Administration, FAA Building, Boeing Field, Seattle, WA 98108.

The official docket may be examined in the Rules Docket, weekdays, except Federal holidays, between 8:30 a.m. and 5:00 p.m. The FAA Rules Docket is located in the Office of the Chief Counsel, Room 916, 800 Independence Avenue, SW., Washington, D.C.

An informal docket may also be examined during normal business hours at the office of the Regional Air Traffic Division.

FOR FURTHER INFORMATION CONTACT: Lewis W. Still, Airspace Regulations and Obstructions Branch (AAT–230), Airspace-Rules and Aeronautical Information Division, Air Traffic Service, Federal Aviation Administration, 800 Independence Avenue, SW., Washington, D.C. 20591; telephone: (202) 426–8783.

SUPPLEMENTARY INFORMATION:

Comments Invited

Interested parties are invited to participate in this proposed rulemaking by submitting such written data, views, or arguments as they may desire. Comments that provide the factual basis supporting the views and suggestions presented are particularly helpful in developing reasoned regulatory decisions on the proposal. Comments are specifically invited on the overall regulatory, economic, environmental, and energy aspects of the proposal. Communications should identify the airspace docket and be submitted in triplicate to the address listed above. Commenters wishing the FAA to acknowledge receipt of their comments on this notice must submit with those comments a self-addressed, stamped postcard on which the following statement is made: "Comments to Airspace Docket No. 83–AWA–11." The postcard will be date/time stamped and returned to the commenter. All communications received before the specified closing date for comments will be considered before taking action on the proposed rule. The proposal contained in this notice may be changed in the light of comments received. All comments submitted will be available for examination in the Rules Docket both before and after the closing date for comments. A report summarizing each substantive public contact with FAA personnel concerned with this rulemaking will be filed in the docket.

Availability of NPRM's

Any person may obtain a copy of this Notice of Proposed Rulemaking (NPRM) by submitting a request to the Federal Aviation Administration, Office of Public Affairs, Attention: Public Information Center, APA–430, 800 Independence Avenue, SW., Washington, D.C. 20591, or by calling (202) 426–8058. Communications must identify the notice number of this NPRM. Persons interested in being placed on a mailing list for future NPRM's should also request a copy of Advisory Circular No. 11–2 which describes the application procedure.

Proposal

The FAA is considering an amendment to § 71.123 of Part 71 the Federal Aviation Regulations (14 CFR Part 71) to alter the descriptions of several VOR Federal airways in the vicinity of Denver, CO, by deleting the alternate route segments. In addition, those alternate routes required for air traffic control will be renumbered. This action supports our agreement with ICAO to eliminate all alternate route designations from the National Airspace System. Section 71.123 of Part 71 of the Federal Aviation Regulations was republished in Advisory Circular AC 70–3A dated January 3, 1983,

List of Subjects in 14 CFR Part 71

VOR Federal airways.

Proposed amendment

PART 71—[AMENDED]

Accordingly, pursuant to the authority delegated to me, the Federal Aviation Administration proposes to amend § 71.123 of Part 71 of the Federal Aviation Regulations (14 CFR Part 71) as follows:

V–8 [Amended]

By deleting the words "Akron, CO; Hayes Center, NE, including a north alternate via INT Akron 063° and Hayes Center 276° radials and also a south alternate via INT Akron 094° and Hayes Center 246° radials; Grand Island, NE, including a N alternate via INT Hayes Center 059° and Grand Island 273° radials, and also a S alternate; Omaha, NE;" and substituting the words "Akron, CO; Hayes Center, NE; Grand Island, NE; Omaha, NE;"

V–26 [Amended]

By deleting the words "Phillip, SD; 56 miles, 35 MSL, Pierre, SD, including a north alternate; Huron, SD;" and substituting the words "Philip, SD; Pierre, SD; Huron, SD;"

V–200 [Amended]

By deleting the words "Meeker, CO; 37 miles, 26 miles, 140 MSL, 130 MSL to Kremmling, CO, including a N alternate via Hayden, CO." and substituting the words "Meeker, CO; to Kremmling, CO."

V–220 [Amended]

By deleting the words "From Kremmling, CO," and substituting the words "From Meeker, CO; Hayden, CO; Kremmling, CO;"

V–211 [Amended]

By deleting the words "to Cortez, including a W alternate via INT Durango 249° and Cortez 150° radials," and substituting the words "to Cortez."

V–421 [Amended]

By deleting the words "Farmington, NM, including a west alternate via INT Gallup 008° and Farmington 233° radials; Durango, CO;" and substituting the words "Farmington, NM; Durango, CO;"

V–484 [Amended]

By deleting the words "Gunnison, CO, including a south alternate from Grand Junction to Gunnison, via Montrose, CO; 13 miles, 112 MSL, 131 MSL" and substituting the words "Gunnison, CO;"

(Secs. 307(a), 313(a), Federal Aviation Act of 1958 (49 U.S.C. 1348(a) and 1354(a)); sec. 6(c), Department of Transportation Act (49 U.S.C. 1655(c)); and 14 CFR 11.65)

Note.—The FAA has determined that this proposed regulation only involves an established body of technical regulation for which frequent and routine amendments are necessary to keep them operationally current. It, therefore: (1) Is not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this rule, when promulgated, will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

Issued in Washington, D.C. on April 15, 1983.

B. Keith Potts,

Manager, Airspace-Rules and Aeronautical Information Division.

[FR Doc. 83–10752 Filed 4–22–83; 8:45 am]

BILLING CODE 4910–13–M

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14 CFR Part 71

[Airspace Docket No. 83–AEA–1]

Proposed Alteration of Transition Area; Chambersburg, Pennsylvania

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of proposed rulemaking.

SUMMARY: This notice proposes to alter the Chambersburg, Pennsylvania Transition Area. A new VOR DME–B Instrument Approach procedure has been developed for Chambersburg Airport and will require protection for aircraft executing the new procedure. An instrument procedure requires the designation of controlled airspace to protect aircraft utilizing the instrument procedure.

