

Chapter 11 Appendix

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Illegal Naked Short Selling Appears to Lie at the Heart of an Extensive Stock Manipulation Scheme

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Investment Consequences of Naked Shorting

Only a motivated enforcement agency with subpoena power and an accompanying powerful enforcement infrastructure can prove that naked shorting is at the heart of an extensive stock manipulation scheme. However, I believe that the observational evidence is overwhelming that naked shorting practices are widely used to manipulate the stock prices of emerging biotechnology companies as well as many other small and large companies. Unfortunately, naked shorting is an investment variable that investors must understand if they are going to make investments in the emerging biotechnology space in particular and the equity markets in general.

Investors may decide that they just won't invest in companies that are most subject to naked shorting, but this would eliminate many small emerging growth stocks with exciting potential. For those like me who are attracted by potentially breakthrough technologies, you will inevitably get caught up in a manipulation that leads to a suddenly plunging stock price of a company in which you are invested. Invariably the scheme starts with and is perpetuated by a flurry of blogs, tweets and message board comments which proclaim that the technology is worthless; management is a band of liars and thieves; and people with a positive view on the Company are being paid by the Company. Then come the lawsuits against the Company and management by the usual group of class action law firms. Each year this scenario is played out hundreds of times.

This carefully scripted and long used manipulation scheme by short selling hedge funds is all meant to shake and then break investors' confidence. The result is usually a painful, steady, day by day erosion of the stock price due to naked shorting practices. Stocks can be cut in half by naked shorting on the basis of little or no change in fundamentals. If you are going to invest in this area, you must decide when this occurs whether you believe strongly in the Company and can ride out the storm or want to cut and run. However, sometimes it happens so rapidly that the latter is not an option. On the positive side, these manipulations can often lead to some excellent investment opportunities if the fundamentals remain intact, investor confidence returns and the shorts are forced to cover.

The Rationale for Investing in Small Emerging Biotechnology Companies; Is It Worth It?

I worked for many years on Wall Street as an analyst covering large pharmaceutical and biotechnology companies and rarely dealt with small companies which I arbitrarily define as having market capitalizations under \$1 billion. From my experience with these large companies, I came to believe that they were excellent at drug development and commercialization and sometimes innovation, but depended extensively on small entrepreneurial companies for their pipelines. Many, indeed most, of the paradigm changing technologies are initially pursued by small companies. The big companies generally wait for proof of concept and then swoop in to either license the technology and/or the drugs stemming from it or to purchase the companies outright. This can lead to some incredible homeruns for investors in small companies so much so that one success can offset several failures.

The behavior of the big companies is understandable as the number of intriguing and promising new technology approaches in drug development seems endless. I personally have done some tracking of over 300 biotechnology companies and this is not an exhaustive list. Moreover, exciting new technologies are evolving like lava flowing over the rim of a volcano. Even big companies lack the infrastructure and financial resources needed to aggressively pursue more than a small fraction of drug development opportunities. Once committed, the development costs for a new drug can run into the hundreds of millions and even over \$1 billion of costs. And of course, the failure rate in new drugs is astronomically high. I have seen estimates that for drugs that begin human phase 1 trials, perhaps only 1 in 10 will reach phase 3 and in phase 3 a significant percentage will fail. And even of those that succeed only a few become blockbusters.

With this high rate of failure, drug development is not for sissies. Research people at large companies get rewarded for successes and fired for failures. Hence there is a tendency to focus on evolutionary (me too) drug development in which there is less risk and leave the paradigm shifting efforts to entrepreneurs willing to accept the very high risk of failure for the extraordinary rewards in those few cases in which success is reached. What are those odds for success? I have no data to back this up, but the chance for moderate success is less than 1 in 10 and for home runs is in excess of 1 in 25 or 1 in 50. Take these numbers as being representative of the risk as opposed to a well-researched estimate.

Wall Street analysts have risk profiles that aren't that different from research people at big pharma. They gain fame for being correct on a stock and can lose their jobs if they take a risk on an unproven drug or technology and get "blown up". As a result, many early stage companies are ignored by analysts or primarily covered by analysts working for investment banks who specialize in bringing such companies public; naturally analysts employed by investment banks are always positive on the stocks their firms underwrite.

As I looked at this situation, about five years ago, I sensed an opportunity to try to bring quality research to some of the companies in this vast universe of poorly followed companies. Obviously, it is not possible to cover all possible companies so I focused on just a few in which I tried to do exhaustive research that could give me an edge. My strategy was primarily although not entirely to focus on stocks that could be homeruns. (Please refer to my earlier comments on the risks involved). Recognizing the high potential for failure, I tried to find as many opportunities as possible and never put all my eggs in one basket. In my own portfolio, I invest in a large number of early stage biotechnology stocks as I fully recognize that I am going to be wrong in a significant percentage of the stocks I deal with. I call my strategy **asymmetric investing** and this is explained in more depth on my website at this link.

Finding Out About Naked Shorting

I started developing my website and its content about four years ago. As I gained more experience, I was startled to find that there was another very important force at work on these companies that was apart from the fundamentals that I was focused on. One would expect a high level of volatility in the stocks in which I specialize. However, this could not always explain the demoralizing collapse of a meaningful number of stocks that I am involved with following some news event. Suddenly and without a major change in the fundamental outlook, I would see stock prices cut in half in a short period of time. During this time there was invariably a steady day by day price erosion (naked shorting at work) accompanied by an unending stream of contrived negative news flow that was demoralizing to me and other investors.

In order to give more insight into what a naked shorting attack might look like, I have put the predictable elements of a typical attack based on my experience in living through a number of them on separate companies.

- Shorts like to target emerging biotechnology stocks that are engaged in high risk drug development and are not widely covered by quality research analysts.
- The initial and subsequent attacks are almost always triggered by some news event. Obviously, the shorts seek out negative news or an event that creates uncertainty. However, sometimes an attack can be based on a positive news event which the shorts spin to make it appear negative.
- Using the ready platform afforded by the internet and social media, a blogger associated with the shorts goes to work with a negative interpretation of an event. These are usually not sophisticated analyses and are usually limited to one or two pages of text which is invariably one-sided and unbalanced. These are meant to provide "intellectual" reasons and cover for the short attack.
- The most prominent of these bloggers usually have no backgrounds in biotechnology analysis or expertise in the science. I believe that in many cases, hedge fund employees actually write the articles which are cut and pasted into the comments of these bloggers.
- The heart of the naked shorting scheme involves a group of hedge fund traders conspiring to steadily knock out offers for the stock and to trigger stop loss orders (This is explained later in this report). This is called walking the stock down. The power of these conspiracies is striking and in many cases allows the shorts can largely determine the price that they want the stock to trade at.
- The stock weakness gives legitimacy to the contrived negative blogs. The idea is to create fear and uncertainty among investors by making all news events appear to be negatives and to fabricate new issues that the shorts hope will demoralize investors.
- The first time I came up against this, my thought was that the blogger was someone who was just more cynical about the chances for success and had an opposite point of view from mine. This is understandable and common in research analysis. I wrote a respectful rebuttal to their argument.
- I thought that after their rebuttal to my rebuttal, this would end the discussion. We had expressed our opposite points of view, would respectfully disagree and move on. This had mainly been my experience in my Wall Street days as an analyst when I disagreed with another analyst. I was wrong.
- The situation quickly escalated. In the rebuttal, the blogger accused me of being stupid, deceitful and being paid by the Company to write positive comments.
- In this case, over 20 articles were then written in a period of a year. Usually, they were timed to a press release and regardless of the news and without exception each was interpreted as a major negative. A major strategy was to argue that management was lying to investors and manipulating the stock.
- The stock would go down on good news, bad news and uncertain news. One of the pillars of stock manipulation is to make good news appear to be bad.
- The blogger was indifferent to truth and actually would make up information that was factually incorrect. When made aware that the information was wrong, he/she would ignore it and even repeat it in later blogs.
- There are a number of bloggers who participate in these attacks. Many of these bloggers appear to work together and coordinate their negative attacks. It is striking that many of these people have connections to one another. Many of them were trained at a well-known blogging site that was founded by hedge fund people.
- Sophisticated use is made of the Internet and social media. Twitter is used to signal that an attack has begun.
- Shorts are well connected to mainstream media and are adept at getting them to unwittingly participate in the scheme.

