Lime
Brokerage LLC
Member NYSE, NASD, NFA, SIPC

June 19, 2009

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 205491090

RE: File No. S7-08-09; Proposed Amendments to Regulation SHO

Dear Ms. Murphy:

Lime Brokerage LLC welcomes the opportunity to comment on the proposed rule amendments to Regulation SHO, in which the SEC considers a variety of approaches to restricting short selling activity. Lime Brokerage LLC ("Lime") is a technologically advanced brokerage firm that caters to a diverse and sophisticated customer base. Lime's clients include professional traders, hedge funds, asset managers and other broker-dealers. Our customers rely on Lime's robust and advanced technology to execute equities transactions on multiple exchanges, ECNs and trading venues.

1. We believe that the Commission Should Support Regulation That Will Be Effective in Curtailing Abusive Short Selling While Maintaining the Beneficial Elements that Legal Short Selling Brings to the Marketplace

a. Existing Regulation Can Provide Sufficient Oversight to Short Selling

Lime appreciates the goal that the SEC describes as its rationale for considering these restrictions; namely restoring investor confidence. However, we believe that existing regulation targeted at eliminating abusive and naked short selling and the enhanced delivery requirements on sales of all equity securities are the most appropriate vehicles to carry out regulation on the practice of short selling. The Commission's active role in preventing naked short selling through requirements such as Rule 204T, Rule 10b-21, Rule 10a-3T and temporary Form SH have all been very effective in preventing manipulative short selling. We believe strengthened oversight and more proactive enforcement of these existing regulations will provide the safeguards necessary to ensure efficient and effective operation of the equity markets. We further believe that implementation of any of the proposed restrictions on short selling will cause the industry to expend precious resources making significant changes to their technology for no appreciable benefit.

b. Empirical Evidence Supports the Use of Existing Regulations to Curb Manipulative Behavior and does Not Support the Imposition of Price Tests

The Commission includes a lengthy discussion of the history of short sale regulation in the Proposal. As noted in this narrative, prior analysis of the impact of short sale restrictions undertaken during the pilot program enacted in 2005-2007 concluded that the price tests "did not prevent short sales in extreme down markets and did limit short selling in up markets"[1]. The Commission also states that "we are not

[1] SEC Proposal, April 10, 2009, page 15

aware of specific empirical evidence that the elimination of short sale price tests has contributed to the increased volatility in U.S. markets"[2].

If, as most experts contend, the price tests will be ineffective in preventing manipulative short sales, and certainly ineffective in preventing market drops, should it still be implemented just because it has some unexplained popularity with lawmakers and investors? The Uptick Rule was in effect for the crash of 1987, when the DJIA fell 22.6% in a single day. How will investors react when they discover that the new Price Tests do not mitigate volatility in times of economic stress? We note that the largest single-day drop in 2008 was 7.0%. Ironically, the 7% drop on 9/29/08 occurred after the House followed the opinion of the public and initially rejected the unpopular, but necessary, bank bailout plan.

In contrast, steps taken over the past year such as enhanced borrowing and delivery requirements pursuant to the July and September Emergency Orders, have proven to be effective at addressing potentially abusive short selling. As discussed at the SEC Open Meeting in April 2009, the "threshold" list of securities with high fail-to-deliver rates has been reduced from hundreds of names to only five at the time of the meeting. These regulations have a proven track record of curbing undesired activity; price tests have no such track record of success in achieving the Commission's stated goals. Lime believes continued focus on effective regulation around borrow and delivery of short sales will have a more positive impact without the potential negative consequences of short sale restrictions.

c. Proposed Short Sale Restrictions Will Have Unintended Consequences and Impact Beneficial Short Selling Activity

As noted in the proposal, short selling activity provides many benefits to the marketplace, including liquidity and pricing efficiency. Short selling enables investors to hedge the risk of carrying economic long positions in a security or a related instrument. It has been estimated that most trades today are executed with some form of computerized liquidity provider on one side. These computers serve as "virtual market makers," selling short to facilitate natural buyers of equities. The uncertainty that would be introduced with the introduction of the proposed Price Tests would greatly increase the risk associated with virtual market making strategies. We believe there would be significant unintended consequences of the proposed restrictions, including reduction in overall market liquidity and widening of spreads, ultimately raising the cost of execution to the investor, due to the increased cost associated with executing automated trading strategies.

On a related note, we believe the SEC has overlooked a significant component of cost to the industry of the implementation of these rules: the cost of modifications to algorithms and other programmatic trading models to account for any of the proposed rule modifications. These costs would be borne not only by the broker-dealer community, but also by the virtual market-making community that employs sophisticated trading models that would be significantly impacted by any type of price test.

