniform Reporting and Trading Rules. We disagree with the Commission’s view that the proposed “uniform bid test” should not be applied to OTCBB and Pink Sheets stocks at the present time because quotations in these markets are not part of a consolidated reporting system. We do not think that there is any problem in defining a NBBO for OTC equity securities as NASD Rule 2320 is used in reference to “best execution” and the same guidelines could be used for any NBBO needed for short selling regulations.

We do believe that the market for a stock that trades infrequently is unlikely to derive much benefit from a uniform bid test, and such a test may deter bona fide market makers from quoting the stock.

Many of the reporting and trading rules governing securities traded on national securities exchanges, NASDAQ, and in some cases the OTCBB, do not apply to securities quoted in other venues, such as the Pink Sheets. In some cases, there are good reasons for different rules. Rules governing



exchanges where only one specialist acts as market maker may not rationally apply to over-the-counter dealer markets where price formation is accomplished through competition among many market makers. It is unfortunately true, however, that differences in rules often reflect markets of the past, before the development of electronic networks and efficient information transmission.

In the past, sensible distinctions in regulatory needs could be drawn between exchanges and different types of over-the-counter markets, where investments in infrastructure greatly affected market conditions. Much of this must now be considered historical artifact. A more rational approach to regulation under current conditions, we believe, would generally base rules on the nature of the market for a particular equity, especially volume and other liquidity measures, rather than the site of quotations.

Increased regulatory and enforcement focus on actions that dilute shareholders. We believe that a current source of supposed “Naked Short Selling” is actually sales by purchasers of private placement and derivative securities from OTC equity issuers. Private placements in public equities (i.e. PIPES) are a growing area where there is substantial room for abuse. We would hope that the Commission would look at the effects of such dilutive actions and craft an approach that made insiders, participants and people with knowledge of such dilutive transactions restricted from any trading in the subject issuer’s public securities until full and complete disclosure was made to the public. The trading on information of a dilutive securities issuance should be considered insider trading and we recommend the Commission pursue high profile enforcement actions in this sector.

We would also hope that the Commission’s department of Corporate Finance would review ways to increase disclosure of shares outstanding on a timely basis by issuers.

We would hope that the Commission would pursue the need for disclosure in not only SEC reporting issuers but non-reporting issuers that could use traditional disclosure systems such as news releases services, Issuer web sites and Pink Sheets’ company news service. Pink Sheets would be glad to meet with the staff and discuss any actions we could do to improve such disclosure by Pink Sheets quoted issuers.

We are aware that legislative action will be required to achieve some of these goals. Nonetheless, proposed Regulation SHO, in our view, takes a large



step in the right direction by proposing uniform rules for securities listed on a national securities exchange or a part of NASDAQ NMS, wherever the securities happen to be quoted. We think this initial step should be part of a larger re-examination of existing trading rules with a view to rational, uniform application across all markets.

Please call me if you have any questions.

Very truly yours,

R. CROMWELL COULSON

R. Cromwell Coulson
Chief Executive Officer