- Vicious attacks are launched on writers who might have an opposite but hopefully more well-reasoned and balanced view. The usual line is that they are being paid by management to write positive articles.
- Seeking Alpha has become very friendly to articles supporting short selling and is used extensively by the hedge funds. The site actually promotes as one of its favorite authors a person who writes only negative attack article on companies in which he claims that managements are lying and paying authors who have a positive view on the Company. In his disclosure, he states that he shorts stocks, then publishes a negative article on Seeking Alpha and states that he may cover immediately after the article is published. This seems to meet the definition of a pump and dump scheme. He also acknowledges that he is collaborating with other short sellers. I think they contribute the information for most of his articles
- Seeking Alpha allows articles to be published by anonymous authors. These articles are often extremely bearish and are almost certainly written by people at hedge funds.
- Hedge fund create pseudonyms and publish on a daily basis negative comments on message boards like Yahoo and Ihub.
- Law suits appear after articles and allege misconduct on the part of managements and urge investors to participate in a class action lawsuit.

Initially, I attributed these actions to people who were just more cynical than me and honestly came to their bearish views. I am also very cognizant that there is not an insignificant amount of stock manipulation that warrants shorting some stocks. There are some bad actors who pump stocks up and then dump them and this is every bit as egregious as naked shorting attacks. Interestingly, I believe that the hedge funds who short can be enthusiastic participants in these manipulation schemes as well. I also understand that managements can and usually are over enthusiastic in presenting the outlook for their companies. They have so much personal wealth and intellectual effort invested in a Company that objectivity can be difficult. I also have to admit that I have a bias toward optimism largely stemming from the belief that we are in a scientific renaissance in biotechnology that will lead to a meaningful number of breakthrough drugs and accompanying home run stocks. I recognize this personal bias and try to adjust for it, but I am only human.

The above paragraph shows that not all of the investment land mines can be attributed to naked shorting. However, it seems to me that many are. Initially I thought that what I now believe to be naked shorting stock manipulation was attributable to market forces. The catalyst for my changing my view was coming across a shocking [You Tube commentary by Jim Cramer](#) of CNBC fame. He explained in detail how as a hedge fund manager, he participated in schemes to manipulate stocks. If you haven't seen this it is a must watch.

This was a wakeup call for me and for the last few years, I have been doing a great deal of work on naked shorting. As I talked to companies, I heard the same stories over and over about techniques used to drive down their stock prices and I came to believe that there was manipulation going on and that it was extensive. The names of hedge funds leading the attack kept coming up in situation after situation. It has been my intent to write an article on naked shorting, but this is an enormous project and while I think I understand the effect that naked shorting can have on stocks, I lack the understanding of the trading techniques used to implement what is essentially an illegal stock manipulations scheme.

Counterfeiting Stock; An Eye Opening Article

Recently, one of my subscribers sent me an article that covers the ground that I wanted to cover in an eloquent way and is much better than what I could have done, especially on the esoteric trading techniques used to cover up this illegal activity. It largely expresses what I would like to have written. He sent me a link to a website called Citizens for Securities Reform. On this website there was a link to an [article called Counterfeiting Stock](#) and a number of other articles on stock manipulation. This article was essentially the one I would like to have written. I have decided to reproduce the article on my website in its entirety. I certainly don't have the information needed to prove the hypotheses presented in the Counterfeiting Stocks article. Only an organization with subpoena power and huge investigative resource can really determine if this article is correct. The author of this article has the following disclaimer and I would make his disclaimer mine.

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Sources — Information used was obtained from public records; the SEC; the Leslie Boni Report to the SEC on shorting; evidence and testimony in court proceedings; conversations with attorneys who are involved in securities litigation; former SEC employees; conversations with management of victim companies; and first hand experience as investors in companies that have suffered short attacks. This web site is sponsored by Citizens for Securities Reform.

The sponsors of the Citizens for Securities Reform website have kept their identities anonymous or at least they have not chosen to identify themselves on their website. Hence I have not received explicit permission to reproduce their article. However, they urge all investors to pass the information on as I show in the next paragraph and I take this as permission to reproduce the article. They say:

What to Do? — Many of our elected officials at the federal and state level do not understand most of what is contained in this paper. They must come to understand this fraud, and, more importantly, understand that their constituents are angry. Pass this information to everyone you know — put it in the public conscience. Then the citizenry needs to engage in a massive letter-writing campaign. Feel free to attach this report. Make sure your elected officials, at the federal level and state level know how you feel. Ultimately, votes in the home district will trump money from the outside.

The next part of this report is the complete reproduction of the article Counterfeiting Stock which appears on the Citizens for Securities Reform website. Some of the details on trading schemes used by hedge funds to execute and cover up naked shorting are a little difficult to wade through. However, the effort is well worth it; even if you don't understand all of the technical points, you can get the gist.

Counterfeiting Stock

Illegal naked shorting and stock manipulation are two of Wall Street's deep, dark secrets. These practices have been around for decades and have resulted in trillions of dollars being fleeced from the American public by Wall Street. In the process, many emerging companies have been put out of business. This report will explain the magnitude of this problem, how it happens, why it has been covered up and how short sellers attack a company. It will also show how all of the participants; the short hedge funds, the prime brokers and the Depository Trust Clearing Corp. (DTCC) — make unconscionable profits while the fleecing of the small American investor continues unabated.

Why is This Important?

This problem affects the investing public. Whether invested directly in the stock market or in mutual funds, IRAs, retirement or pension plans that hold stock — it touches the majority of Americans. The participants in this fraud, which, when fully exposed, will make Enron look like child's play, have been very successful in maintaining a veil of secrecy and impenetrability. Congress and the SEC have unknowingly (?) helped keep the closet door closed. The public rarely knows when its pocket is being picked as unexplained drops in stock price get chalked up to "market forces" when they are often market manipulations.

The stocks most frequently targeted are those of emerging companies who went to the stock market to raise start-up capital. Small business brings the vast majority of innovative new ideas and products to market and creates the majority of new jobs in the United States. Over 1000 of these emerging companies have been put into bankruptcy or had their stock driven to pennies by predatory short sellers.

It is important to understand that selling a stock short is not an investment in American enterprise. A short seller makes money when the stock price goes down and that money comes solely from investors who have purchased the company's stock. A successful short manipulation takes money from investment in American enterprise and diverts it to feed Wall Street's insatiable greed — the company that was attacked is worse off and the investing public has lost money. Frequently this profit is diverted to off-shore tax havens and no taxes are paid. This national disgrace is a parasite on the greatest capital market in the world.

A Glossary of Illogical Terms

The securities industry has its own jargon, laws and practices that may require explaining. Most of these concepts are the creation of the industry, and, while they are promoted as practices that ensure an orderly market, they are also exploited as manipulative tools. This glossary is limited to naked short abuse, or counterfeiting stock as it is more correctly referred to.