DATE: Comments must be received on or before June 6, 1983.

ADDRESS: Send comments on the proposal in triplicate to: Glen A. Bales, Manager, Airspace and Procedures Branch, AEA-530, Federal Aviation Administration, Fitzgerald Federal Building (Formerly Federal Building), John F. Kennedy International Airport, Jamaica, New York 11430.

The official dockets may be examined in the Office of Regional Counsel, Federal Aviation Administration, Fitzgerald Federal Building (Formerly Federal Building), John F. Kennedy International Airport, Jamaica, New York 11430.

An informal docket may also be examined during normal business hours at the Airspace and Procedures Branch, AEA-530, Federal Aviation Administration, Fitzgerald Federal Building (Formerly Federal Building), John F. Kennedy International Airport, Jamaica, New York 11430.

FOR FURTHER INFORMATION CONTACT: Glen A. Bales, Manager, Airspace and Procedures Branch, AEA-530, Federal Aviation Administration, Fitzgerald Federal Building (Formerly Federal Building), John F. Kennedy International Airport, Jamaica, New York 11430, telephone (212) 665-3390.

SUPPLEMENTARY INFORMATION:

Comments Invited

Interested parties are invited to participate in this proposed rulemaking by submitting such written data, views, or arguments as they may desire. Comments that provide the factual basis supporting the views and suggestions presented are particularly helpful in developing reasoned regulatory decisions on the proposal. Comments are specifically invited on the overall regulatory, economic, environmental, and energy aspects of the proposal. Communications should identify the airspace docket and be submitted in triplicate to the address listed above. Commenters wishing the FAA to acknowledge receipt of their comments on this notice must submit with those comments a self-addressed, stamped postcard on which the following statement is made: "Comments to Airspace Docket No. 83-AEA-1." The postcard will be date/time stamped and returned to the commenter. All communications received before the specified closing date for comments will be considered before taking action on the proposed rule. The proposal contained in this notice may be changed in the light of comments received. All comments submitted will be available for examination in the Rules Docket both before and after the closing date for comments. A report summarizing each substantive public contact with FAA personnel concerned with this rulemaking will be filed in the docket.

Availability of NPRMs

Any person may obtain a copy of the Notice of Proposed Rulemaking (NPRM) by submitting a request to the Office of Regional Counsel, AEA-7, Federal Aviation Administration, Fitzgerald Building (Formerly Federal Building), John F. Kennedy International Airport, Jamaica, New York 11430. Communications must identify the notice number of this NPRM. Persons interested in being placed on a mailing list for future NPRMs should also request a copy of Advisory Circular No. 11-2 which described the application procedure.

Proposal

The FAA is considering an amendment to § 71.181 of Part 71 of the Federal Aviation Regulations (14 CFR Part 71) so as to extend the 700 foot transition area generally out to the west of the airport beyond the 6.5 mile radius of the airport and four miles either side of the 080° radial of the St. Thomas Vortac, to the vortac. Section 71.181 of Part 71 of the Federal Aviation Regulation was republished in Advisory Circular AC70-3A dated January 3, 1983.

List of Subjects in 14 CFR Part 71

Transition areas.

Proposed Amendment

PART 71—[AMENDED]

Accordingly, pursuant to the authority delegated to me, the Federal Aviation Administration proposes to amend § 71.181 of Part 71 of the Federal Aviation Regulations (14 CFR Part 71) as follows:

1. Amend § 71.181 of Part 71, Federal Aviation regulations, by altering the description of the Chambersburg, Pennsylvania, 700-Foot Floor Transition Area as follows:

Chambersburg, Pa. amended.

That airspace extending upward from 700 feet above the surface within a 6.5-mile radius of the center, 39°58'23" N., 77°38'37" W. of Chambersburg Municipal Airport, Chambersburg, Pa.; within an 8-mile radius of the center of the airport, extending clockwise from a 039° bearing from the airport to a 061° bearing from the airport; within a 15-mile radius of the center of the airport, extending clockwise from a 061° bearing from the airport to a 135° bearing from the airport; within an 8-mile radius of the center of the airport, extending clockwise from a 135° bearing from the airport to a 174° bearing from the airport; within a 7-mile radius of the center of the airport, extending clockwise from a 174° bearing from the airport to a 241° bearing from the airport; within 4 miles each side of the St. Thomas VORTAC 080° radial, extending from the 6.5-mile radius area to 29 miles east of the VORTAC; the St. Thomas 233° radial within four miles each side of the Runway 6 centerline from the Chambersburg Municipal Airport, and extending southwest for eight miles.

(Secs. 307(a) and 313(a), Federal Aviation Act of 1958 (49 U.S.C. 1348(a) and 1354(a)); sec. 6(c), Department of Transportation Act (49 U.S.C. 1655(c)); and 14 CFR 11.65)

Note.—The FAA has determined that this proposed regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. It, therefore: (1) Is not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this rule, when promulgated, will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

Issued in Jamaica, New York on March 31, 1983.

Norbert A. Owens,

Acting Director, Easter Region.

[FR Doc. 83-10756 Filed 4-22-83; 8:45 am]

BILLING CODE 4910-13-M

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Rel. No. 34-19678; File No. S7-969]

Processing of Tender Offers Within the National Clearance and Settlement System

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rulemaking.

SUMMARY: Because of certain securities processing inefficiencies that have been occurring in connection with tender offers when depositaries do not make allowance for book-entry delivery of tendered securities, the Commission is today publishing this release, which discusses, among other things, the causes of those inefficiencies and their effects on the national clearance and settlement system and in the secondary trading markets. This release also proposes for comment Rule 17Ad-14 under the Securities Exchanges Act of 1937 (the "Act") which would require registered transfer agents acting on

behalf of bidders as tender agents to establish and maintain at all qualified registered securities depositories holding the subject company's securities specially designated accounts for purposes of receiving by book-entry from depository participants the delivery of tendered securities that are depository eligible.

DATE: Comments must be received on or before May 27, 1983.

