

Short sellers under siege by regulators

By [EAMON JAVERS](#) | 7/24/08 5:10 AM EST

For a billionaire, Jim Chanos has a lot to worry about these days.

Chanos is the president of Kynikos Associates, a multibillion-dollar hedge fund that specializes in uncovering troubled companies and profiting from their declines in the stock market.

He's perhaps the world's most famous short seller, having cemented his reputation in 2001 as one of the earliest critics of Enron Corp.

He shorted the stock of the energy giant at a time when it was still widely viewed as a pillar of the "new economy," and he flagged Enron's problems for a Fortune magazine exposé of the company. As the stock collapsed in 2001, Chanos profited wildly.

These days, he lives large: He owns a lavish home in the Hamptons, which he has used as something of a bachelor pad in recent years.

But Chanos' problem isn't on Wall Street or in the Hamptons — it's in Washington.

Short sellers like Chanos are under attack in the nation's capital, as Congress and federal regulators look to combat what some see as abusive tactics that are driving the stock market's nearly yearlong decline from a high of more than 14,000 last October to the 11,000 range today.

In the commodity markets, too, there's a hue and cry against "speculators" who are allegedly driving up the price of oil.

Chanos says there's no evidence the scary scenarios are actually happening. And he worries that even more measures are under discussion to shake out the shorts.

"We're not the most popular people in the world. We understand that," Chanos told Politico. "But we're on the side of the angels here."

Chanos is the chairman of the Coalition of Private Investment Companies, and he's leading the short sellers' effort to fight back against a range of regulatory proposals designed to limit their ability to bet against companies in the stock market. The coalition works in Washington through the lobbying office of Porterfield & Lowenthal, to which it paid \$360,000 in fees last year.

Chanos' personal political benefactors in recent years have included Democratic Gov. Bill Richardson of New Mexico, Sen. Chris Dodd (D-Conn.) and the Democratic Senatorial Campaign Committee.

In Chanos' mind, short sellers like him are the moral equivalent of private investigator Sam Spade: They may be gruff, but they get the truth out there.

"Short sellers are the real-time detectives in the financial markets," he said. "Do we really want to be muzzling these people?"

To some extent, Washington's answer to that question lately has been yes.

On Monday, the Securities and Exchange Commission imposed a new, limited-duration rule designed to protect 19 large financial firms from a practice called naked short selling.

Short selling is an investing maneuver designed to help a trader profit from declining stocks. To sell a stock short, an investor borrows shares and sells them into the market, buying them back later when the price has gone down. The investor returns the shares to their owner and pockets the difference in price as profit.

In naked short selling, though, the investor doesn't bother to borrow shares first and sells what can sometimes be imaginary shares into the market. Critics say naked short selling exerts undue downward pressure on stock prices. But the short sellers themselves say that hasn't been proved. And they say short selling generally is good for the markets because investors have an incentive to discover bad information about companies, keeping prices from soaring beyond their true value.

The new SEC rule would require traders to get a commitment from stock owners that they will supply the shares before shorting them.

The knock against short sellers generally is that they create a market feeding frenzy that drives prices down across the board. But the short sellers say they exert an important check on the value of stocks, ferreting out unpleasant details about companies that management would just as soon keep secret and keeping prices at a reasonable level.

If anything, the momentum is entirely on the side of the regulators.

Chanos is swimming against the tide: On the first day of trading under the new rule, the American Bankers Association complained that its members should be included in the protection against naked shorting. And former SEC Chairman Harvey Pitt called for the ban to be extended to all public companies.

The short reform is “something that is very good of the SEC to have done,” Pitt told Reuters. “They can’t do it across the board without going through formal rule-making, but I do believe that they need to expedite that.”

But Chanos and his finance industry allies fought back against the measure. In a letter to SEC Chairman Christopher Cox, they complained that the new rule had been passed too quickly and without any evidence that naked short selling was actually to blame for the market’s recent troubles. The five-page and eight-footnote letter was signed by Chanos and former Rep. Richard Baker (R-La.), now the head of the Managed Funds Association, a hedge fund lobbying group.

Chanos says the effort to vilify short sellers comes from corporate America’s inability to critique itself.

“They’re saying, ‘We don’t like stock prices, so it’s got to be those nefarious short sellers again,’” he said. Although the shorts say the temporary rule won’t cause undue trouble in the markets, they don’t want it to last a second beyond its current expiration deadline: 11:59 p.m. on July 29.

“We’re just trying to point out to people that this is going to put you on a slippery slope, where government comes in to intervene on the stock prices it doesn’t like,” he said.

Next, he suggested, could be a fight over the so-called uptick rule.

From the 1930s until last year, the uptick rule prevented investors from shorting a stock at its current price — they could short only at a price higher than the last trade. But when that rule was eliminated, shorts could engage in downtick sales, during which sellers were allowed to short at the most current price.

Critics of that practice say that downtick sales contribute to the spiral of downward pressure on stock prices and may be to blame for some of the stock slide of the past year. They would like to see the uptick rule reinstated.

Chanos hates that idea, too.