

February 7, 2005

New York State Office of the Attorney General
Eliot Spitzer
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Re: Speech at the National Press Club, Social Security Privatization, Securities fraud, Regulation SHO, failure to deliver, RICO

Dear Mr. Spitzer,

You are a busy man I will try to stay brief. I have been impressed with your efforts to take on some of the ills that have plagued our corporate world, and I think you have made a genuine difference. I watched your speech to the National Press Club, and I have a couple of comments, and a couple of pleas from a small, disillusioned investor.

From your speech it is evident that you understand some of the workings of "the markets" and I was particularly encouraged to hear you say "self regulation does not work". Your comments about the SEC appear to be right on.

Now there is another problem on Wall Street, which I am sure you are aware of (I and others have written to you before). It is the "fail to deliver" problem, or commonly known as "naked shorting". Some unscrupulous hedge funds have, with passive and/or active help from the DTC, their brokers, and the SEC, been allowed to borrow shares through the DTC loan program, and sell shares short, without ever delivering these shares. The companies, which are particularly egregiously sold short in this manner, are listed daily on the threshold list mandated by regulation SHO (e.g.: <http://www.nyse.com/Frameset.html?displayPage=/threshold/>).

From the perspective of this investor, not only is this activity illegal, immoral and nothing more than organized theft, it also deprives victimized companies from fair access to capital (non-existent shares sold short depress share price and increase the cost of financing), something I know from your speech you also understand. I offer as an example the case of Novastar (NFI), on the NYSE threshold list since inception. (I am a shareholder.) As a REIT, Novastar must pay out 95% of its earnings, and therefore is particularly sensitive to capitalization requirements to fund ongoing and new business. Details of the rampant alleged irregularities involving NFI are well explained on a shareholder-run website: www.nfi-info.net.

Novastar will survive. There have been by some estimates over 7000 small (OTC, and Bulletin Board) companies that have not survived this type of "bear raid" or "short

attacks". Many of these companies have experienced short interest that exceeded the float, prior to going out of business, a direct result of the tactics of the unscrupulous short sellers, who then never have to deliver shares sold short, and walk away with the illegal proceeds of their short sales.

I believe the national and international faith in the US financial markets is at stake here. I am also extremely concerned about the administration's proposal to allow individuals to put social security monies into an obviously rigged financial market. Individual investors are not only not protected adequately; individual investors are systematically being ripped off to the tune of billions of dollars a year.

This problem has received increasing press recently, lawsuits have been filed, but it appears no one with influence has paid attention, or perhaps is willing to touch this very hot potato. This is a direct challenge to you, someone with a record of looking out for the consumer and small investor, but somehow, I fear that this may be even too big for you. You have my respect for your work so far, if you were to tackle this in earnest you would earn my admiration (and vote) for a long time to come.

This problem ought to be tackled now! Now it may only have a fallout of tens or hundreds of billions of dollars, and only modest impact on the credibility of the markets in general. And perhaps some of these illegal gains are still recoverable. If this is allowed to fester longer it will grow into a trillion dollar problem, and upon implosion will bring a total market collapse with it. Do I sound too dramatic? I can only imagine the pressure you would come under if you tackled this...

Some suggestions:

- 1) Frame this as a Social Security Privatization issue; if the markets are not "perfect" then SSI should not be entrusted to the markets yet.
- 2) National security, there have been reports of naked shorting, and profits thereof being used to launder money, and finance terrorism. If you dig, you will find.
- 3) RICO: there is no question (in my humble opinion) that this is an organized activity involving hedge funds, brokers, the financial press (including the Wall Street Journal) the DTCC, and by neglect the SEC.
- 4) Securities Act of 1934, does not permit selling a security, which cannot be delivered, the SHO threshold list proves that this is not being enforced.
- 5) Regulation SHO: was a nice thought, but has no teeth; at least we have a daily admission that there is a problem, nobody will tell us the size of the problem (SEC, NYSE will not release how many shares for a given security are "fails to deliver")- why not I wonder?
- 6) Perhaps going after one particularly egregious case will be relatively simple, bring the necessary attention to this issue, avoid a total collapse of the US financial markets, and deter future abuse (particularly if brokers are forced to buy back loaned shares which a failed hedge fund could not cover), make an example of someone! (I selflessly offer manipulation of NFI, Novastar as such an example, but any stock on the threshold list will do).

Having written before, I have little hope of attracting your attention to this letter, let alone the problems and issues it raises. I know I am not alone, and if I (a physician, not a financial professional) can grasp the magnitude of this problem others will too, and soon.

Please, please, please with sugar on top, This problem is bigger than anything you have tackled to date. I wish you the courage and fortitude if you chose to go to battle on the behalf of those of us who are, and I quote "raped by mountain men" on a daily basis.

Sincerely, and very concerned,

Andreas Kaubisch.

PS. I would be happy to discuss any of the above allegations, or perhaps more productively ask some resident experts (Friends of NFI) to do the same, if requested.

PPS. I noticed a full page ad in the Washington post 2/8/2005, which also addresses this issue (page A11, also at : <http://www.ncans.net>).