David

30 copies

M E M O R A N D U M

June 1, 1983

TO: Linda Quinn

FROM: Douglas Scarff

SUBJECT: Subcommittee on Regulation of Market Participants

In general, we have no problems with the conclusions of the subcommittee. It would be helpful, however, if the subcommiteee gave further attention to certain aspects of its report. Our comments refer to the May 2, 1983 draft and are as follows:

I. Short Tendering, Hedged Tendering and Multiple Tendering

The second sentence of the first full paragraph on page 2 states, "Unlike short tendering, hedged tendering cannot result in a total tender in excess of the issue outstanding." This statement is incorrect. Persons who purchase shares from those who hedge tender may also tender resulting in the potential for the same shares to be tendered twice. Omission of the sentence and consequent revision to the following sentence would strengthen the subcommittee's recommendation to prohibit hedged tendering.

II. Options/Overtendering

We agree with the recommendation to "prohibit the sale of a (naked call) option by a person who has tendered stock in a tender offer." That recommendation will, however, solve only part of the problem being addressed. Presumably, the subcommittee would also wish to prohibit a person with a long stock, short call position from tendering the stock and leaving himself with a naked call position. Otherwise, the recommended prohibition could be easily circumvented by selling the option before, rather than after, tendering. The subcommittee may wish to consider whether, if the more comprehensive prohibition were in effect, there would be any adverse effect on option specialists and market makers, who often have stock positions that they wish to tender as well as large short call options positions that they may have assumed in performing their market making function.

In addition, we doubt the feasibility of the subjective test set forth at the bottom of page 3. Aside from the difficulty of enforcing a non-objective test, last-minute market movements could dramatically change the likelihood of exercise and render otherwise valid tenders illegal, an undesirable result.

It is not clear whether the subcommittee has or has not considered whether regulatory changes are needed to deal with options trading practices, apart from those that are analogous to hedged tendering. For example, naked call writing both before and during the offer by persons who do <u>not</u> tender contributes to the possibility of overtendering and would not be addressed by the recommendation.

Finally, the reference in the fourth sentence to expiration date is confusing, since in-the-money call options will be exercised for the purpose of tendering the underlying stock shortly before a tender offer terminates whenever it is expected that the post-tender offer price will decline substantially. The expiration date is largely irrelevant in these circumstances. The clause starting with "If the expiration date" and the word "expiring" should be deleted.

III. <u>Depository Participation</u>

No comments.

IV. <u>Market Professionals/Arbitrageurs</u>

No comments.