<u>University of Houston Law Review</u>
<u>Spring 2007 – Naked Short Selling – How Exposed are Investors</u>

It was the spring of 2007 when I co-authored (with Dr. Robert Shapiro) the University of Houston Law Review article "Naked Short Selling – How Exposed are Investors".

It was my belief at that time that with: 1) increased regulatory oversight; and 2) multiple lawsuits exposing this illegal practice of naked short selling; and its devastating impact on allowing new and existing public companies to thrive; that in 5-10 years the government and civil litigation could stop this illegal practice.

So, as I find myself attending in Toronto, Canada on November 19, 2019 (as a panelist) the roundtable discussion sponsored by the prestigious law firm, McMillian, it is my firm belief this illegal practice of naked short selling has become more prevalent, notwithstanding the billions of dollars in fines paid by prime brokers and affiliates in the U.S.; and the 20 plus lawsuits myself and my colleagues have filed against prime brokers and others exposing these illegal acts at a systemic level.

The purpose of the panel was to discuss and debate the findings and recommendations of the authors of the well-researched and published paper (by McMillian) entitled: Short Selling in Canada: Regulations are Weak and a nNew Path Forward is Needed to Reduce Systemic Risk dated November 2019 (the "Paper").

As a litigator for 40 years, I have spent half my professional career (20 years) prosecuting to trial or settlement 20 of these naked short selling cases in federal or state courts. These cases have been filed primarily in the U.S. with some discovery actions in Canada. (the "Cases").

Many of the Cases have resulted in actions being filed by the Justice Department of the United States of America and/or the Security Exchange Commission against the perpetrators.

It is my belief that a portion of the stock market in Canada, the United States of America (and elsewhere) is rigged. The entities principally responsible for the "rigging" are the prime brokers and hedge funds. This "rigging" by the above actors primarily resides in mining, biomed and other companies that are either: 1) IPO's or start-ups; or 2) are companies that require years to reach positive cash flow.

The rigging occurs as follows:

1. <u>Naked Short Sells</u>:

The stock of an issuer is sold but not delivered (on a large scale basis). The fails are hidden either in cross border subsidiaries or margined in other nefarious ways. When this is done on a large scale basis, the counterfeit value of the stock being sold is usually in excess of the demand. As a result, the stock goes down in price.

2. Use of Offshore Accounts, Direct Market Access Trading Systems and Dark Pools:

   Utilization of these vehicles makes it much more difficult to track the trades and attribute them to a particular broker.

3. Dissemination of false and misleading information:

   The information is intentionally placed in all the public media outlets to: a) create fear about the subject company; b) cause journalist to "buy in" to the false narrative; and c) scare the auditors of the company; d) persuade the regulatory bodies; e) filing (by the perpetrator of their affiliates) a fraudulent complaint with regulatory authorities, causing an investigation by regulatory bodies against the subject company.

4. Trading Abuses by Market Makers that ARE NOT Bona Fide Market Makers:

   Market makers are: a) systemically naked short selling shares as they are not required to borrow as a bona fide market maker—which they are not. This creates a large amount of counterfeit shares further driving the share price down; and b) spoofing and layering means the market maker post a large number of orders to sell or purchase the stock (creating a large block) which are pulled down (day after day) immediately prior to the close of the trading day. These tactics artificially control the price of the stock.

5. Class Action Lawsuits:

   Based on the fake narrative, SEC investigates and a falling stock price (internally inflicted by the perpetrator by the illegal practice above).

Canada allowing 12 trading days to deliver appears to allow a safe space for manipulators. Simply stated, manipulators can drive the price down measurably in approximately 3 weeks of trading and deliver a much lower price.

As evidenced mainly by enforcement actions in the United States and to a lesser extent, Canada, the proprietary trading desk of certain prime brokers and their hedge fund clients.

As evidenced by Dr. Rob Shapiro report dated March 2006, 500,000,000 to 1 billion shares per day are sold but not delivered.

The problem is systemic - why Canada has decided to allow brokers to use their customer's cash account shares to lend to clients (or lend to themselves) to short sell the same stock (in hopes the share price goes down), I do not know.

This rigging the system has impaired the ability of many products and medicines to come to market that could benefit us all. Until this illegal process (and its components) can no longer happen, I believe the markets are not safe. Why? Brokers make more money killing companies this way than they do investing I or buying them.