ADDRESSES: Comment letters should refer to File No. S7-969 and should be submitted in triplicate to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 450 Fifth Street, Washington, D.C. 20549. All comments will be available for public inspection and copying at the Commission's Public Reference Room.

FOR FURTHER INFORMATION CONTACT: Dan W. Schneider, Esq., at (202) 272-2401, or Thomas V. Sjoblom, Esq., at (202) 272-7379, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: Tender offer activity by bidders [1] has increased dramatically over the last few years. The Commission believes, however, that insufficient attention has been paid to the functioning of the national clearance and settlement system in the context of tender offers, even though the magnitude of some recent large tender offers has discernibly affected the clearance and settlement of securities transactions associated with those offers. Accordingly, the release discusses certain facilities available to financial institutions that participate in registered securities depositories, the securities processing problems that have occurred in connection with some recent large tender offers, the need for uniform resolution of those problems, and the existence of automated programs for processing tender offers. In addition, the release discusses a proposal made by The Depository Trust Company, Inc. ("DTC") that would not only mandate the use of automated, book-entry services provided by depositories but also facilitate the uniform use of automated trade clearance systems during tender offers. While the Commission is confident that bidders and securities processors will continue voluntarily to make changes in their securities processing programs to accommodate tender offers, the Commission regards these problems as so important that it is responding to DTC's recommendations by proposing a tender agent rule, Rule 17Ad-14, which would require the bidder's agent to establish specially designated accounts with qualified registered securities depositories for purposes of receiving by book-entry the delivery of tendered securities from depository participants.

I. The National Clearance and Settlement System

Since the "paperwork crisis" in the late 1960's [2] entities involved in post-execution, "back-office" securities processing services— namely, broker-dealers, banks, clearing corporations, securities depositories and transfer agents (collectively, the "securities processing industry")—have corporated in developing and using efficient date processing and communication techniques to complete their securities transactions. Although brokerage firms had used centralized clearing facilities to process securities transactions for decades, those processing systems, for the most part, operated on a manual basis. [3] During the 1970's, however, the securities processing industry began rapidly building an automated, reliable and financially responsible national system for trade comparison, clearance, settlement and transfer. [4]

Integral to the developing national system were securities depositories.[5] The growth and success of securities depositories occurred as a direct result of the financial industry's desires to minimize the physical movement of stock certificates and related paper, facilitate book-entry settlement of securities transactions, enable the use of centralized dividend accounting, and provide for increased communication efficiencies among depository participants and transfer agents located throughout the country. Centralized vault facilities at registered securities depositories, for instance, greatly facilitate the immobilization [6] of corporate securities certificates.[7]

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[1] The term "bidder" is defined in Rule 14d-1(b)(1) of the Act [17 CFR 240.14d-1(b)(1)] to mean, in pertinent part, "any person who makes a tender offer or on whose behalf a tender offer is made. . . ." For purposes of this release, however, the term bidder also encompasses issuers making tender offers for their own shares.

[2] The paperwork crisis of the late 1960's nearly brought the securities industry to a standstill and directly or indirectly resulted in the failure of a large number of broker-dealers. This crisis resulted from the sharply increased volume and historic inattention to securities processing (*e.g.*, inefficient, duplicative and extensively manual clearance and settlement systems, poor records, insufficient controls over funds and securities, and the use of untrained personnel to perform processing functions). In the aftermath of the paperwork crisis, the securities industry, the Commission and the Congress turned their attention to securities processing. Among other things, the Commission actively urged policies designed to foster greater access to clearing corporations and securities depositories by all qualified broker-dealers and other financial intermediaries, and the Congress amended the Act to authorize development of a national system for the prompt and accurate clearance and settlement of securities transactions. *See* Section 17A(a) of the Act.

[3] *Id. See.* S. Huebner, *The Stock Market*, at 236-65 (1938).

[4] During the 1970's the entities comprising the securities processing industry developed and implemented significant improvements in their securities processing operations. The improvements included the automation of labor-intensive functions (*e.g.*, broker-dealer and transfer agents converted their recordkeeping and processing functions from primarily manual to automated systems), the establishment of new and more efficient clearance and settlement systems (*e.g.*, continuous net settlement ("CNS") systems, *see note 29 infra*, and institutional trade settlement systems), rapid growth in the use of securities depositories, and an intensification of efforts to complete interfaces among previously unrelated clearance and settlement systems.

[5] A securities depository is a "custodial" clearing agency that operates a centralized system for the handling of securities certificates. *See* § 3(a)(23) of the Act. As clearing agencies, securities depositories must be registered with the Commission pursuant to §§ 17A(b) and 19 of the Act. Currently, there are five registered securities depositories: DTC, the Philadelphia Depository Trust Company ("Philadep"), the Pacific Securities Depository Trust Company, the Midwest Securities Trust Company ("MSTC") and the New England Securities Depository Trust Company.

A registered securities depository accepts deposits of securities from broker-dealers, banks and other financial institutions (collectively referred to as "participants"); credits those securities to the general free accounts of the depositing participants; and, pursuant to instructions of the participants, effects book-entry deliveries of securities (including pledges) among participants (and participating pledgee banks). *See, e.g.*, DTC, *Participant Operating Procedures*, §§ B and C. The physical securities deposited with a securities depository are held in a fungible bulk, no significant portion of which is identified or identifiable to a particular participant or pledgee; each participant or pledgee having securities of a given issue credited to its account has a pro-rata interest in the physical securities of the issue held in custody by the securities depository in its nominee name. *See generally* §8-320 of the Uniform Commercial Code. Depositories also may provide facilities for payment by participants to other participants in connection with book-entry deliveries of securities. Securities credited to a participant's or a pledgee's account may be withdrawn by the participant or pledge in physical form for delivery to persons who do not maintain accounts with the depository. Certificates may be withdrawn (I) after re-registration in a name designated by the withdrawing party ("withdrawals by transfer") or (ii) in the name of a depository's nominee ("nominee name certificates"), in which case the nominee appoints the withdrawing party as attorney to effect transfer of the certificate ("COD withdrawals"). *See e.g.*, DTC, *Participant Operating Procedures*, §§ D and E.