1. **Broker Dealer or Prime Broker** — The big stockbrokers who clear their own transactions, which is to say they move transacted shares between their customers directly, or with the DTC. Small brokers will clear through a clearing house — also known as a broker's broker.
2. **Hedge Funds** — Hedge funds are really unregulated investment pools for rich investors. They have grown exponentially in the past decade and now number over 10,000 and manage over one trillion dollars. They don't register with the SEC, are virtually unregulated and frequently foreign domiciled, yet they are allowed to be market makers with access to all of the naked shorting loopholes. Frequently they operate secretly and collusively. The prime brokers cater to the hedge funds and allegedly receive eight to ten billion dollars annually in fees and charges relating to stock lent to the short hedge funds.
3. **Market Maker** — A broker, broker dealer or hedge fund who makes a market in a stock. In order to be a market maker, they must always have shares available to buy and sell. Market makers get certain sweeping exemptions from SEC rules involving naked shorting.
4. **Short Seller** — An individual, hedge fund, broker or institution who sells stock short. The group of short sellers is referred to as "the shorts."
5. **The Securities and Exchange Commission** — The SEC is the federal enforcement agency that oversees the securities markets. The top-level management is a five-person Board of Governors who are Presidential appointees. Three of the governors are usually from the securities industry, including the chairman. The SEC adopted Regulation SHO in January 2005 in

an attempt to curb naked short abuse.

6. **Depository Trust Clearing Corp** — Usually known as the DTCC, this privately held company is owned by the prime brokers and it clears, transacts and holds most stock in this country. It has four subsidiaries, which include the DTC and the NCSS. The operation of this company is described in detail later.
7. **Short Sale** — Selling a stock short is a way to make a profit while the stock price declines. For example: If investor S wishes to sell short, he borrows a share from the account of investor L. Investor S immediately sells that share on the open market, so investor S now has the cash from the sale in his account, and investor L has an IOU for the share from investor S. When the stock price drops, investor S takes some of the money from his account and buys a share, called "covering", which he returns to investor L's account. Investor S books a profit and investor L has his share back. This relatively simple process is perfectly legal — so far. The investor lending the share most likely doesn't even know the share left his account, since it is all electronic and occurs at the prime broker or DTC level. If shares are in a margin account, they may be loaned to a short without the consent or knowledge of the account owner. If the shares are in a cash account, IRA account or are restricted shares they are not supposed to be borrowed unless there is express consent by the account owner.
8. **Disclosed Short** — When the share has been borrowed or a suitable share has been located that can be borrowed, it is a disclosed short. Shorts are either naked or disclosed, but, in reality, some disclosed shorts are really naked shorts as a result of fraudulent stock borrowing.
9. **Naked Short** — This is an invention of the securities industry that is a license to create counterfeit shares. In the context of this document, a share created that has the effect of increasing the number of shares that are in the market place beyond the number issued by the company, is considered counterfeit. This is not a legal conclusion, since some shares we consider counterfeit are legal based upon today's rules. The alleged justification for naked shorting is to insure an orderly and smooth market, but all too often it is used to create a virtually unlimited supply of counterfeit shares, which leads to widespread stock manipulation — the lynchpin of this massive fraud.

Returning to our example, everything is the same except the part about borrowing the share from someone else's account: There is no borrowed share — instead a new one is created by either the broker dealer or the DTC. Without a borrowed share behind the short sale, a naked short is really a counterfeit share.

10. **Fails-to-Deliver** — The process of creating shares via naked shorting creates an obvious imbalance in the market as the sell side is artificially increased with naked short shares or more accurately, counterfeit shares. Time limits are imposed that dictate how long the sold share can be naked. For a stock market investor or trader, that time limit is three days. According to SEC rules, if the broker dealer has not located a share to borrow, they are supposed to take cash in the short account and purchase a share in the open market. This is called a "buy-in," and it is supposed to maintain the total number of shares in the market place equal to the number of shares the company has issued.

Market makers have special exemptions from the rules: they are allowed to carry a naked short for up to twenty-one trading days before they have to borrow a share. When the share is not borrowed in the allotted time and a buy-in does not occur, and they rarely do, the naked short becomes a fail-to-deliver (of the borrowed share).

11. **Options** — The stock market also has separate, but related markets that sell options to purchase shares (a "call") and options to sell shares (a "put"). This report is only going to deal with calls; they are an integral part of short manipulations. A call works as follows: Assume investor L has a share in his account that is worth \$25. He may sell an option to purchase that share to a third party. That option will be at a specific price, say \$30, and expires at a specific future date. Investor L will get some cash from selling this option. If at the expiration date, the market value of the stock is below \$30 (the "strike price"), the option expires as worthless and investor L keeps the option payment. This is called "out of the money." If the market value of the stock is above the strike price, then the buyer of the option "calls" the stock. Assume the stock has risen to \$40. The option buyer tenders \$30 to investor L and demands delivery of the share, which he may keep or immediately sell for a \$10 profit.
12. **Naked call** — The same as above except that investor L, who sells the call, has no shares in his account. In other words, he is selling an option on something he does not own. The SEC allows this. SEC rules also allow the seller of a naked short to treat the purchase of a naked call as a borrowed share, thereby keeping their naked short off the SEC's fails-to-deliver list.

How The System Transacts Stocks — This explanation has been greatly simplified in the interest of brevity.

1. **Customers** — These can be individuals, institutions, hedge funds and prime broker's house accounts.
2. **Prime Brokers** — They both transact and clear stocks for their customers. Examples of prime brokers include Goldman Sachs; Merrill Lynch; Citigroup; Morgan Stanley; Bear Stearns, etc.
3. **The DTCC** — This is the holding company that owns four companies that clear and keep track of all stock transactions. This is where brokerage accounts are actually lodged. The DTC division clears over a billion shares daily. The DTCC is owned by the prime brokers, and, as a closely held private enterprise, it is impenetrable. It actively and aggressively fights all efforts to obtain information regarding naked shorting, with or without a subpoena.

Stocks clear as follows:

If customer A-1 purchases ten shares of XYZ Corp and Customer A-2 sells ten shares, then the shares are transferred electronically, all within prime broker A. Record of the transaction is sent to the DTC. Likewise, if Investor A-1 shorts ten shares of XYZ Corp and

Investor A-2 has ten shares in a margin account, prime broker A borrows the shares from account A-2 and for a fee lends them to A-1.

If Customer A-1 sells shares to Customer B-2, in order to get the shares to B-2 and the money to A-1, the transaction gets completed in the DTC. The same occurs for shares that are borrowed on a short sale between prime brokers.

As a practical matter, what happens is prime broker A, at the end of the day, totals all of his shares of XYZ owned and all of the XYZ shares bought and sold, and clears the difference through the DTC. In theory, at the end of each day when all of the prime brokers have put their net positions in XYZ stock through the system, they should all cancel out and the number of shares in the DTC should equal the number of shares that XYZ has sold into the market. This almost never happens, because of the DTC stock borrow program which is discussed later.

Who are the Participants in the Fraud? The participants subscribe to the theory that it is much easier to make money tearing companies down than making money building them up, and they fall into two general categories: 1) They participate in the process of producing the counterfeit shares that are the currency of the fraud and/or 2) they actively short and tear companies down.

The counterfeiting of shares is done by participating prime brokers or the DTC, which is owned by the prime brokers. A number of lawsuits that involve naked shorting have named about ten of the prime brokers as defendants, including Goldman Sachs, Bear Stearns, Citigroup, Merrill Lynch; UBS; Morgan Stanley and others. The DTCC has also been named in a number of lawsuits that allege stock counterfeiting.

The identity of the shorts is somewhat elusive as the shorts obscure their true identity by hiding behind the prime brokers and/or hiding behind layers of offshore domiciled shell corporations. Frequently the money is laundered through banks in a number of tax haven countries before it finally reaches its ultimate beneficiary in New York, New Jersey, San Francisco, etc. Some of the hedge fund managers who are notorious shorters, such as David Rocker and Marc Cohodes, are very public about their shorting, although they frequently utilize offshore holding companies to avoid taxes and scrutiny.

