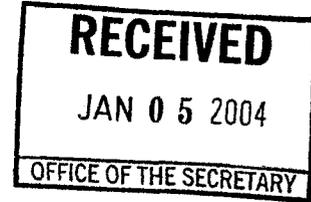


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Jonathan G Katz
Secretary, Securities and Exchange Commission
450 Fifth Street NW
Washington DC 20549-0609



RE: Comment Letter to the SEC
Proposed Rule SHO

57-23-03

Dear Sirs,

Regulation SHO removes some unnecessary obstacles to short-selling which should benefit orderly and liquid markets. You are to be commended for taking on the many issues raised by this challenging rule reform.

However, there are several aspects of the proposed rules related to affirmative determination and share borrows which raise substantial concerns, because they are based on assumptions which appear fair but are not equitable in practice. If you implement SHO as drafted, there will be widespread negative consequences for individual investors.

While excessive short-selling may be disruptive of a fair and orderly market, relying on the affirmative borrow as the "gold standard" for limiting excessive short selling is a disastrous choice. The "borrow-ability" of shares is itself already subject to substantial manipulation; the proposed rules will provide further incentive for abuse, and the beneficiaries will be those with the greatest incentive for selling grossly inflated and/or worthless shares to the public.

First, the borrow of securities at US brokerage firms is an unlevel playing field for the investor, especially the small investor. Within the last two years, many of the major brokerage firms have transformed their borrow desks into profit centers, from what used to be merely a clerical task prerequisite to executing a short sale order. Fees, which used to be negligible or non-existent, have skyrocketed dramatically, being quoted as high as 18% per annum in some cases. It is unclear who are the beneficiaries of these fees, but it is unlikely to be the stockholder whose shares are borrowed.

Of far more concern, it appears that it is becoming common practice for borrow desks affording preferential treatment to the firm's best customers. Access to borrows is starting to resemble the pattern of abuses which characterized brokerage firm management of IPO allocations during the 1999 – 2000 bubble; the firms' best customers get the best access to the short sale market. (Margin requirements for short positions are also skewed away from what would be necessary for fair and orderly markets, but that is a separate topic I have not discussed here.)

Second, in the case of thinly distributed stocks (which are most commonly the ones subjected to abusive promotion on the OTCBB and pink sheets) finding shares is very difficult when the available shares are broken up into small lots spread across all the major brokerage and clearing firms in the US.

To level the field for short selling requires a centralized inventory of borrowable shares. The “inventory” held by a trader’s firm or clearing firm should not be a limiting factor, especially when that inventory is being allocated preferentially. For a “good customer” the borrow desk will “call around”, but for the retail customer, the answer is most often just “not available”.

Third, currently available data about outstanding shares, shares in float, and amount of short interest, is inadequate and flawed. Short interest is only reported monthly, and at that, lags two or more weeks behind the cutoff date. Even this inadequate level of data is unavailable for OTCBB or Pink Sheet stocks.

Inexplicably, although the data to support the premise of short-selling abuses is lacking, Reg SHO seeks to regulate the presumed problem. Under such conditions, it is not possible to know if there is a problem, or measure the degree of success of new regulations to solve it.

Without better data, it is not possible to assess the real market conditions with regard to availability to borrow. More significantly, it is not possible to address whether short interest in any given issue is excessive. It is therefore premature to institute rule in the absence of this data critical to measuring the abuse the rule is intended to curb.

Fourth, in OTCBB and Pink Sheet markets, where abusive promotional activities are much more prevalent, new SHO regulations do not seem to consider that promoters of overpriced securities already routinely engage in numerous market-manipulative tactics of no legitimate economic benefit, purely for the purpose of removing or restraining market access to borrowable shares. These activities include, among others:

- 1) Issuers writing letters to shareholders encouraging them to “take delivery” of their shares in paper form (Last year many of these same issuers tried to exit the DTC for the same reason.)
- 2) Insiders moving blocks of shares from firm to firm, and account to account, to make borrows against those shares difficult to maintain
- 3) Marginal stock splits and share reissues, especially those involving fractional shares in spin-off companies with no market value or public market
- 4) Orchestrated buy-ins at above-market prices
- 5) Issuers announcing purported massive short positions in their stock, threatening legal action, etc., when there is no public quantitative information to verify the allegations.
- 6) Issuers and allied insiders engaging in sham trades to create volume and price movement.

These actions are direct market manipulations whose only intent is to manipulate the supply of borrowable shares. Imposing further restrictions and sanctions on selling short stocks subject to such manipulative practices invites escalating abuses, and a proliferation of intentionally created float manipulations.

Fifth, current speculative market conditions are marked by headline-grabbing press releases which can cause massive volume surges. It seems at least once a week a stock trades share volumes in excess of its entire public float in a single day. This rapid circulation of shares can render affirmative borrow impossible, even though there remain plenty of shares in the float to support a reasonable short position.

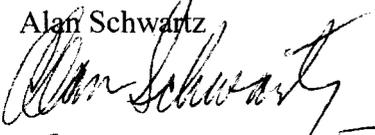
Reg SHO does not address how a short position may be established or maintained through such a wave of speculative frenzy.

Under these conditions, I believe it is premature to modify regulations as you have proposed. If Regulation SHO is implemented as drafted, it risks stimulating a wave of negative unintended consequences due to removing the damper of short selling from abusive stock promotions and frauds, as well as waves of rampant speculation. The market is already rife with such issues.

In conclusion, I support all regulations intended to establish a "level playing field" with regard to short-selling's valuable role in market activities. Reg SHO as conceived unfortunately takes us farther from that goal, rather than closer to it. The SEC's legitimate concern with abusive "riskless" short selling in the context of "death spiral" financing should be directed specifically to those financing terms and the parties that craft them. That is a different situation entirely than the legitimate "at-risk" short sale transaction made in good faith by an investor, who is willing to stand the risk of loss if his premise about overvaluation of the security is truly incorrect.

Yours truly,

Alan Schwartz


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