[6] The desire to immobilize securities certificates became a matter of affirmative federal regulatory policy in 1975 when Section 17A(e) was added to the Act. That Section provides, in pertinent part, that "the Commission shall use its authority under this title to end the physical movement of securities certificates inconnection with the settlement among brokers and dealers of transactions in securities. . . ."

[7] Eligibility of a security issue for depository services generally depends on whether that security is traded in an active market and is easily transferable. *See, e.g.*, DTC Rule 5; MSTC Rule 2, section 2; and Philadep Rule 5.

Industry confidence in securities depositories as custodians, moreover, has reduced certificate withdrawals, generally, to special circumstances such as customer requests, that place heavy demand on a broker-dealer's limited working supply of certificates. In addition, through reciprocal accounts and telephonic and electronic interfaces, the nation's registered securities depositories have become linked on an automated basis. Furthermore, through these automated depository links, registered clearing corporations—which compare, account for, and initiate settlement of, securities transactions—have experienced increased efficiency in processing trades of their clearing members.

The securities processing industry, therefore, has made great progress since the paperwork crisis in exploiting "state of the art" data processing and communication techniques and in linking together the several components of the national clearance and settlement system.[8] Today, as a result, brokers and other participating institutions can compare, clear and settle securities transactions through a nationwide network of automated facilities, irrespective of the market in which a particular trade has been executed.

II. Current Problems Associated With the Processing of Tender Offers

Despite the extensive growth of automated processing systems, however, many of the paperwork problems that led in 1975 to enactment of Section 17A(a) still exist with respect to tender offer processing that occurs without the benefit of securities depositories.[9] Indeed, the processing of tendered securities and regular-way trades [10] in the subject company's securities during tender offers has not effectively been integrated into the national clearance and settlement system, even though that system should be able to accommodate in a safe, efficient and automated manner all related aspects of securities processing activities during tender offers.[11] Particularly when the services of securities depositories cannot be used during a tender offer (*e. g.*, when the subject company's securities become ineligible for those services), [12] the consequent manual handling of certificates for pysical trade settlement and tender activity increases inefficiency and poses financial risk for all entities involved in securities processing.

Moreover, increased cost and confusion for securities firms and ultimately, for investors (*e.g.*, in the form of increased interest or other charges and delays) inevitably result when securities firms must deal separately with several clearing systems and procedures to settle trades involving securities that are the subject of a tender offer. These problems, apparent during recent large tender offers and discussed in detail below, occur when securities tendered for acceptance and when secondary trades in those securities are processed without the benefit of depository services.

A. *Processing of Tendered Securities in a Non-Depository Physical Certificate Environment.* As suggested above, a central processing benefit of securities depositories lies in eliminating the physical circulation of securities certificates. In a tender offer, however, deliveries for purposes of tender must be made to the bidder's *depositary*.[13] If that depositary agent does not participate, for purposes of the offer, in a securities depository holding the subject company's securities as custodian, delivery to the depositary agent must be accomplished by broker-dealers, banks and other institutions through the physical tender of securities certificates outside the securities depository, rather than through book-entry delivery, even though they may be depository participants. [14] The time contraints, however, surrounding physical delivery during a sizeable tender offer can be severe. [15] For that reason, and because of the inventory management problems that can be encountered when a securities depository attempts to operate in a manual, rather than an automated, mode,[16] some securities depositories

[8] *See* Section 17A(a) (1) (C), (D) of the Act.

[9] The Senate Subcommittee's February 1972 Report accompanying the Securities Industry Study identified two primary causes of the paperwork crisis:

First, the industry had failed to develop a nationwide system for the clearance and settlement of securities transactions. Second, there existed a lack of uniformity and coordination among the various methods and systems of clear[ance] and settlement. The Subcommittee found an alarming lack of supervision, coordination, and central decision making which was delaying implementation of many of the technological innovations available to help solve processing problems.

S. Rep. No. 94-75, 94th Cong., 1st Sess., reprinted in [1975] U.S. Code Cong. & Ad. News, at 232. *See generally* note 2 *supra*.

[10] The term "regular-way" trades, as used in this release, refers to exchange executed transactions that are scheduled to settle on the fifth day following the execution date (*i.e.*, "trade date + 5," or "T+5").

[11] While some securities depositories have adopted special programs and procedures to accommodate tender offer activity, only one securities depository has available an automated, book-entry program for the processing of tendered securities. *See* note 44 *infra* and accompanying text, and discussion *infra* at 26-36.

[12] *See* note 16 *infra* and accompanying text.

[13] A depositary—to be distinguished from a registered securities depository, which is a clearing agency (*see* note 5 *supra*)—is a key entity involved in the processing of most, if not all, tender offers. While the bidder customarily answers all questions regarding the validity, form, eligibility, and acceptance of tenders, the depositary, commonly a bank, is appointed by the bidder to receive and hold on behalf of the bidder all securities submitted by tendering securityholders.

As agent for tendering securityholders pursuant to the letters of transmittal (*see* note 19 *infra*), the depositary receives tenders (*i.e.*, letters of transmittal, guarantees of delivery, stock powers and certificates). In that capacity, the depositary usually is constituted with full powers of substitution to (1) deliver the certificates for tendered shares, with accompanying evidence of transfer and authority, to, or upon the order of, the bidder upon receipt from the bidder of the consideration offered; (2) present those certificates for transfer on the books and records of the subject company; and (3) receive all benefits and otherwise exercise all rights of beneficial ownership for tendered securities registered in "street" or nominee" name. *See* note 22 *infra*. In addition, as agent for the tendering securityholders, the depositary receives payment from the bidder and distributes that payment to tendering securityholders for securities accepted by the bidder.

[14] Simply stated, if the depositary agent does not establish and maintain an account at the securities depository, there can be no book-entry delivery from depository participants to the bidder's depositary agent.

