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February 10, 2009

Senator Patrick J. Leahy  
Chairman of the Senate Judiciary Committee  
433 Russell Senate Building  
Washington, D.C. 20510

Dear Chairman Leahy:

I am pleased that the Senate Judiciary Committee has scheduled a February 11 hearing on “The Need for Increased Fraud Enforcement in the Wake of the Economic Downturn.” I have long believed there is, and Overstock.com has experienced, a pervasive pattern of fraudulent and manipulative practices in the nation’s equity markets. My focus has been on how unscrupulous traders, often in coordination with market analysts, create a bear run on a stock through the practice of known as naked short selling. I have enclosed a two-page paper explaining naked short selling. This is a \$15 billion a year problem.

Naked short selling is when a stock is sold short without having first either borrowed it or secured a binding agreement to borrow the shares for delivery at settlement. This results in the intentional failure to deliver of shares, which creates phantom shares and has the effect of skewing supply and demand for the security being raided; the true price of the security is artificially depressed by these phantom shares. Former SEC Chairman Cox repeatedly called naked short selling illegal and vowed to end it. Many others have called for its end, including the American Bankers Association, the U.S. Chamber of Commerce, former SEC Commissioner Roel Campos, and former SEC Chairman Harvey Pitt. Yet the practice continues, notwithstanding some tentative steps taken by the SEC. As the enclosed charts show, (1) naked short sellers significantly contributed to the collapses of Bear Stearns and Lehman Brothers, and (2) many of the financial institutions receiving TARP funds are victims of naked short selling. Last year Senator Levin’s Permanent Subcommittee on Investigations and the GAO began looking into naked short selling and the SEC’s reaction to it.

There is a simple way to end illegal naked short selling: an SEC requirement that a party must have a legally enforceable right to deliver shares sold short by the settlement date before executing a short sale, or, alternatively, an act of Congress making it illegal to sell a stock short without such a legally enforceable right. This, combined with vigorous enforcement by the SEC and the Justice Department, will stop the manipulation of stocks owned by millions for the benefit of a handful of unscrupulous manipulators.

I thank you for holding a hearing on the need for increased fraud enforcement in the wake of our current economic situation. I am willing to help in any way that I can and I welcome the opportunity to speak with you or your staff about the problems created by naked short selling and how to end the practice.

Sincerely,

A handwritten signature in black ink that reads 'Jonathan E. Johnson III'.

Jonathan E. Johnson III  
President