

B. Shelf Offerings

We believe that the use of shelf offerings (offerings filed under § 230.415 of the Securities Act of 1933) is common today. If an individual with notice of a shelf offering takedown effects short sales during the five days prior to pricing and covers his short sale with shelf offering securities, his conduct may cause the same downward price pressure that occurs with pre-pricing short sales in connection with non-shelf offerings. The trading has the same manipulative potential, the same effect on offering price, and causes the same abuse that Rule 105 of Regulation M is designed to prevent. Accordingly, we propose eliminating the current shelf offering exception in Rule 105 of Regulation M. We solicit comment concerning the proposed elimination of the shelf offering exception. We also seek comments concerning other areas of the Rule.

Q. In what manner are shelf offerings of equity securities marketed to potential investors? Include a discussion of the similarities and/or differences with respect to the marketing efforts of shelf and non-shelf offerings. Discuss the types of marketing efforts used and whether potential investors have notice of a shelf takedown before it occurs.

Q. Should Rule 105 of Regulation M be applicable to only equity offerings? What is the Rule's relevance with respect to debt offerings and the potential for manipulation with debt offerings or other offering types?

Q. Should the prohibitions of Rule 105 of Regulation M extend to derivative securities, i.e., should a person be prohibited from covering put options entered into within the period five days prior to pricing with securities purchased from an underwriter, broker or dealer participating in the offering?

Q. Should the prohibitions of Rule 105 of Regulation M extend to short sales effected prior to the exercise of conversion rights under a debenture, or other security, and covering the short sales with securities issued in the conversion when the conversion consideration is based upon the security's market price during a certain time period prior to the conversion?

Q. Should a person who executes short sales during the five day business period prior to the pricing of an offering be permitted to cover preexisting short positions held prior to that five day period with offering securities? Please provide a detailed analysis, including a discussion regarding the fungibility of securities. Can you trace offering shares in a person's account to show that they are used to cover the preexisting short position as opposed to the short sales executed five days prior to pricing?

Q. Does the language "cover a short sale" provide the proper scope of prohibited activity? Is there additional or alternative language we should consider?

Q. What is the manner in which firms, including prime brokerage firms, monitor

compliance with Rule 105 of Regulation M, both manually and with computer systems?

Q. Should Rule 105 apply to acquisitions from an issuer in a shelf takedown, such as a public equity line from an issuer or other direct purchase arrangement with an issuer?

C. Sham Transactions Designed To Give the Appearance of Covering With Open Market Securities

Recently, the Commission has become aware of, and taken action, with respect to conduct designed to evade, but which violates Rule 105 of Regulation M.²²⁸ This conduct may involve short sales within the restricted period of Rule 105, the purchase of offering shares, and the contemporaneous sale and purchase of the same class of shares as the offering shares. For example, an individual may sell the shares in the market and immediately purchase an equivalent number of shares. Where the transaction is structured such that there is no legitimate economic purpose or substance to the contemporaneous purchase and sale, no genuine change in beneficial ownership, and/or little or no market risk, that transaction may be a sham transaction.

The Commission would continue to consider enforcement action against those participating in sham transactions structured in a manner to give the appearance of compliance with Rule 105, but in fact, violate the rule. We are not proposing revisions to Rule 105 with respect to activities that violate the current rule. We seek comment, however, on criteria in addition to economic purpose or substance, change in beneficial ownership, and market risk, that may distinguish sham transactions from legitimate trading. The Commission also solicits comment regarding whether there should be additional language in the rule text of Rule 105 to address other transactions that cause the harm the Rule 105 is designed to prevent.

XVII. General Request for Comment

The Commission seeks comment generally on all aspects of proposed Regulation SHO and the proposed amendment to Rule 105 of Regulation M under the Exchange Act. In addition to the specific requests for comment found throughout this release, the Commission asks commenters to address whether proposed Regulation SHO furthers the Commission's objectives to (1) allow relatively unrestricted short selling in an advancing market, (2) prevent short selling at successively lower prices, thus eliminating short selling as a tool for

driving the market down, and (3) preventing short sellers from accelerating a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers. Commenters are requested to provide empirical data to support their views and arguments related to the proposals herein. In addition to the questions posed above, commenters are welcome to offer their views on any other matter raised by the proposed Regulation SHO and Rule 105.

XVIII. Paperwork Reduction Act

Proposed Regulation SHO would impose a new "collection of information" within the meaning of the Paperwork Reduction Act of 1995,²²⁹ and the Commission has submitted them to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. OMB has not yet assigned a control number to the new collection of information imposed by Regulation SHO.

A. Summary of Collections of Information

Proposed Regulation SHO, Rule 201 contains a requirement that all sell orders of securities registered under Section 12(g) of the Exchange Act be marked "long," "short," and "short exempt." Currently, Rule 10a-1 prohibits the execution of a sell order for a security covered by Rule 10a-1 unless the order is marked either "long" or "short." Proposed Regulation SHO would be a new collection of information because the collection would cover a much larger number of securities. Proposed Regulation SHO, Rule 201 would add two elements to this marking requirement. First, a new category for "short exempt" orders would be added. Second, the marking requirement would be extended to apply to all equity securities, including exchange-listed securities, Nasdaq NMS, Nasdaq SmallCap, OTCBB, and Pink Sheet securities. If the Commission adopts Proposed Regulation SHO, Rule 10a-1 would be repealed and any collection of information under Rule 10a-1 would be eliminated.

Sell orders of exchange-listed and Nasdaq securities are already marked "long," "short," or "short exempt" pursuant to Rule 10a-1, NYSE Rule

²²⁸ See, Ascend Capital, LLC, Securities Exchange Act Release No. 48188 (July 17, 2003).

²²⁹ 44 U.S.C. 3501 et seq.