[15] Of course, there may be little time after an offer is announced for a bidder and its depositary to set up with a securities depository receipt and delivery arrangements for the subject company's securities. Thus, the need for such arrangements should be taken into account at an early stage by the bidder and persons acting on behalf of the bidder when designing the tender offer.

[16] Heavy certificate withdrawal demands for physical delivery can present enormous inventory management problems to any sizeable securities depository. As a general matter, securities depositories maintain in their vaults primarily large denomination certificates representing aggregated participants' positions in that issue of securities ("jumbo certificates"). The number of certificates in smaller denominations is often just sufficient to meet participants' routine withdrawal needs. In a tender offer in which depository facilities cannot be used for the offer, the precise timing and extent of demand for physical certificates can be unpredictable. Because "jumbo certificates" may need to be presented by the securities depository to the transfer agent for breakdown into several certificates of smaller denominations, a securities depository, at critical points during such tender offers, can have difficulty delivering to participants on an expedited basis certificates in the precise denominations needed. Moreover, even when a bidder provides in an offer for a protection period (*see* note 27 *infra*), a large securities depository may be unable to assure its participants that appropriately denominated certificates will be available from the depository or the transfer agent for timely delivery by participants directly to the bidder's depositary agent. Further, it may not always be possible for every securityholder to obtain a "guarantee of delivery" (*see* note 21 *infra*) from an eligible institution acceptable to the bidder or its depositary. For example, the terms of tender offers commonly require that the guarantor must be a member of the NASD or national securities

step out of the processing stream during large tender offers handled by non-participating depositary agents by declaring deposited stock of the subject company ineligible for continued depository services and returning those deposits to participants.[17]

When the services of a securities depository are not available, securityholders desiring to tender their securities to the bidder face special problems not otherwise confronted in today's automated processing environment. As a consequence, tendering securityholders and the bidder may be adversely affected.[18] For example, tendering securityholders must, pursuant to letters of transmittal,[19] deposit physical certificates with the bidder's depositary either directly or through financial institutions,[20] or they must guarantee later delivery.[21] Before certificates can be delivered to the bidder's depositary, however, securities registered in the name of a person other than the beneficial owner (*e.g.*, stock registered to a broker-dealer in street or nominee name)[22] may first need to be presented by the custodian of those securities to the transfer agent for denominational breakdown of share quantities represented by the certificate[23] and for re-registration.[24] A securityholder who decides at the last minute to tender—or even a securityholder who decides to tender by guarantee of subsequent delivery—may be unable to accomplish timely delivery of physical certificates to the bidder. In that event, tendering securityholders may miss the offer entirely[25] or at least miss it at that premium;[26] or they may remain obligated to the bidder under guarantees of delivery. In addition, bidders may not receive before the expiration date has elapsed, or prior to the end of the protect period when one is provided,[27] the desired precentage of the subject company's securities.

A certificate-based, non-depository, physical tender, settlement and transfer system, therefore, ineffectively serves most, if not all, of the parties involved.

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exchange, a commercial bank or a trust company, which may not be ready accessible to a tendering securityholder.

[17] For example, DTC, the largest of the four active securities depositories, declared the securities of Conoco, Inc. ("Conoco") ineligible for DTC's services during the summer 1981 competing tender offers by E. I. DuPont de Nemours ("DuPont"), Joseph E. Seagram & Sons, Inc. ("Seagram") and Mobil Corporation ("Mobil") for control of Conoco. DTC customarily "exits" the stock of the subject company during large tender offers in which the bidder's depositary agent does not establish an account at DTC for purposes of book-entry delivery of that stock, particularly when those offers are for a significant percentage of that stock on deposit at DTC and when the target company's transfer agent is located outside of New York. Not all securities depositories follow such procedures, however. Midwest Securities Trust Company ("MSTC"), for example, did not declare Conoco stock ineligible for its depository services. The different decisions made by securities depositories regarding the continued eligibility of the subject company's stock appear to be attributable to such factors as the relative volume of activity in that stock, number of participants, size of deposits, share denominations of registered certificates currently being held, percentage of shares on deposit in relation to the percentage of shares sought in the offer, relative inventory management problems, and differing fiduciary philosophies.

[18] Financial intermediaries, who are depository participants, also may lose the opportunity to use depository services for the collateral use of untendered shares (*e.g.*, as collateral for loans, delivery for short sales, or for delivery on customer's fails to deliver, *see note* 31 *infra*).

[19] A letter of transmittal is the document by which a securityhoder of the subject company accepts the bidder's invitation to tender or offer to purchase; offers to sell the subject company's shares to the bidder; appoints the depositary as the agent to receive and hold tendered securities; and actually deposits with, or guarantees to deliver to, the depositary the subject company's securities being tendered. For the most part, securityholders who possess certificates registered to their name and who desire to tender into the offer need only submit those certificates properly endorsed with a letter of transmittal to the bidder's depositary. The latter of transmittal is the basic instrument for effecting transfer of the tendered securities. After expiration of the offer or applicable withdrawal periods (*see* Section 14(d)(5) of the Act and Rule 14d-7 thereunder [17 CFR 240.14d-7]), the bidder can present those certificates to the subject company's transfer agent for cancellation and for issuance of certificates registered in the name of the bidder. If certificates are not immediately available for tender and delivery to the depositary or forwarding agent (*e.g.*, securities are being held in a custodial account, or securities are registered in street or nominee name, *see* note 22 *infra*), bidders commonly permit tenders to be made by or through eligible institutions (*i.e.*, commercial banks, trust companies, members of a national securities exchange, or members of the NASD) without the concurrent deposit of certificates. In that case, the guarantee of delivery (*see* note 21 *infra*) contained in the letter of transmittal must be executed by an eligible institution. *See* note 16 *supra*. *See, e.g.*, *Indiana Nat'l Bank* v. *Mobil Oil Corp.*, 578 F.2d 180, 182 (7th Cir. 1978).

