

FINAL DRAFT

2 May 1983

Memorandum of Position

This Memorandum sets forth the Subcommittee's positions on the issues concerning regulation of market participants set forth in the memorandum, dated March 31, 1983, of Douglas Scarff to the Advisory Committee.

1. Short Tendering, Hedged Tendering and Multiple Tendering

The Subcommittee is unanimously in favor of continuing the prohibition of Rule 10b-4 on short tendering. This position is based upon the same rationale that prompted adoption of the Rule: that short tendering, available almost entirely to market professionals, would result in reducing the percentage of shares accepted for purchase from non-market professionals who, as a practical matter, can tender only the shares they own. Such a result was and would be perceived by the non-market professional to allow an unfair advantage to market professionals. To rescind the ban on short tendering would be to risk undermining public confidence in the integrity of the market.

In taking this position the Subcommittee notes a technical matter that impacts upon the effectiveness of Rule 10b-4. Because often the results of a partial offer are announced before guarantees of delivery must be honored (typically, a guarantee provides for delivery of share certificates within eight business days of tender), a practice has developed that permits delivery of shares certificates only to the extent of the "proration factor" - i.e., if 1,000 shares were tendered, but only 500 accepted, certificates for only 500

Page Two

need be delivered. This practice obviously provides a temptation and a means to short tender, and the Subcommittee believes it should not normally be permitted. (Exceptions might be to remedy bona fide errors or to deal with the technical problems in tendering.)

Given the basic reason for prohibiting short tendering of maintaining public confidence in the markets, the Subcommittee recommends that hedged tendering also be prohibited. Unlike short tendering, hedged tendering cannot result in a total tender in excess of the issue outstanding. However, the short selling, supported by borrowed stock, involved in hedged tendering does increase the amount of stock tendered to the detriment of all tendering shareholders, while being available as a protective device almost exclusively to professional investors. As such, the problems of unfair advantage to market professionals and undermining confidence in the market remain. The Subcommittee therefore believes that the proposed amendment to Rule 10b-4 to prohibit hedged tendering is appropriate.

Finally, the Subcommittee also believes that Rule 10b-4 should prohibit multiple tendering. The incentive for multiple tendering has been reduced by the recent amendment of the prorationing rule, but the Subcommittee believes that multiple tendering might still be attempted if each of two or more competing tender offers has as a condition the requirement that a 51% minimum number of shares be tendered. In that situation, only one of the offers will have its minimum condition met and only the guarantee of tender to that offer would need to be honored; thus, persons might tender to each offer on the theory that this would not be short tendering with respect to the successful offer. The Subcommittee, however, thinks that such multiple tendering should be regarded as a variant of short tendering and should not be allowed for the

same reason of maintaining public confidence in the markets. An additional reason for this position is that, to the extent such multiple tendering was widespread in any one competitive situation, it is possible that more than one offer would appear to be successful, with resultant confusion in the market.

II. Options/Overtendering

In general, the Subcommittee thinks that, as a policy matter, it is preferable to rely on procedures that would deny persons who cannot fulfill their guarantees of tender the benefit of the offer rather than attempting to expand Rule 10b-4 to encompass all the possible situations that could result in overtendering. The Subcommittee, however, refers to the earlier point regarding the need to require that guarantees be honored in full. In addition, there is one situation that should be addressed. If the expiration date of an "in the money" option coincides with the last day of a tender offer, a person owning stock may both tender the stock and sell an expiring "in the money" option on it. The seller knows that the option will be exercised, but, since he will not be notified of the exercise until the following business day, he can regard himself as long stock at the time of tender. However, the purchaser of the option can, upon filing notice of exercise that day, likewise regard himself as long stock, so that he may tender without violating Rule 10b-4. The Subcommittee believes that Rule 10b-4 should prohibit the sale of an option by a person who has tendered stock in a tender offer, if the exercise of the option prior to the expiration of a tender offer would result in the seller being short stock needed to honor his tender and the seller should reasonably know that at the time of expiration of the tender there is a high likelihood that the option will be exercised.

III. Depository Participation

On the basis of discussions with personnel of broker-dealers familiar with the mechanics of tendering shares and problems that have arisen in connection with processing such tenders, the Subcommittee is in favor of the basic proposal (without commenting on the technical aspects of the proposal) to require bidders' tender agents to establish during tender offers an account with qualified registered securities depositories to permit financial institutions participating in such depository systems to use the services of the depository to tender shares if desired. The Subcommittee understands that the use of such a system should greatly reduce the number of "items" which the tender agent must process and would facilitate continued trading in the securities subject to the tender offer with the benefits of efficiencies, cost savings and reduced confusion and delay. The Subcommittee believes that such a system would also benefit indirectly shareholders who do not have access to the depository system, in that, due to the benefits noted, the tender agent should be able to process tenders and make payments to such shareholders more quickly than would now be the case. The Subcommittee believes that requiring this procedure is appropriate in that, although the voluntary system is now sometimes used, there is perhaps an incentive to bidders and their agents to avoid a system that expedites payment and, even if that is not a factor, often the press of time, or unfamiliarity with the depository system, could result in it not being used.

IV. Market Professionals/Arbitrageurs

The issue posed in Mr. Scarff's memorandum refers both to the "access" of professionals to "market information" and their "trading activities", with

Page Five

special focus on three areas - arbitrageur ability to (i) monitor customer tendering decisions, (ii) borrow untendered customer securities and (iii) receive soliciting dealers fees. The Subcommittee believes that market professionals of all types have advantages that derive from their professional involvement, and that the arbitrageur does not have greater advantages in his market than other professionals do in their markets. Barring/^{all}professional advantages in any market would mean elimination of the professional activities that contribute greatly to market efficiency. Thus, this Subcommittee believes that such advantages should be eliminated only where the effect is so substantial as to threaten public confidence in the fairness of markets, and none of the practices listed above would seem to present that problem. The Subcommittee notes particularly that borrowing untendered customer securities would serve no purpose as long as short and hedged tendering are barred, and soliciting dealer fees are as a practical matter almost always subject to such limits on payments that arbitrageurs cannot receive them except perhaps on meaninglessly few shares.