

CLIENT ALERT

SEC's Continuing Focus on Short Tendering

The Securities and Exchange Commission recently brought and settled short tendering cease and desist proceedings against two broker-dealers. Those broker-dealers did not take their short options positions into account to calculate their "net long position" in connection with a partial tender offer by Lockheed Martin (effectively in exchange for shares of Leidos Holdings):

<https://www.sec.gov/litigation/admin/2019/34-87787.pdf> (*Bluefin Trading*)

<https://www.sec.gov/litigation/admin/2019/34-87786.pdf> (*Critical Trading*)

Rule 14e-4, as relevant here, requires a person tendering into a partial to:

1. Have a net long position equal to the amount of its tender both on the date of tender and at the end of the proration period; and
2. Reduce its net position by the amount of shares represented by short call options written on or after the date that the tender offer was publicly announced, if the exercise price is lower than the stated amount of consideration offered for the Lockheed shares.

BLUEFIN TRADING

1. Had a short position in 750 Lockheed call options acquired between July 29 and August 15, with a strike price of \$300 (and the options had expiration dates after the expiration of the tender offer period);
2. Established a long position of 4,178,463 Lockheed shares between August 2 and August 15;
3. Tendered 4,178,463 shares on August 15, which were accepted by Lockheed and exchanged for Leidos shares;
4. The SEC alleged that Bluefin was required to reduce its net position in Lockheed shares by the amount of the 750 call options because the stated amount of consideration of the partial tender offer exceeded the \$300 strike price of the options [note: the order does not show how the "stated amount of the consideration" was calculated or the value as of the end of the proration period];
5. Because Bluefin did not account for its call options, it tendered 75,000 shares more than its net long position apparently at the time of its tender and at the end of the proration period, and realized an excess profit of \$223,836 [note: the order does not show how this "profit" was calculated];
6. Bluefin consented to an order to cease and desist from violations of Rule 14e-4, was censured, and ordered to pay disgorgement of \$223,836, prejudgment interest of \$29,802, and a civil money penalty of \$50,000.

CRITICAL TRADING

1. Established a long position of 55,000 Lockheed shares between August 3 and August 11;
2. Wrote 500 Lockheed call options during the same period which had a strike price of \$300 and expiration date of August 19;
3. Tendered 55,000 shares on August 15, which were accepted by Lockheed and exchanged for Leidos shares;

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KEY DATES:

JULY 11, 2016:

- ❖ Announcement of Lockheed partial tender offer

AUGUST 12, 2016:

- ❖ Announcement of exchange ratio for the partial tender offer (*presumably, the value of the "stated amount of the consideration offered" was then determinable*)

AUGUST 16, 2016 (8:00 AM):

- ❖ Expiration of the partial tender offer (*presumably, also the end of the proration period*)

For more information

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4. The SEC order states that “later [on August 15], the value of the consideration offered for each Lockheed share increased to over \$300 [note: the order does not show how the “stated amount of the consideration” was calculated or the value as of the end of the proration period];
5. The SEC order then states that “Critical did not reduce the number of Lockheed shares that it had tendered;”
6. Accordingly, the order alleges that Critical’s net long position at the end of the day on August 15 was only 5,500 shares;
7. As a result, Critical tendered 50,000 shares more than its net long position at the end of the proration period, and realized excess profits of \$149,224 [note: the order does not show how this “profit” was calculated];
8. Critical consented to an order to cease and desist from violations of Rule 14e-4, was censured, and ordered to pay disgorgement of \$149,224, prejudgment interest of \$19,868, and a civil money penalty of \$50,000.

OBSERVATIONS

1. It is interesting to compare the SEC’s discussion in the two orders:
 - a. the Critical order indicates that Critical should have reduced the amount of Lockheed shares that Critical already had tendered because the value of the stated consideration rose above \$300 on August 15 [so, even if Critical trading had a net long position of 55,000 shares as of the time of its tender, it had a smaller net long position at the end of the proration period because the value of the tender offer consideration rose above the strike price of its options before the end of the proration period];
 - b. the Bluefin order suggests that the value of the stated consideration had exceeded \$300 at the time that Bluefin tendered its shares on August 15, and so the amount that it tendered should have been less than it actually tendered [and, in any event, its net long position at the end of the proration period was less than it had tendered].
2. The SEC press release accompanying the settlement orders states that the SEC “will continue to police these opportunities where market participants can enrich themselves by gaining an unfair advantage at the expense of others.” <https://www.sec.gov/news/press-release/2019-268>
3. Both orders contain an identical statement in footnote 2 regarding the term “willfully” for purposes of imposing relief under Exchange Act Section 15(b). The footnote states: “The decision in *The Robare Group, Ltd. v. SEC*, which construed the term “willfully” for purposes of a differently structured statutory provision [Section 207 of the Investment Advisers Act], does not alter that [Section 15(b)] standard.”



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