Most of the prime brokers have multiple offshore subsidiaries or captive companies that actively participate in shorting. The prime brokers also front the shorting of some pretty notorious investors. According to court documents or sworn testimony, if one follows one of the short money trails at Solomon, Smith Barney, it leads to an account owned by the Gambino crime family in New York. A similar exercise with other prime brokers, who cannot be named at this time, leads to the Russian mafia, the Cali drug cartel, other New York crime families and the Hell's Angels.

One short hedge fund that was particularly destructive was a shell company domiciled in Bermuda. Subpoenas revealed the Bermuda company was wholly owned by another shell company that was domiciled in another tax haven country. This process was five layers deep, and at the end of the subterfuge was a very well known American insurance company that cannot be disclosed because of court-ordered sealing of testimony.

Most of the large securities firms, insurance companies and multi-national companies have layers of offshore captives that avoid taxes, engage in activities that the company would not want to be publicly associated with, like stock manipulation; avoid U.S. regulatory and legal scrutiny; and become the closet for deals gone sour, like Enron.

The Creation of Counterfeit Shares — There are a variety of names that the securities industry has dreamed up that are euphemisms for counterfeit shares. Don't be fooled : Unless the short seller has actually borrowed a real share from the account of a long investor, the short sale is counterfeit. It doesn't matter what you call it and it may become non-counterfeit if a share is later borrowed, but until then, there are more shares in the system than the company has sold.

The magnitude of the counterfeiting is hundreds of millions of shares every day, and it may be in the billions. The real answer is locked within the prime brokers and the DTC. Incidentally, counterfeiting of securities is as illegal as counterfeiting currency, but because it is all done electronically, has other identifiers and industry rules and practices, i.e. naked shorts, fails-to-deliver, SHO exempt, etc. the industry and the regulators pretend it isn't counterfeiting. Also, because of the regulations that govern the securities, certain counterfeiting falls within the letter of the rules. The rules, by design, are fraught with loopholes and decidedly short on allowing companies and investors access to information about manipulations of their stock.

The creation of counterfeit shares falls into three general categories. Each category has a plethora of devices that are used to create counterfeit shares.

1. **Fails-to-Deliver** — If a short seller cannot borrow a share and deliver that share to the person who purchased the (short) share within the three days allowed for settlement of the trade, it becomes a fail-to-deliver and hence a counterfeit share; however the share is transacted by the exchanges and the DTC as if it were real. Regulation SHO, implemented in January 2005 by the SEC, was supposed to end wholesale fails-to-deliver, but all it really did was cause the industry to exploit other loopholes, of which there are plenty (see 2 and 3 below).

Since forced buy-ins rarely occur, the other consequences of having a fail-to-deliver are inconsequential, so it is frequently ignored. Enough fails-to-deliver in a given stock will get that stock on the SHO list, (the SEC's list of stocks that have excessive fails-to-

deliver) – which should (but rarely does) see increased enforcement. Penalties amount to a slap on the wrist, so large fails-to-deliver positions for victim companies have remained for months and years.

A major loophole that was intentionally left in Reg SHO was the grandfathering in of all pre-SHO naked shorting. This rule is akin to telling bank robbers, "If you make it to the front door of the bank before the cops arrive, the theft is okay."

Only the DTC knows for certain how many short shares are perpetual fails-to-deliver, but it is most likely in the billions. In 1998, REFCO, a large short hedge fund, filed bankruptcy and was unable to meet margin calls on their naked short shares. Under this scenario, the broker dealers are the next line of financial responsibility. The number of shares that allegedly should have been bought in was 400,000,000, but that probably never happened. The DTC — owned by the broker dealers — just buried 400,000,000 counterfeit shares in their system, where they allegedly remain — grandfathered into "legitimacy" by the SEC. Because they are grandfathered into "legitimacy", the SEC, DTC and prime brokers pretend they are no longer fails-to-deliver, even though the victim companies have permanently suffered a 400 million share dilution in their stock.

Three months prior to SHO, the aggregate fails-to-deliver on the NASDAQ and the NYSE averaged about 150 million shares a day. Three months after SHO it dropped by about 20 million, as counterfeit shares found new hiding places (see 2 and 3 below). It is noteworthy that aggregate fails-to-deliver are the only indices of counterfeit shares that the DTC and the prime brokers report to the SEC. The bulk of the counterfeiting remains undisclosed, so don't be deceived when the SEC and the industry minimize the fails-to-deliver information. It is akin to the lookout on the *Titanic* reporting an ice cube ahead.

2. Ex-clearing counterfeiting — The second tier of counterfeiting occurs at the broker dealer level. This is called ex-clearing. Multiple tricks are utilized for the purpose of disguising naked shorts that are fails-to-deliver as disclosed shorts, which means that a share has been borrowed. They also make naked shorts "invisible" to the system so they don't become fails-to-deliver, which is the only thing the SEC tracks.

Some of the tricks are as follows:

- Stock sales are either a long sale or a short sale. When a stock is transacted the broker checks the appropriate box. By mismarking the trading ticket — checking the long box when it is actually a short sale the short never shows up, unless they get caught, which doesn't happen often. The position usually gets reconciled when the short covers.
- Settlement of stock transactions is supposed to occur within three days, at which time a naked short should become a fail-to-deliver, however the SEC routinely and automatically grants a number of extensions before the naked short gets reported as a fail-to-deliver. Most of the short hedge funds and broker dealers have multiple entities, many offshore, so they sell large naked short positions from entity to entity. Position rolls, as they are called, are frequently done broker to broker, or hedge fund to hedge fund, in block trades that never appear on an exchange. Each movement resets the time clock for the naked position becoming a fail-to-deliver and is a means of quickly getting a company off of the SHO threshold list.
- The prime brokers may do a buy-in of a naked short position. If they tell the short hedge fund that we are going to buy-in at 3:59 EST on Friday, the hedge fund naked shorts into their own buy-in (or has a co-conspirator do it) and rolls their position, hence circumventing Reg SHO.
- Most of the large broker dealers operate internationally, so when regulators come in (they almost always "call ahead") or compliance people come in (ditto), large naked positions are moved out of the country and returned at a later date.
- The stock lend is enormously profitable for the broker dealers who charge the short sellers large fees for the "borrowed" shares, whether they are real or counterfeit. When shares are loaned to a short, they are supposed to remain with the short until he covers his position by purchasing real shares. The broker dealers do one-day lends, which enables the short to identify to the SEC the account that shares were borrowed from. As soon as the report is sent in, the shares are returned to the broker dealer to be loaned to the next short. This allows eight to ten shorts to borrow the same shares, resetting the SHO-fail-to-deliver clock each time, which makes all of the counterfeit shares look like legitimate shares. The broker dealers charge each short for the stock lend.
- Margin account buyers, because of loopholes in the rules, inadvertently aid the shorts. If short A sells a naked short he has three days to deliver a borrowed share. If the counterfeit share is purchased in a margin account, it is immediately put into the stock lend and, for a fee, is available as a borrowed share to the short who counterfeited it in the first place. This process is perpetually fluid with multiple parties, but it serves to create more counterfeit shares and is an example of how a counterfeit share gets "laundered" into a legitimate borrowed share.
- Margin account agreements give the broker dealers the right to lend those shares without notifying the account owner. Shares held in cash accounts, IRA accounts and any restricted shares are not supposed to be loaned without express consent from the account owner. Broker dealers have been known to change cash accounts to margin accounts without telling the owner, take shares from IRA accounts, take shares from cash accounts and lend restricted shares. One of the prime brokers recently took a million shares from cash accounts of the company's founding investors without telling the owners or the stockbroker who represented ownership. The shares were put into the stock lend, which got the company off the SHO threshold list, and opened the door for more manipulative shorting.

