

June 17, 2009

Attached please find a letter submitted today by Wachtell, Lipton, Rosen & Katz to the Securities and Exchange Commission in response to the Commission's request for comments on its proposed amendments to Regulation SHO (short sale proposals).

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Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549-1090
Via email: rule-comments@sec.gov

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

Dear Ms. Murphy:

The repeated abuse of short selling over the past eighteen months has led to the destruction of businesses, cost countless numbers of jobs and created systemic risk in the global economy. Though some have asserted that short selling aids liquidity and price discovery in the market, the possibility of such functions should not be used to justify the damaging and corrosive consequences of abusive short sales. Since the repeal of the uptick rule in 2007, the market has suffered a resurgence of manipulative short selling, including widespread "bear raids," in which short sales of equity securities are employed, sometimes in combination with other trading strategies, in a concentrated effort to drive down their prices. These practices have badly damaged institutions, destroyed billions of dollars in shareholder value, and crippled investor confidence.

We strongly urge the Commission to adopt effective regulation to constrain abusive short selling and related trading strategies, thereby protecting institutions, employees, shareholders and

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the wider economy from the manipulation and ensuing damage that have been pervasive over the past several years.¹

First, we urge the Commission to adopt a short sale price test to decelerate the short selling process, thereby reducing short sellers' ability to overwhelm companies' shares and quickly profit from the resulting "downward spiral" in share prices. We believe that, in order to function effectively in the modern marketplace, a price test based on the national best bid is appropriate. To provide the most comprehensive protection against manipulation, any price test should be adopted through both the "policies and procedures" and "straight prohibition" approaches. The former requires that exchanges and other trading centers develop the policies, systems and technology necessary to ensure trades' compliance with the price test, while the latter gives all market participants responsibility for compliance and provides the Commission with maximum enforcement authority over any violations.

Such a price test rule must not overlook the myriad ways traders are able to effect a short position in a company's stock, including synthetic short positions created through the use of options and exchange traded funds. Thus, any short sale price test rule adopted by the Commission should address these strategies and provide the Commission with enforcement authority over synthetic shorting activity aimed at evading the price test.

In addition to a price test based on the national best bid, we recommend that the Commission implement a "circuit breaker" rule that would impose additional restrictions on short sales of a security that has been the subject of a severe price decline. Following a decline of five percent in a security's price from its previous day's close, short sales in the security should be suspended for the remainder of the trading day. This suspension will prevent a destabilizing downward spiral in the triggering security and give the market time to arrive at a rational valuation. Short sales should be allowed to resume on the next trading day, albeit with additional restrictions, such as a strict "pre-borrow" requirement for a certain recovery period to ensure that aggressive short sellers are not permitted to further damage the security's price during this sensitive time. A properly calibrated "circuit-breaker," in combination with a short sale price test, will interrupt the instances of extreme intraday volatility that destabilize the market, prevent efficient price discovery and cause investors to doubt the fairness and integrity of the market.

Any action the Commission attempts to take against manipulative short selling will not be completely effective without parallel, reinforcing reforms applied to the derivatives market, particularly with respect to credit default swaps ("CDS"). The responsiveness of equity prices to changes in CDS spreads makes the purchase of CDS a powerful device for bear raids, particularly when used in connection with short sales. Combining a short sale with the purchase of CDS sends a false signal into the marketplace about a company's credit and, accordingly,

¹ In addition to the adoption of a price test and other actions described below, we believe that the Commission should extend and strengthen the rules it adopted last fall aimed at curbing naked short selling and requiring greater short selling disclosure.

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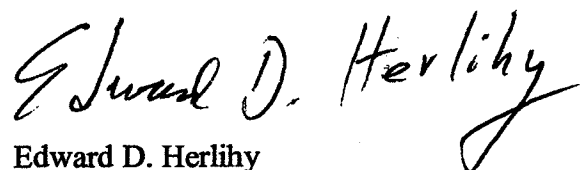
causes a drop in the stock price that makes the short position profitable. Such manipulation is dangerously cost-effective, as a relatively small investment in an institution's CDS is sufficient to spark rumors of default or a ratings downgrade and immediately sink stock prices.

To prevent this and other abuses of the CDS market, we believe that only those who are economically exposed to the underlying credit risk of a company should be allowed to buy CDS protection on the company. The purchase of a "naked" CDS, made by a purchaser with no exposure to the reference company, is more akin to gambling than obtaining insurance, and such instruments are capable of causing serious distortions in the market. A prohibition on naked CDS would allow the appropriate use of these instruments while restraining those using the CDS market in a manipulative and abusive way. As an intermediate step, the Commission should use its ability to regulate short sales to require a waiting period between any purchase of a CDS and short sale involving the same reference company. In addition, to alert the marketplace to situations when CDS are being used to manipulate share prices in conjunction with short selling, the Commission should require disclosure when an actual or synthetic short position in a company's equity securities is accompanied by a long position in the company's CDS.

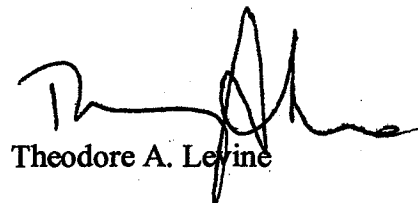
Stock and derivative markets must be effectively regulated so that a few profit-seeking bear raiders cannot contribute to a "run on the bank" that destroys an enterprise and risks global systemic collapse, as in the cases of Bear Stearns and Lehman Brothers. We urge the Commission to ensure that the regulatory scheme it formulates in response to the current financial crisis has sufficient flexibility to reach the many ways abusive and manipulative practices have affected the market and harmed small investors and the wider economy.

Thank you for the opportunity to comment on this proposal.

Very truly yours,



Edward D. Herlihy



Theodore A. Levine