

Clients & Friends Memo

Recent Enforcement Actions Define the “Person” that Participates in a Partial Tender:¹

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The Financial Industry Regulatory Authority (“**FINRA**”) recently brought enforcement actions against two broker-dealers that violated [Rule 14e-4](#) under the Securities Exchange Act of 1934 (the “**SEA**”) (generally known as the “partial tender rule”) by, among other things, performing required position calculations at the level of the various aggregation units or individual trading units within the broker-dealer, rather than at the entity level.² By calculating their positions in this manner, these broker-dealers did not take account of the position in business units that were short and did not account for these short positions in their [SEA Rule 14e-4](#) calculations.³ As a result of effectively ignoring the positions in business units that were short, the two broker-dealers over-tendered in violation of SEA Rule 14e-4. While FINRA only has enforcement authority over broker-dealers, FINRA’s actions put other types of firms, subject to the SEC enforcement authority, on notice.

The two FINRA enforcement actions were foreshadowed, at least partially, by two FINRA risk monitoring and examination priorities letters. In its 2018 Risk Monitoring and Examination Priorities Letter, FINRA raised concerns regarding violations of SEA Rule 14e-4, primarily in the context of broker-dealers’ miscounting options in making position calculations.⁴ In its 2019 Risk Monitoring

¹ The hyperlinks in the memorandum are generally to the Cadwalader Cabinet (www.FindKnowDo.com) and are in some cases password-protected for Cabinet subscribers. If you wish to sign up for our free daily newsletter, you may do so at the bottom of the www.FindKnowDo.com home page. Nonsubscribers interested in a demonstration or trial of the Cabinet may contact Cheryl Kuntz at cabinet.subscriptions@cwtt.com. See some of our awards and honors: <https://www.findknowdo.com/search-site/endorsements>.

² See [FINRA Enforcement Release, 20180596150-01\(July 21, 2020\)](#) and [FINRA Enforcement Release, 2018058651301\(July 24, 2020\)](#).

³ [SEA Rule 14e-4](#) restricts the number of securities a person may tender for his own account in a partial tender offer based on such person’s “net long position” in such securities and certain related securities. The “net long position” equals the excess, if any, of such person’s “long position” over such person’s “short position.” SEA Rule 14e-4(a)(1) sets forth the specific elements of the required calculation, including what constitutes a long or short position. This calculation must be made both at the time of tender and at the end of the proration period or period during which securities are accepted by lot.

⁴ See [FINRA 2018 Risk Monitoring and Examination Priorities Letter \(January 2018\)](#).

and Examination Priorities Letter, FINRA stated its intention to continue educating firms about the requirements of SEA Rule 14e-4 and to evaluate firms' compliance.⁵

In 2019, the Securities and Exchange Commission ("**SEC**") brought its first actions in over twenty years relating to violations of SEA Rule 14e-4.⁶ As with the FINRA's Examination Priorities Letters, the SEC actions focused on violations or potential violations of SEA Rule 14e-4 resulting from inaccurate position calculations.

By contrast, the two recent FINRA enforcement actions stand out for the firms' failures to perform their "net long position" calculations at the firm level. While FINRA has regulatory authority only over broker-dealers, the FINRA enforcement actions may also serve as a cautionary warning for other entities including, for example, an investment fund that may have separate investment managers or pools of funds managed independently.

Summary of the Rule and Guidance

SEA Rule 14e-4 prohibits a person that does not have a "net long position" from tendering shares in a partial tender offer.⁷ This prohibition applies to tenders by a person "acting alone or in concert with others, directly or indirectly." For this purpose, a "net long position" is to be calculated in accordance with the terms of SEA Rule 14e-4.

A person may not tender more than the "net long position" he holds at both the time of tender and at the end of the proration period or period during which securities are accepted by lot. In addition to having a "net long position," a person tendering for their own account must deliver or cause to be delivered the security for the purpose of tender to the person making the offer within the specified period. A person tendering for the account of another must either possess the subject security or an equivalent security, or have "a reasonable belief that, upon information furnished by the person on whose behalf the tender is made, such person owns the subject security or an equivalent security and will promptly deliver the subject security or such equivalent security for the purpose of tender to the person making the tender."

⁵ See [FINRA 2019 Risk Monitoring and Examination Priorities Letter \(January 2019\)](#).

⁶ See [SEC Release No. 87787, Administrative Proceeding, In re Bluefin Trading, LLC \(Dec. 18, 2019\)](#) and SEC Release No. 87786, Administrative Proceeding, *In re Critical Trading, LLC* (Dec. 18, 2019).

⁷ The SEC's adoption of Rule 14e-4 in effect reversed the decision of the Second Circuit Court of Appeals in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930 (2d Cir. 1986) (holding a broker-dealer liable for refusing to assist a customer in shorting into a partial tender). SEA Rule 14e-4(a)(5) defines "partial tender offer" as "a tender offer or request or invitation for tenders for less than all of the outstanding securities subject to the offer in which tenders are accepted either by lot or on a pro rata basis for a specified period, or a tender offer for all of the outstanding shares that offers a choice of consideration in which tenders for different forms of consideration may be accepted either by lot or on a pro rata basis for a specified period."

The SEC has previously provided guidance as to calculations under SEA Rule 14e-4, but it did not address specifically who was the “person” performing those required calculations.⁸ In the 1984 adopting release for amendments to SEA Rule 10b-4 (which was later renumbered to be SEA Rule 14e-4), the SEC also noted that “[t]he phrase ‘directly or indirectly,’ together with the ‘in concert’ language, is intended to make it clear that persons may not do indirectly what they may not do directly, and thereby to emphasize that indirect forms of short tendering are prohibited.”⁹ No material further guidance was provided as to the meaning of acting in concert.

Conclusion

These FINRA enforcement actions, along with the literal language of SEA Rule 14e-4, make clear that a broker-dealer may not perform “net long position” calculations at a level lower than firm-wide. Further, although FINRA does not have enforcement authority over investment funds and advisers, funds and advisers should review their practices as to the calculation of net long positions for partial tenders in light of the FINRA enforcement actions. It would seem unlikely that FINRA’s interpretation of a “person” for purposes of Rule 14e-4 would be materially different from the position that the SEC intends to be applied.

On the positive side, it is reasonably clear that SEA Rule 14e-4 is entity specific. That is to say, nothing in the rule, releases, or enforcement actions indicates that calculations of the “net long position” should be made above the entity level. In fact, both of the recent enforcement actions are very explicit that the relevant calculations should be performed at the entity level; there is no suggestion that firms would be required to aggregate across affiliates, provided that there is no “acting in concert,” although, as noted, that term is not itself well-defined.

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⁸ SEC Release Nos. 33-8107; 34-46101; Commission Guidance on the Application of Certain Provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and Rules thereunder to Trading in Security Futures Products (June 21, 2002).

⁹ See SEC Release 34-20799, 49 F.R. 13867 (April 9, 1984) (the “**1984 Adopting Release**”) at 13869. The release continued by noting that this was explicitly a clarification and not a substantive change in the rule, as “Section 20(b) of the Act (15 U.S.C. 78t(b)) makes it unlawful for ‘any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of [the Act] or any rule or regulation thereunder through or by means of any other person.’”