This is a sample of tactics used. For a company that is under attack, the counterfeit shares that exist at this ex-clearing tier can be ten or twenty times the number of fails-to-deliver, which is the *only* category tracked and policed by the SEC.

3. **Continuous Net Settlement** — The third tier of counterfeiting occurs at the DTC level. The Depository Trust and Clearing Corporation (DTCC) is a holding company owned by the major broker dealers, and has four subsidiaries. The subsidiaries that are of interest are the Depository Trust Company (DTC) and the National Securities Clearing Corporation (NSCC). The DTC has an account for each broker dealer, which is further broken down to each customer of that broker dealer. These accounts are electronic entries. Ninety seven percent of the actual stock certificates are in the vault at the DTC with the DTC nominee's name on them. The NSCC processes transactions, provides the broker dealers with a central clearing source, and operates the stock borrow program.

When a broker dealer processes the sale of a short share, the broker dealer has three days to deliver a borrowed share to the purchaser and the purchaser has three days to deliver the money. In the old days, if the buyer did not receive his shares by settlement day, three days after the trade, he took his money back and undid the transaction. When the stock borrow program and electronic transfers were put in place in 1981, this all changed. At that point the NSCC guaranteed the performance of the buyers and sellers and would settle the transaction even though the seller was now a fail-to-deliver on the shares he sold. The buyer has a counterfeit share in his account, but the NSCC transacts it as if it were real.

At the end of each day, if a broker dealer has sold more shares of a given stock than he has in his account with the DTC, he borrows shares from the NSCC, who borrows them from the broker dealers who have a surplus of shares. So far it sounds like the whole system is in balance, and for any given stock the net number of shares in the DTC is equal to the number of shares issued by the company.

The short seller who has sold naked — he had no borrowed shares — can cure his fail-to-deliver position and avoid the required forced buy-in by borrowing the share through the NSCC stock borrow program.

Here is the hocus pocus that creates millions of counterfeit shares.

When a broker dealer has a net surplus of shares of any given company in his account with the DTC, only the *net amount* is deducted from his surplus position and put in the stock borrow program. However the broker dealer does *not* take a like number of shares from his customer's individual accounts. The net surplus position is loaned to a second broker dealer to cover his *net* deficit position.

Let's say a customer at the second broker dealer purchased shares from a naked short seller — counterfeit shares. His broker dealer "delivers" those shares to his account from the shares borrowed from the DTC. The lending broker dealer did not take the shares from any specific customers' account, but the borrowing broker dealer put the borrowed shares in specific customer's accounts. Now the customer at the second prime broker has "real" shares in his account. The problem is it's the same "real" shares that are in the customer's account at the first prime broker.

The customer account at the second prime broker now has a "real" share, which the prime broker can lend to a short who makes a short sale and delivers that share to a third party. *Now there are three investors with the same counterfeit shares in their accounts.*

Because the DTC stock borrow program, and the debits and credits that go back and forth between the broker dealers, only deals with the net difference, it never gets reconciled to the actual number of shares issued by the company. As long as the broker dealers don't repay the total stock borrowed and only settle their net differences, they can "grow" a company's issued stock.

This process is called Continuous Net Settlement (CNS) and it hides billions of counterfeit shares that never make it to the Reg. SHO radar screen, as the shares "borrowed" from the DTC are treated as a legitimate borrowed shares.

For companies that are under attack, the counterfeit shares that are created by the CNS program are thought to be ten or twenty times the disclosed fails-to-deliver, and the true CNS totals are only obtained by successfully serving the DTC with a subpoena. The SEC doesn't even get this information. The actual process is more complex and arcane than this, but the end result is accurately depicted.

Ex-clearing and CNS counterfeiting are used to create an enormous reserve of counterfeit shares. The industry refers to these as "strategic fails-to-deliver." Most people would refer to these as a stockpile of counterfeit shares that can be used for market manipulation. One emerging company for which we have been able to get or make reasonable estimates of the total short interest, the disclosed short interest, the available stock lend and the fails-to-deliver, has fifty "buried" counterfeit shares for every fail-to-deliver share, which is the only thing that the SEC tracks, consequently the SEC has not acted on shareholder complaints that the stock is being manipulated.

The Anatomy of a Short Attack — Abusive shorting are not random acts of a renegade hedge funds, but rather a coordinated business plan that is carried out by a collusive consortium of hedge funds and prime brokers, with help from their friends at the DTC and major clearinghouses. Potential target companies are identified, analyzed and prioritized. The attack is planned to its most minute detail.

The plan consists of taking a large short position, then crushing the stock price, and, if possible, putting the company into bankruptcy. Bankrupting the company is a short homerun because they never have to buy real shares to cover and they don't pay taxes on the ill-gotten gain.

When it is time to drive the stock price down, a blitzkrieg is unleashed against the company by a cabal of short hedge funds and prime brokers. The playbook is very similar from attack to attack, and the participating prime brokers and lead shorts are fairly consistent as well.

Typical tactics include the following:

1. Flooding the offer side of the board — Ultimately the price of a stock is found at the balance point where supply (offer) and demand (bid) for the shares find equilibrium. This equation happens every day for every stock traded. On days when more people want to buy than want to sell, the price goes up, and, conversely, when shares offered for sale exceed the demand, the price goes down.

The shorts manipulate the laws of supply and demand by flooding the offer side with counterfeit shares. They will do what has been called a short down ladder. It works as follows: Short A will sell a counterfeit share at \$10. Short B will purchase that counterfeit share covering a previously open position. Short B will then offer a short (counterfeit) share at \$9. Short A will hit that offer, or short B will come down and hit Short A's \$9 bid. Short A buys the share for \$9, covering his open \$10 short and booking a \$1 profit.

By repeating this process the shorts can put the stock price in a downward spiral. If there happens to be significant long buying, then the shorts draw from their reserve of "strategic fails-to-deliver" and flood the market with an avalanche of counterfeit shares that overwhelm the buy side demand. Attack days routinely see eighty percent or more of the shares offered for sale as counterfeit. Company news days are frequently attack days since the news will "mask" the extraordinary high volume. It doesn't matter whether it is good news or bad news.

Flooding the market with shares requires foot soldiers to swamp the market with counterfeit shares. An off-shore hedge fund devised a remarkably effective incentive program to motivate the traders at certain broker dealers. Each trader was given a debit card to a bank account that only he could access. The trader's performance was tallied, and, based upon the number of shares moved and the other "success" parameters, the hedge fund would wire money into the bank account daily. At the end of each day, the traders went to an ATM and drew out their bribe. Instant gratification.

Global Links Corporation is an example of how wholesale counterfeiting of shares will decimate a company's stock price. Global Links is a company that provides computer services to the real estate industry. By early 2005, their stock price had dropped to a fraction of a cent. At that point, an investor, Robert Simpson, purchased 100%+ of Global Links' 1,158,064 issued and outstanding shares. He immediately took delivery of his shares and filed the appropriate forms with the SEC, disclosing he owned all of the company's stock. His total investment was \$5205. The share price was \$.00434. The day after he acquired all of the company's shares, the volume on the over-the-counter market was 37 million shares. The following day saw 22 million shares change hands — all without Simpson trading a single share. It is possible that the SEC has been conducting a secret investigation, but that would be difficult without the company's involvement. It is more likely the SEC has not done anything about this fraud.

Massive counterfeiting can drive the stock price down in a matter of hours on extremely high volume. This is called "crashing" the stock and a successful "crash" is a one-day drop of twenty-percent or a thirty-five percent drop in a week. In order to make the crash "stick" or make it more effective, it is done concurrently with all or most of the following:

2. Media assault — The shorts, in order to realize their profit, must ultimately purchase real shares at a price much cheaper than what they shorted at. These real shares come from the investing public who panics and sells into the manipulation. Panic is induced with assistance from the financial media.