[20] In the context of a tender offer, a securityholder simply may want a broker-dealer, bank or trust company to effect the transaction for him. In these situations, the tender may be made by one of those institutions, if eligible, by submitting a letter of transmittal and by representing that the tender is being made on behalf of a person deemed to own the shares within the meaning of Rule 10b-4 under the Act [17 CFR 240.10b-4]. Rule 10b-4 under the Act makes it a "manipulative or deceptive device or contrivance" within the meaning of Section 10(b) of the Act for any person to tender a security unless he owns it or owns a security convertible into, exchangeable or exercisable for, the tendered security. *See* Rule 10b-4(a) [17 CFR 240.10b-4(a)]. An owner of a security is defined as one who has title to the security, has purchased the security, or has converted, exchanged or exercised another security (*e.g.*, option) that entitles him to obtain the security. A person is deemed to own a security, however, only to the extent that he has a "net long position" in the security. *See* Rule 10b-4(b) [17 CFR 240.10b-4(b)].

[21] The offer to purchase (in the case of a cash tender offer) or prospectus (in the case of a registered exchange offer) ordinarily specifies how securities may be tendered when certificates are not immediately available for delivery. A method commonly employed is the use of a "guarantee of delivery," whereby a tendering securityholder or eligible institution promises that the certificates for those securities will be delivered to the bidder's depositary within a specified number of days (usually eight days) after the date of the letter of transmittal.

[22] Securityholders frequently may not personally possess the certificates needed for delivery and deposit in response to a bidder's offer because other financial institutions may have custody of those certificates, in which case they usually are registered in "street name" or "nominee name." "Nominee name" registration refers to arrangements used by institutional investors (*e.g.*, insurance companies and investment companies) and financial intermediaries (*e.g.*, broker-dealers, banks and trust companies) for registration of securities held by them for their own account or for the account of their customers who are the beneficial owners of the securities. "Street name" registration refers to the practice of a broker-dealer registering in its name, or in the name of a nominee, securities left with the broker by its customers or held by a broker for its own account. It is a specialized type of nominee name registration. *See, Final Report of the Securities and Exchange Commission on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other than the Name of the Beneficial Owner of Such Securities*, at 1 (December 3, 1976).

[23] When securities are being held by a financial institution (*e.g.*, a broker-dealer or custodian bank) for beneficial owners, that institution usually possesses only a few certificates of small denomination for anticipated physical delivery; the remaining securities either are held in, and represented by, large denomination share certificates or are on deposit at a securities depository. In order to provide a given beneficial owner with a certificat representing the appropriate number of shares needed for tender, the financial institution may need to send a certificate to the transfer agent for breakdown into smaller denominations.

[24] Of course, if the person to whom the securities are registered in street name has a certificate representing the precise number of shares needed by the beneficial owner for purposes of tender, that person can simply endorse the certificate or provide a stock power to the beneficial owner.

[25] *See, e.g.*, *Indiana Nat'l Bank* v. *Mobil Oil Corp.*, *supra* note 19, 578 F.2d at 184 (failure to deliver certificates pursuant to letter of transmittal when required by offer as condition precedent to payment did not constitute proper tender). Pursuant to Rule 14e-1(d), of course, the bidder tender). Pursuant to Rule 14e-1(d), of course, the bidder may extend the expiration date of the offer on proper notification. *See* 17 CFR § 240.14e-1(d). In addition, the bidder may extend the delivery date after the offer expires. For example, Seagram several times extended the delivery date for Conoco stock. *See* "Seagram Extends Stock Deadline," Washington Post, August 21, 1981, at D-8.

[26] *See also* Section 14(d)(7) of the Act and Rule 14e-1(b) thereunder [17 CFR 240.14e-1(b)], which prescribe the conditions under which the bidder may increase the consideration offered.

[27] A "protect period" or "protection period" refers to that period of time *after* expiration of an offer during which securities of the subject company may be delivered to the bidder's depositary in accordance with the letters of transmittal, guarantees of delivery or other documentation (*e.g.*, telegrams, facsimile transmissions or letters from eligible institutions) submitted prior to expiration. During large tender offers, bidders commonly provide for a protection period of approximately eight days.

Participants and the bidder's agent are burdened with labor-intensive operations to control a large volume of certificate movement in the subject company's securities, and several parties, including securityholders who desire to tender their shares, may suffer monetary losses.

B. *Problems Associated with Trade Settlement in the Subject Company's Securities.* During a tender offer there often is unusually heavy trading activity in the securities of the subject company. When depository services for those securities are unavailable, however, trade clearance and settlement can become inefficient and costly. For example, trades in those securities cannot be settled through institutional delivery ("ID") systems [28] or continuous net settlement ("CNS") systems [29] because those systems depend on book-entry access to participants' depository accounts.[30]

The inability of brokers, banks and other institutions to use ID systems for settlement of institutional trades during tender offers increases securities processing costs and may increase institutional trade commission fees. To settle delivery obligations in secondary market trades under these circumstances, institutions that act as their own custodians, as well as brokers and agent banks, necessarily incur greater personnel and other costs in delivering physical certificates and funds. In addition, because delays can occur in dispatching and delivering physical certificates to complete secondary market trades, brokers' physical "fails-to-deliver" and "fails-to-receive" [31] are likely to increase, which inevitably requires brokers to incur extraordinary financing costs. These additional financing costs, therefore, coupled with increased expenses associated with processing institutional secondary market trades outside the depository,[32] can influence brokers to increase their commission fees to institutions.

Similarly, when depository and CNS systems are unavailable, trades in the subject company's securities are likely to be settled pursuant to clearing corporation balance orders.[33] Balance orders instruct participants to settle trades among themselves on a net daily basis, in the absence of depository book-entry services, through the physical exchange of securities for cash. Even though balance orders reflect netted daily settlement instructions and thereby reduce the number of settlements necessary for that day, as contrasted to a CNS system, balance orders increase the physical movement of certificates; and, by requiring brokers to devote additional resources to manual certificate settlement, balance orders can reduce the efficiency of broker-dealer trade processing. Such increased physical certificate movement inevitably contributes to "fails-to-deliver" and "fails-to-receive" and requires broker-dealers that are parties to balance orders to employ several remedial mechanisms to effect delivery or to protect rights of ownership.