[2] SEC Proposal, April 10, 2009, page 17

2. Price Test Rules are Not Effective When Broadly Applied Due To Varied Latencies in Delivery

While we agree that a price test based on the National Best Bid is superior to one based on the Last Sale price for the reasons noted in the proposal, Lime believes that both tests are fundamentally flawed. There is no assurance that all market participants, or even all trading centers, will receive the same information regarding the current national best bid at the same time. The proposal describes the three networks that disseminate market information for NMS stocks, but the reality is that market participants receive data from a variety of sources: sometimes directly from exchanges, sometimes from vendors that perform consolidation. Lime has observed over 10 times the latency between SIP data and direct exchange feeds in one case.

Differences in the quality of market data infrastructure at the various providers as well as at each participant cause the timing of receipt of the data to vary widely across recipients, even if they are working with the same SIP or exchange feed. Some consumers of market data will receive that data within seconds of its publication by the Market Center; others such as clients of Lime Brokerage can receive the same data in a matter of milliseconds. In that context, it is impossible for there to be a single "National Best Bid" in the view of every market participant and every system simultaneously. As discussed in further detail below, Lime therefore believes that the variability in the dissemination and receipt of market data makes implementation of a Price Test, as well as the Broker-Dealer Exemption Provision, impractical in today's environment.

3. If the SEC Proceeds with Implementing Regulation, We Believe that the Circuit Breaker Halt Proposal is the Least Disruptive Mechanism for Promulgating Fair and Orderly Markets

Of the proposed structures for restricting short selling activity, Lime believes that the proposed Circuit Breaker Halt approach, while not optimal for investors and market participants, would be the preferred option. The targeted nature of the circuit breaker halt would address specific situations where individual stocks are overheating, and we believe it would be effective in providing a "time-out" to the market during which no short selling would be allowed. As discussed further below, we do not believe that a one-size-fits-all 10% benchmark is sufficient, and would like to see a more flexible approach that takes a stock's normal volatility into account if this approach is adopted.

4. Short Sale Regulation Should Be Applied Equally to All Market Participants

The Commission has incorporated numerous exemptions in each of the proposed Rules. Lime strongly believes that in order to maintain a level playing field, rules should be applied uniformly to all market participants. To single out specific market participants or behaviors for exemptions creates an unfair environment for those participants that cannot strictly qualify for those exemptions, and will therefore be penalized by not being able to obtain executions when other "protected" classes of participants can. As noted in more detail below, exemptions often create opportunities for gaming and abuse that will weaken the ability of the Rule to function as intended and curb undesired activity.

5. Additional Detailed Comments on Specific Proposals

Lime believes that additional regulation of Short Sales is not necessary at this time. However, we recognize the extraordinary pressure that has been placed upon the SEC to enact some form of regulation in order to restore investor confidence in the marketplace. We are therefore providing comment on the individual proposals in the event that the SEC does conclude that regulation is, in fact, appropriate.

a. Proposed Modified Uptick Rule

As noted above, Lime believes that regulation based on a Price Test is impractical given the inability to ensure that all market participants are reacting to the same information at the same time.

By including provisions in the rule that allow trading centers to display and execute an order at a "down-bid" price if it is permissibly priced at the time the trading center displays or executes the order, the Commission seems to be acknowledging that each trading center will have its own unique view of the current national best bid. The ability for each trading center to make its own determination of what is 'valid' behavior could lead to confusion in the marketplace as trades are executed that appear to some participants to be in violation of the regulations.

1. Short Exempt Provision

Lime believes that the Broker-Dealer Provision allowing broker-dealers to mark a short sale order as "short exempt" to identify an order as not on a down-bid price at the time of submission to the trading center, further exacerbates the potential for confusion in the marketplace, as well as creates an un-level playing field that actually penalizes participants with the most efficient market data infrastructure. This penalty comes into play due to the fact that broker-dealers with more robust market data infrastructure will have a more accurate picture of the state of the market, and will be less likely to mark an order as 'short exempt' based on stale information. The fact that orders marked 'short exempt' will bypass price tests at the trading center will give brokers with stale information an advantage in that they may receive executions due to the exemption that the more efficient broker-dealer will not receive since they will be more correctly marking the order as 'short' and subjecting it to price tests.

Another potential outcome of the extension of the validation of a short sale to the individual market participants will be for some firms to 'arbitrage' various data providers to facilitate marking of the maximum number of orders as 'short exempt'. In cases where a broker-dealer receives data from a market data vendor as well as directly from a market center, it could be possible for them to systematically record data from whichever provider has the beneficial 'tick' whenever possible. Numerous gaming opportunities will be possible.