The shorts have "friendly" reporters with the Dow Jones News Agency, the Wall Street Journal, Barrons, the New York Times, Gannett Publications (USA Today and the Arizona Republic), CNBC and others. The common thread: A number of the "friendly" reporters worked for The Street.com, an Internet advisory service that hedge-fund managers David Rocker and Jim Cramer owned. This alumni association supported the short attack by producing slanted, libelous, innuendo laden stories that disparaged the company, as it was being crashed.

One of the more outrageous stories was a front-page story in USA Today during a short crash of TASER's stock price in June 2005. The story was almost a full page and the reporter concluded that TASER's electrical jolt was the same as an electric chair — proof positive that TASERs did indeed kill innocent people. To reach that conclusion the reporter over estimated the TASER's amperage by a factor of one million times. This "mistake" was made despite a detailed technical briefing by TASER to seven USA Today editors two weeks prior to the story. The explanation "Due to a mathematical error" appeared three days later — after the damage was done to the stock price.

Jim Cramer, in a video-taped interview with The Street.com, best described the media function: "When (shorting) ... The hedge fund mode is to not do anything remotely truthful, because the truth is so against your view, (so the hedge funds) create a new 'truth' that is development of the fiction — you hit the brokerage houses with a series of orders (a short down ladder that pushes the price down), then we go to the press. You have a vicious cycle down — it's a pretty good game."

This interview, which is more like a confession, was never supposed to get on the air, however, it somehow ended up on YouTube. Cramer and The Street.com have made repeated efforts, with some success, to get it taken off of YouTube.

3. **Analyst Reports** — Some alleged independent analysts were actually paid by the shorts to write slanted negative ratings reports. The reports, which were represented as being independent, were ghost written by the shorts and disseminated to coincide with a short attack. There is congressional testimony in the matter of Gradient Analytic and Rocker Partners that expands upon this. These libelous reports would then become a story in the aforementioned "friendly" media. All were designed to panic small investors into selling their stock into the manipulation.
4. **Planting moles in target companies** — The shorts plant "moles" inside target companies. The moles can be as high as directors or as low as janitors. They steal confidential information, which is fed to the shorts who may feed it to the friendly media. The information may not be true, may be out of context, or the stolen documents may be altered. Things that are supposed to be confidential, like SEC preliminary inquiries, end up as front-page news with the short-friendly media.
5. **Frivolous SEC investigations** — The shorts "leak" tips to the SEC about "corporate malfeasance" by the target company. The SEC, which can take months processing Freedom of Information Act requests, swoops in as the supposed "confidential inquiry" is leaked to the short media.

The plethora of corporate rules means the SEC may ultimately find minor transgressions or there may be no findings. Occasionally they do uncover an Enron, but the initial leak can be counted on to drive the stock price down by twenty-five percent. The announcement of no or little findings comes months later, but by then the damage that has been done to the stock price is irreversible. The San Francisco office of the SEC appears to be particularly close to the short community.

6. **Class Action lawsuits** — Based upon leaked stories of SEC investigations or other media exposes, a handful of law firms immediately file class-action shareholder suits. Milberg Weiss, before they were disbanded as a result of a Justice Department investigation, could be counted on to file a class-action suit against a company that was under short attack. Allegations of accounting improprieties that were made in the complaint would be reported as being the truth by the short friendly media, again causing panic among small investors.
7. **Interfering with target company's customers, financings, etc.** — If the shorts became aware of clients, customers or financings that the target company was working on, they would call and tell lies or otherwise attempt to persuade the customer to abandon the transaction. Allegedly the shorts have gone so far as to bribe public officials to dissuade them from using a company's product.
8. **Pulling margin from long customers** — The clearinghouses and broker dealers who finance margin accounts will suddenly pull all long margin availability, citing very transparent reasons for the abrupt change in lending policy. This causes a flood of margin selling, which further drives the stock price down and gets the shorts the cheap long shares that they need to cover.
9. **Paid bashers** — The shorts will hire paid bashers who "invade" the message boards of the company. The bashers disguise themselves as legitimate investors and try to persuade or panic small investors into selling into the manipulation.

This is not every dirty trick that the shorts use when they are crashing the stock. Almost every victim company experiences most or all of these tactics.

How Pervasive Is This? —

At any given point in time more than 100 emerging companies are under attack as described above. This is not to be confused with the day-to-day shorting that occurs in virtually every stock, which is purportedly about thirty percent of the daily volume.

The success rate for short attacks is over ninety percent - a success being defined as putting the company into bankruptcy or driving the stock price to pennies. It is estimated that 1000 small companies have been put out of business by the shorts. Admittedly, not every small company deserves to succeed, but they do deserve a level playing field.

The secrecy that surrounds the shorts, the prime brokers, the DTC and the regulatory agencies makes it impossible to accurately estimate how much money has been stolen from the investing public by these predators, but the total is measured in billions of dollars. The problem is also international in scope.

Who Profits from this Illicit Activity? — The short answer is everyone who participates. Specifically:

1. **The shorts** — They win over ninety percent of the time. Their return on investment is enormous because they don't put any capital up when they sell short — they get cash from the sale delivered to their account. As long as the stock price remains under their short sale price, it is all profit on no investment.
2. **The prime brokers** — The shorts need the prime brokers to aid in counterfeiting shares, which is the cornerstone of the fraud. Not only do the prime brokers get sales commissions and interest on margin accounts, they charge the shorts "interest" on borrowed shares. This can be as high as five percent per week. The prime brokers allegedly make eight to ten billion dollars a year from their short stock lend program. The prime brokers also actively short the victim companies, making large trading profits.
3. **The DTC** — A significant amount of the counterfeiting occurs at the DTC level. They charge the shorts "interest" on borrowed shares, whether it is a legitimate stock borrow or counterfeit shares, as is the case in a vast majority of shares of a company under attack. The amount of profit that the DTC receives is unknown because it is a private company owned by the prime brokers.

The Cover Up — The securities industry, certain "respected" members of corporate America who like the profits from illegal shorting,

certain criminal elements and our federal government do not want the public to become aware of this problem.

The reason for the cover up is money.

Everyone, including our elected officials, gets lots of money. Consequently there is an active campaign to keep a lid on information. The denial about these illegal practices comes from the industry, the DTC, the SEC and certain members of Congress. They are always delivered in blanket generalities. If indeed there is no problem, as they claim, then why don't they show us the evidence instead of actively and aggressively fighting or deflecting every attempt at obtaining information that is easily accessible for them and impossible for companies and investors? Accusers are counter attacked as being sour-grapes losers, lunatics or opportunistic lawyers trying to unjustly enrich themselves. Death threats are not an unheard of occurrence, although it doesn't appear that anyone has been "whacked" so far.

The securities industry counters with a campaign of misinformation. For example, they proudly pointed out that only one percent of the dollar volume of listed shares are fails-to-deliver. What they don't mention:

- that the fails-to-deliver are concentrated in companies being attacked
- for companies under attack, for every disclosed fail-to-deliver there may be ten to forty times that number of undisclosed counterfeit shares
- companies under attack have seen their stock price depressed to a small fraction of the price of an average share, therefore the fails-to-deliver as a percentage of number of shares is considerably higher than as a percentage of dollar volume
- the examples cited are limited to listed companies, but much of the abuse occurs in the over the counter market, regional exchanges and on unregulated foreign exchanges that allow naked shorting of American companies, who are not even aware they are traded on the foreign exchanges.