The two most common clearing agency remedies are buy-ins [34] and liability notices.[35] Because the national clearance and settlement system consists of several clearing corporations and depositories, however, broker-dealers, when relating to these various clearing corporations in settling trades, can face differing buy-in and liability notice rules and procedures.[36] Similarly, clearing agencies that are parties to balance orders may have to accommodate remedies that vary in important details from agency to agency. The existence of differing procedures can reduce the efficiency and

[28] For a discussion of institutional delivery systems, *see, e.g.*, DTC, *Participant Operating Procedures*, § M; File No. SR-MSTC-82-1 (National ID System). *See also* Securities Exchange Act Release No. 19227 (November 9, 1982) [47 FR 51658 (November 16, 1982)].

[29] A CNS system is characterized generally by the severance of the link between the *original* parties to compared trades and the interposition of the *system* as the *contra* party. The system generates a single, daily net "buy" or "sell" position for each issue of securities in which a participant has compared trades due to settle on T+5 and nets accumulated positions against any previously unsettled net buy or sell positions in that issue. As the *contra* side for each net settlement obligation, the clearing agency's CNS system, rather than the original parties to the trades, becomes the entity which is obligated to deliver or receive securities and money and with which fails to deliver or receive securities must be resolved. *See* note 31 *supra*. The clearing agency carries "fails" forward from day to day as open obligations and protects itself against financial risk by, among other things, obtaining mark-to-the-market payments on open obligations from each participant whose failure to satisfy those open obligations would place the system at risk.

[30] The Commission recognizes that, even if depository facilities remain available during a tender offer, the CNS system of an affiliated clearing corporation may be unavailable. This is most notably the case at the National Securities Clearing Corporation ("NSCC"), which has a limited set of CNS account numbers in its current program. So that NSCC's CNS services can be available to participants during tender offers in which depository services are available, the Commission encourages NSCC to continue its efforts to redesign its CNS account system.

[31] A "fail-to-deliver" arises when the selling broker-dealer does not deliver a certificate in proper form at the agreed upon settlement date to the buying broker-dealer. Conversely, a "fail-to-receive" arises when the buying broker-dealer has not received delivery of securities from a selling broker-dealer as of settlement date.

[32] In that respect, recent concerted industry efforts to eliminate these broker financing costs and streamline the institutional trade settlement process through the mandatory use of ID systems, hinged as those systems are on the eligibility of securities for depository services, will become irrelevant during tender offers processed without the benefits of securities depositories. *See* Securities Exchange Act Release No. 19227 (November 9, 1982) [47 FR 51658 (November 16, 1982)].

[33] Unlike CNS systems, daily balance order ("DBO") systems currently do not involve clearing agency interpositioning between the parties to a trade. Instead, while the system generates a daily net "buy" or "sell" position for each issue of securities in which a participant has a compared trade due to settle that day, it allocates among, and issues to, participants balance orders to deliver or receive net buy or sell positions. DBO systems do not net accumulated positions against any previous unsettled trades in that issue. Due to the allocation procedure, on a given day participants may be required to deliver securities to or receive securities from a participant with which it had no trades. Although securities and money settlement are made through the DBO system, any "fails" resulting from a participant's failure to deliver or receive are treated as fails between the *parties* to the balance order and must be resolved between them (rather than with the system).

[34] If a broker-dealer holding a deliver balance order does not make delivery of all cleared securities pursuant to a balance order within the time specified, the broker-dealer holding the receive balance order to whom the securities are to be delivered may cause securities not so delivered to be bought-in (*i.e.*, cause execution of an order to buy those securities at a reasonable price in the market of its choice). *See, e.g.*, NSCC Rule 10.

[35] Clearing corporations, by rule, enable their participants to use liability notices to protect their rights in a tender offer (*i.e.*, protect the value of the offer) when a trade occurs on or before the last day of expiration or the protection period but when the settlement date is scheduled to occur thereafter. The broker holding the receive balance order that wants its right to tender protected must issue a notice of liability to the delivering broker (*i.e.*, *contra* party) directly or through the clearing agency. The rules of the various clearing corporations specify the time within which the notice must be issued (usually one business day prior to the end of the protect period). If the *contra* party/broker-dealer fails to deliver the securities on expiration date as specified in the notice, the *contra* party is liable for any damages caused thereby.

[36] For example, The Options Clearing Corporation's ("OCC") buy-in rule for the exercised equity options (OCC Rule 910) permits buy-ins approximately 24 hours after scheduled settlement has failed; under Rule 9 of the Midwest Clearing Corporation ("MCC"), when the long value participant (*i.e.*, the clearing member to whom stock is owed) originating the buy-in notice for stock trades is an MCC clearing member, the proposed execution date for the buy-in cannot be set earlier than the third business day following settlement date; and NSCC's rules permit execution of buy-ins three business days after settlement date when securities are in its balanced order system, but provides a shorter time frame for continuous net settlement buy-ins through NSCC. (*See* NSCC's Procedures, § IX. A.) Moreover, the rules of some clearing corporations do not permit retransmittal of buy-in notices. To compound the problem, both the NYSE and the NASD have buy-in rules which some brokers attempted to utilize during the tender offers for Conoco. *See* NYSE Rule 282 and NASD Manual (CCH) ¶3559. Because varying procedures produce confusion and delay, the Commission encourages the clearing agencies to continue to work together to reach a uniform resolution to these differences. *See also* note 38 *infra*.

predictability of settlement resolution,[37] increase the demand for stock in the cash market, and expose clearing corporations to financial risk.[38]

These inefficiencies, delays and risks are amplified when the subject company's security underlies exchange-traded options contracts. Processing problems in these securities may be exacerbated if a large number of options exercises occur prior to the offer's expiration date. Theoretically, the number of options contracts written on the underlying securities and outstanding at any given time can far exceed the authorized or outstanding amount for the particular underlying issue. While most options contracts normally are closed out in the secondary market, during a tender offer outstanding options contracts for a significant percentage of the public float of the subject company's security may be exercised in order to enable market participants to tender on the basis of the exercised position or to cover a separate delivery obligation.[39] If, at the same time, a significant percentage of the public float has been tendered by physical delivery or guarantees of delivery to the bidder's agent, so that those securities already are committed and unavailable, a "short squeeze" may be created.[40] This phenomenon may not only require the institution of extraordinary settlement procedures,[41] but also contribute to significant upward price pressure in the secondary cash market.[42]