Finally, the creation of this exemption will expand the implementation burden of this regulation significantly. With no broker-dealer exemption, the bulk of the technology changes required to implement compliance with the Proposed Modified Uptick Rule will be undertaken by the Trading Centers. Other participants may need to make minor modifications (to allow entry and routing of 'short exempt' transactions in trading applications) but requirements such as market data "snapshots" will not be necessary for a non-Trading Center participant. If this Exemption is enacted, a majority of all broker-dealer participants that service customer orders will look to implement this capability in order to remain competitive and ensure that their client orders receive the best possible execution. The overall cost to the industry will be increased many-fold in this case, as now non-Trading Center participants will become subject to market data "'snapshotting" and other compliance-related changes to underpin this implementation.

b. Proposed Uptick Rule

Lime agrees with the Commission's position that a price test based on the last sale price is even more flawed than one based on the national best bid. As discussed in the Proposal, last sale information can be subject to delays in reporting, and are not sequenced in such a way that they are useful to determine directionality of the market at any given point in time. We therefore believe this approach is the least effective of those proposed.

c. Proposed Circuit Breaker Halt Rule

Of the alternatives outlined in this proposal, Lime Brokerage feels the Circuit Breaker Halt approach is the most reasonable. Implementing a "cooling-off" period after a steep decline in a given security's price will give market participants a chance to absorb the situation and possibly reassess their desire to continue short selling. Implementing a short sale ban in this scenario eliminates the ineffectiveness of the price tests discussed above.

That being said, there are concerns even with this approach. The first is the likely "magnet effect" discussed in the proposal. This could lead to the rapid escalation of short selling as the security comes close to the trigger price.

Our other concerns relate to the structure of the trigger that would cause the halt in short selling to be implemented. We believe a one-size-fits all 10% trigger is not appropriate given the wide variation in "standard" volatilities that exist. For some instruments a 10% price move is a much more significant event than for others. We therefore suggest that the following considerations be taken when constructing the trigger mechanism:

1. Lime believes a more appropriate benchmark to use to determine intra-day change is the opening price of the security, as opposed to the prior day's close. Significant events can occur outside of trading hours that can impact the opening price of a stock (earnings announcements, macro-economic events). If a stock which has a significant earnings "miss" opens down more than the trigger threshold, under the current proposal short selling would be eliminated for the entire day. We do not believe this is appropriate.

2. Standard volatility and volume should be taken into account for each instrument. Only a price move that is well above the standard volatility for a stock and only in a situation where volume is significantly higher than the norm for a given instrument should trigger a potential short selling halt.

3. Human intervention should be required. Just as trading halts are implemented in today's environment for news events and other unusual market conditions, Lime believes that short sell Circuit Breaker Halt decisions should be made on an exception basis, and judgment should be applied to determine if it is the appropriate step given the specific situation.

d. Proposed Circuit Breaker Price Test Rules

For the reasons discussed above regarding the proposed Price Test Rules, Lime has concerns with the implementation of either of the suggested Circuit Breaker Price Test Rules. Lime would also suggest that our recommendations regarding the definition of the trigger be taken into consideration if either of the Circuit Breaker Price Test Rules is to be implemented.

CONCLUSION

In summary, Lime believes that:

- **The Commission Should Support Regulation That Will be Effective in Curtailing Abusive Short Selling While Maintaining the Beneficial Elements that Legal Short Selling Brings to the Marketplace**
    - Existing Regulation Can Provide Sufficient Oversight to Short Selling
    - Empirical Evidence Supports the Use of Existing Regulations to Curb Manipulative Behavior and does Not Support the Imposition of Price Tests
    - Proposed Short Sale Restrictions Will Have Unintended Consequences and Impact Beneficial Short Selling Activity
- **Price Test Rules are Not Effective When Broadly Applied Due To Varied Latencies in Delivery**
- **If the SEC Proceeds with Implementing Regulation, We Believe that the Circuit Breaker Halt Proposal is the Least Disruptive Mechanism for Promulgating Fair and Orderly Markets**
- **Short Sale Regulation Should Be Applied Equally to All Market Participants**

Sometimes a decision can be framed as choosing what is correct versus what is popular. Whatever approach the Commission chooses, we believe that it should base its decision upon what it believes is the correct and most effective solution to a specific problem. Bear markets are by their very nature unpopular; but we reject the notion that removal of the Uptick Rule is to blame for the current market situation. Correlation is not causation, and we have not heard a credible argument to date that reinstatement of short selling restrictions would be effective at preventing a future market downturn. We applaud the Commission's implementation of effective short sale reform in the past year, and we support its continued activities to prevent abusive short selling.

Sincerely,

Jeffrey S. Wecker
CEO, Lime Brokerage LLC