Why does this continue to happen? It is no accident that the most pervasive financial fraud in the history of this country continues unabated. The securities industry advances its agenda on multiple fronts:

1. The truth about counterfeiting remains locked away with the perpetrators of the fraud. The prime brokers, hedge funds, the SEC and the DTC are shrouded in secrecy. They actively and aggressively resist requests for the truth, be it with a subpoena or otherwise. Congressional subpoenas are treated with almost as much disdain as civil subpoenas.
2. The body of securities law at the federal level is so stacked in favor of the industry that it is almost impossible to successfully sue for securities fraud in federal court.

For example, in a normal fraud case, a complaint can be filed based upon "information and belief" that a fraud has been committed. The court then allows the plaintiff to subpoena evidence and depose witnesses, including the defendants. From this discovery, the plaintiff then attempts to prove his case.

Federal securities fraud cases can't be filed based upon "information and belief"; you must have evidence first in order to not have the complaint immediately dismissed for failure to state a cause of action. This information is not available from the defendants (see above) without subpoenas, but you can't issue a subpoena because the case gets dismissed before discovery is opened.

This is only one example of the terrible inequities that exist in federal securities law.

3. The SEC is supposed to protect the investing public from Wall Street predators. While the vast majority of SEC staffers are underpaid, overworked, honest civil servants, the top echelons of the SEC frequently end up in high-paying Wall Street jobs. The five-person Board of Governors, who oversee the SEC, is dominated by the industry. The governors are presidential appointees and the industry usually fills three slots, frequently including the chairmanship.
4. For those rare occasions when the SEC prosecutes an industry insider, the cases almost never go to a judgment or a criminal conviction. The securities company settles for a fine and no finding of guilt. The fine, which may seem like a large sum, is insignificant in the context of an industry that earned 35 billion dollars in 2006. Fines, settlements and legal expenses are just a cost of doing business for Wall Street.
5. The root cause of the impossibly skewed federal laws and the ineffectiveness of the SEC and other regulatory bodies rests squarely with our elected officials. The securities industry contributes heavily to both parties at the presidential and congressional levels. As long as the public is passive about securities reform, our elected officials are happy to take the money, which at the federal level was 65 million dollars in 2006.

The Democrats swept into power with a promise of ethics reform. Their majority in congress allowed Christopher Dodd (D-CT) to ascend to the chairmanship of the Senate Banking Committee, which regulates the securities industry. His largest single contributor (\$175,400) in the first quarter of 2007 was (employees of) SAC Capital, a very aggressive short hedge fund. Are we surprised that Dodd has opposed additional regulation of hedge funds. They are virtually unregulated.

6. Some states have their own securities laws and their own enforcement arm. Certain states including Connecticut, Illinois, Utah, Louisiana and others, have begun active enforcement of their own laws. The state laws are not nearly as pro industry as federal laws and plaintiffs are having success.

To thwart this, the industry with the support of the SEC, is attempting to have the federal court system and federal agencies, be the sole venue for securities matters. The SEC is working hand in hand with the industry to advance this theory of federal preemption, which would put all securities matters under federal law, all litigation in federal courts, and all enforcement with the SEC.

The following are recent examples of how the SEC is advancing the industry agenda:

- The San Francisco office of the SEC issued subpoenas to various short friendly media outlets after congressional hearings about David Rocker and Gradient Analytic. This investigation into the media involvement with the shorts was ended by the chairman of the SEC, Christopher Cox, who withdrew the subpoenas, apparently concluding that the First Amendment right to free speech protected participants in an alleged stock manipulation. Jim Cramer ripped up his subpoena on his television show, thumbing his nose at the SEC.
- In early 2007, the SEC completely exonerated Gradient, citing Gradient's First Amendment rights.
- The Nevada Supreme court heard a case captioned Nanopierce vs. DTCC. Nanopierce is an emerging company that was attacked by the shorts and subjected to massive counterfeiting of their stock by the DTCC. This state court case is close to opening discovery against the DTCC, so the industry is attempting to kill the lawsuit by arguing it should be in federal court — where it will be DOA. The SEC showed up as a friend of the defendant DTCC, and filed a brief in support of the DTCC efforts to remove the case to the federal court system.
- Both houses of the Utah legislature passed a bill that required daily disclosure of fails-to-deliver, including identifying specific companies and the specific broker dealer positions in that company. The bill also outlawed naked shorting of companies domiciled in Utah. The industry threatened litigation based upon federal preemption and backed the state down. The bill was not signed into law.
- A bill was introduced to the Arizona legislature that required disclosure similar to the Utah bill, but without the illegal naked shorting provision. This is the same information that the DTC confidentially provides to the SEC. Certain prime broker's lobbying effort allegedly managed to get the bill killed in committee. The industries efforts to curtail state authority, is an effort to draw all securities matters under the federal umbrella, where small investors don't have a chance of obtaining justice.
- In February 2007 the SEC determined that the hedge fund industry did not require any additional regulation — they are virtually unregulated. This may be the height of arrogance.

Sources — Information used was obtained from public records; the SEC; the Leslie Boni Report to the SEC on shorting; evidence and testimony in court proceedings; conversations with attorneys who are involved in securities litigation; former SEC employees; conversations with management of victim companies; and first hand experience as investors in companies that have suffered short attacks. This web site is sponsored by Citizens for Securities Reform.

What to Do? — Many of our elected officials at the federal and state level do not understand most of what is contained in this paper. They must come to understand this fraud, and, more importantly, understand that their constituents are angry.

Pass this information to everyone you know — put it in the public conscience. Then the citizenry needs to engage in a massive letter-writing campaign. Feel free to attach this report. Make sure your elected officials, at the federal level and state level know how you feel. Ultimately, votes in the home district will trump money from the outside.

Tagged as [counterfeiting stocks](#), [illegal naked shorting](#), [naked shorting](#), [Stock manipulation](#) + Categorized as [Smith On Stocks Blog](#)

14 Comments



1. wmburd says:

June 16th, 2015 at 7:50 pm

What a God damn shame! Why even invest. The big boys have the system so rigged, i wonder if it's even worth investing at all. The only potentially positive aspect of this whole sordid topic is that given enough time, these fraudulent financial wheelers-and-dealers will eventually go to far and get their butts crushed. In the meantime, many companies will go out of business and, in the

case of biotechs, patients will suffer. SHAMEFUL!



2. mswyman says:

June 16th, 2015 at 8:58 pm

Astonishing, Larry. Thanks for posting this. It explains a lot about the volatility companies in the biotech sector often experience. It also makes clear that this big business: not just a couple of journalists publishing hit pieces while profiting on the side. Who knew?

It makes me wonder what the overall impact on the market will be. Could this kind of rip-off be a danger to the market at the same scale as securitized mortgages based on junk loans? Are we getting a foreshadowing of major trouble to come for the whole market, and not just a few companies? Chilling.



3. dpolson says:

June 16th, 2015 at 9:55 pm

Excellent coverage of this odd racket. The irony is that I was able to average down nicely on NWBO last year due to this very racket (all straight cash account purchases), but it was scary to think that the potentially groundbreaking cancer treatment it is in trials for may have never gotten a chance to succeed because of several lying scoundrels allowed to publish on SA and elsewhere. Moreover, how on earth was the critic in the Washington post compelled to apologize for his similar critique? This remains a complicated and shroudy issue.



4. bmatthews@realshortdata.com says:

June 18th, 2015 at 1:29 am

I have been reporting on naked short selling for nearly a decade. I have been in 2 documentaries, and I can tell you with 100% certainty...Dendreon cured prostate cancer....they cured it, and Wall Street made sure no one would know about it. There's a third documentary I know of that details the plight of dendreon.

I have files from companies that the CEO's asked me to publish, that were driven under and out of business. Look at the decline in CZR last year....or SPDC recently....all have one thing in common....they begin with a debt payment coming due in 18-24 months, and the short sellers counterfeit the stock down to pennies so that when the time to pay off the debt arrives, the company no longer has the ability to seek capital through equity markets.

Usually under a threat at that point of delisting, the best a company can do is opt for a brutally unfair loan which results in a change of control, for pennies on the dollar to a billionaire shark or white knight stepping in, or they issue convertible debt which sets into motion convertible arbitrage as every single share represented is immediately shorted against the debt, guaranteeing that no loss is incurred by the convert holders, and sinking the stock at the expense of equity holders.

It is the reason I began looking into ways that reported daily short volume from the public exchanges that began being released in 09, and could be used to protect investors. Well I came up with the answer and the only protection investors have (The SEC and FINRA are not going to do it, and the Market Makers were given an exemption to continue the practice while countries like Germany outlawed it...The only ones that cannot naked short stocks to their death, is you and I.

Most people have no idea they can get daily short volume info and rely on two week delayed , bimonthly reports of what occurred on a single day of trading, two weeks before.

RealShortData.com is the only source in the world for daily, current short volume and dark pool volume data, complete with charts, which is programmed to trigger investor alerts as certain events combine like high volume accompanied by open short volume above 70% and total short volume above 50%, which would qualify as a Red Flag Alert.

I like what you're doing here Smithonstocks, and I hope we might team up down the road to help people not become victims of this scheme that has no end, and no punishment that would cause any firm to stop.

Also, I've interviewed Patrick Byrne from Overstock who was a leader in the field, and Mark Mitchell who is a reporter at DeepCapture.com. Not sure if I read it above, but its a good reference for anyone looking to establish just how rampant and NOT NEW this is....

Everyone is at risk, but thanks to efforts of those like you, and I, and a dozen others, no one ever has to be a victim again. Have a look at what I've done. I've brought visibility to the dark corners of Wall Street...No one ever has to lose their wealth, hopes, savings and goals to Wall Street greed and corruption...at least, that's the idea I had going into it. It's grown to much more but that is its core.



5. Larry Smith says:
June 18th, 2015 at 6:50 am

Thank you for your input. We all have to work to build awareness of this scheme which has massive reach and impact.



6. bmatthews@realshortdata.com says:
June 18th, 2015 at 1:31 am

ps: You'll find a few articles of mine at SA...I was a top 3 author with 50,000 followers but I ruffled feathers with my market manipulation, blame Goldman And Merrill articles...so ...now they dont print them anymore,



7. Larry Smith says:
June 18th, 2015 at 6:55 am

Seeking Alpha defended Adam Feuerstein when the Washington Post expose was published. As I commented, it will publish extremely bearish articles by anonymous authors and allows activist investors to operate what appears to be pump and dump schemes.



8. hd says:
June 22nd, 2015 at 5:14 pm

Larry,

Great, and long article. I have seen some of those short attacks on some bio companies I am invested in. Your article gives validation to what I had thought and what other posters at the yahoo message boards had hinted.

Now, the short attack is fine and I can have strong hands to get through those. What concerns me is that in all your analysis, you have not indicated what a long investor, who has fundamentals as the investment thesis, is supposed to do. You seem to be driving the point that when they pick a company to attack, THE COMPANY WILL FAIL, GET BANKRUPT, OR STOCK GO TO PENNIES, because the hedge funds initiating the short attack are very powerful and coordinated and no one is stopping them. You also say that 90% of the time, they are successful in their attack. You give an example of DNDN, which I have not researched but had a great product according to your article. And everyone knows about plight of DNDN.

So, is you point to say that if we see an organized short attack orchestrated on a biotech firm that we are invested in, that company MOST probably is going down and hence, we should cut the losses and get the hell out of there????????? Because the resistance if futile???

Or is there any way to fight it, if one believes the product IS very good with potential to get approval from FDA and final commercialization?



9. CamelTrader says:
August 19th, 2015 at 7:40 pm

"Illegal Naked Short Selling Appears to Lie at the Heart of an Extensive Stock Manipulation Scheme"....

Wow....great attempt to explain 1 of the many ways that stocks are manipulated...BIO's are really in the kill zone for this type of well coordinated gaming/manipulation. I have been following stocks & reading tape checking short data following the noise via all forms of media since later 2009 early 2010. One point that was made in the comments(I believe) or I wanted to make very clear, is that manipulation & collusion are not anything new to our markets. What is, or rather has been made possible due to

technology...i.e."the internet" has exponentially increased the speed, scope and amount of information manipulation that bombards people investing (or not)...And also aids to the labyrinth (or maybe gauntlet) of connections/directions one needs to get through to find who is at the other end of the Hedge Fund's rainbow & pot-o-gold. Your what might be considered more than "cursory" map of acronyms & how or who is connected, misdirected and hiding was a feat in it self...Good job!

And as to DNDN and also another post about a band-aid and/or something for dental health...BIO-techs that really work, safe, and cure that I know of personally is not what sadly survives...rarely make it to the public in need of such products. The most recent example of this is AMRN (ticker) Amarin corp. w/product VASCEPA®...is a Q-3 highly purified EPA and works on inflammation...the story is unreal what FDA has done and what looks like a NSS candidate as I have watched this tape for >3years and the social media, & where the Adam Feuerstein name first showed up for me...what a travesty...I have no idea where this co. ends up but I own shares only because the product saved my arm and many other benefits...Ok, said enough...what will change? How can it change? Wait one other note, BATS exchange July 30, 2015 – BATS Global Markets (BATS) filed with the Securities and Exchange Commission the BATS Client Suspension Rule, which would enable the company to take swifter action to prohibit manipulative behavior, such as spoofing and layering, on the BATS Exchanges. Client Suspension Rule would allow BATS to stop ongoing manipulative conduct in a matter of weeks, instead of the lengthier, longstanding regulatory process that can take several years to reach a final resolution. The Rule distinguishes itself by specifically addressing the practices of layering and spoofing via an expedited process. http://cdn.batstrading.com/resources/press_releases/BATS-Client-Suspension-Rule-FINAL.pdf Intersting...say belives mostly day traders etc. Now I am done...Keep up good work...

R.K.
Ha ha, hey you get chance look up ConAgra Dupont venture DCV Story where scientists saved i26 a product that was getting shelved...worked to good, I use/used it too ha ha The end 😊

Trackbacks & Pingbacks

1. **Cytokinetics: Comments on Sharp Price Decline After 2Q, 2015 Conference Call (CYTK, Buy, \$6.28) | Expert Financial Analysis and Reporting | Smith on Stocks**
July 31, 2015 at **12:57 pm**

[...] For those of you who have followed my writing you will understand that I believe that there is widespread manipulation of stock prices by hedge funds using naked shorting practices. I have no objective evidence, but the observable evidence for manipulation is overwhelming. See my report *Illegal Naked Short Selling Appears to Lie at the Heart of an Extensive Stock Manipulation Scheme*. [...]
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August 11, 2015 at **10:44 am**

[...] a honey to companies with weak balance sheets who need to finance. Using techniques as described in my recent report in situations like this shorts can manipulate the stock price virtually to wherever they [...]
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August 13, 2015 at **9:55 am**

[...] attack on the stock as so often happens with emerging biotechnology stocks. See my article "Illegal Naked Short Selling Appears to Lie at the Heart of an Extensive Stock Manipulation Scheme" to see how short sellers can blatantly manipulate [...]
4. **OCAT Nasdaq Daily PPS Movements - Page 208**
September 9, 2015 at **10:20 pm**

[...] in the industry... this was put up by Gizmo on an other topics thread and how many have read it? *Illegal Naked Short Selling Appears to Lie at the Heart of an Extensive Stock Manipulation Scheme* | ... I believe that the observational evidence is overwhelming that naked shorting practices are widely [...]
5. **Naked Stocks | Best Stock Market Futures**
October 9, 2015 at **2:34 am**

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