For example, the competing tender and exchange offers for Conoco collectively resulted in all or substantially all of Conoco's shares being tendered. During August 1981, when a "short squeeze" became apparent, exercising holders of call options who had not received Conoco stock by exercise settlement date, and uncovered call option writers seeking to cover settlement obligations, turned to the cash market to satisfy their tender obligations. On Monday, August 17, Conoco stock was trading regular-way in the primary market at a price of $80 per share; the cash market price, however, had climbed to $97 per share. As the last date approached for delivery of certificates pursuant to guarantees of delivery within the terms of Seagram's offer (August 19th), accumulating purchase requirements reportedly threatened to push the cash market price above $100, to perhaps more than 20 points above the price in the regular-way market.[43]

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[37] For example, during the June–August 1981 competing tender offers for Conoco, broker-dealers, particularly those that held arbitrage positions in the stock of Conoco, were faced with receiving, issuing and retransmitting multiple letters of liability; borrowing Conoco shares, often at a premium, in order to avoid liability; arranging for rush transfers or the exchange of certificates with other firms in order to meet denominational needs for balance order deliveries; continuing to receive or deliver certificates in satisfaction of balance order obligations and incurring interest costs when deliveries could not be turned around the same day; and attempting to satisfy their delivery obligations in Conoco by offsetting transactions that had settled in one system with transactions that had settled in another system (*e.g.*, firms attempted to assert rights to receive under NSCC balance orders to offset buy-in liabilities that resulted from OCC exercise assignments).

[38] For example, some but not all clearing agencies will accept liability notices through the clearing interfaces for trades executed on, or immediately prior to, the expiration date of the tender offer but which settle after the expiration date. When one clearing corporation accepts such a liability notice from a long value participant (*i.e.*, the participant to whom securities are owed) and the short value (*i.e.*, the participant account that owes the securities) is in the account of another clearing corporation that, through the interface, either declines the notice or agrees to provide "best efforts" protection only, the clearing corporation accepting the long value participant's notice can have a significant financial exposure. Even when they will accept a liability notice, some clearing corporations customarily will not act on a notice for physical delivery prior to the last day of the tender offer (or the protect period, if one exists), regardless of the terms of the liability notice. In that instance, if the bidder's agent begins paying on the offer early, receiving (long value) participants that have not yet taken delivery (and thus have not presented securities to the bidder's agent) cannot obtain and use their tender proceeds on the early payment date. Moreover, if a long value participant in one clearing corporation tenders the subject company's securities by a guarantee of delivery five business days prior to expiration of the offer, it is customary for the depositary to require delivery of those securities eight days after tender (*i.e.*, in this case, by the third day of the protect period following expiration of the offer). If a *contra* clearing corporation that is short in the tendering participant's clearing system does not make delivery to that clearing system by the date specified in the liability notice (usually the day prior to the last day of the protect period, which is normally the eighth business day following expiration of the offer), then the clearing corporation whose long value participant tendered by submitting the gurantee of delivery runs the risk of being held liable by that participant pursuant to the liability notice for the terms of the offer for having caused that tendering participant to fail to satisfy its guarantee. While significant losses to date have been avoided due to special cooperative efforts by the staffs of the respective clearing corporations, the Commission believes that this situation cannot continue and must be resolved uniformly among the clearing corporations as soon as possible.

[39] For purposes of Rule 10b-4, the irrevocable exercise of a call option makes the holder an owner of the underlying stock at the time of exercise and thus able to tender without having to wait to receive the stock. *See* Rule 10b-4(b)(4) [17 CFR 240.10b-4(b)(4)]. *See generally* note 20 *supra*.

[40] For example, in the tender offers for Conoco, a short squeeze developed because, among other things: (i) there were competing bidders; (ii) Conoco's stock was made ineligible for depository services; (iii) securities processing problems occurred in delivering physical shares among brokers, the forwarding agent and the depositary, which produced a large number of fails to deliver Conoco stock, including fails by "naked" call option writers who did not have stock available for delivery when assigned exercise notices; and (iv) an apparently thin cash market existed for Conoco stock just prior to expiration of Seagram's offer, which precluded defaulting parties to stock trades and exercising call option holders from obtaining stock to meet delivery or tender obligations.

In an extreme case, a significant shortage of underlying stock could mean that one competing bidder would fail to receive the requested amount.

In addition, under new Rule 14d-8 under the Act [17 CFR § 240.14d-8], which provides for a pro rata period of five business days beyond the withdrawal period under Rule 14d-7 [17 CFR § 240.14D-7], call option writers, who have tendered the underlying stock into the offer but who, after the withdrawal date has elapsed, are assigned exercise notices as a result of exercise activity near the expiration date, will be unable to withdraw from the offer to meet their delivery obligations to these exercising holders.

[41] A short squeeze, among other things, may result in the introduction of the extraordinary cash settlement remedy at OCC. Whenever, in the judgment of OCC, a tender offer or competing offers threaten to reduce the available supply of the subject company's stock to a level expected to be insufficient, among other things, to permit performance by uncovered writers of their obligations on outstanding call options contracts on that stock, OCC may invoke special settlement procedures. Under OCC's by-laws, OCC may first institute broker-to-broker settlement on a trade-by-trade basis, requiring exercising clearing members to exchange cash for physical securities directly with an assigned clearing member (rather than effect settlement of trades in the subject company's stock through automated netting programs of correspondent clearing corporations). Broker-to-broker settlement of exercised options contracts enables OCC to identify specifically which contracts fail to settle and, in turn, which writers fail to deliver stock.

Second, OCC may suspend the settlement obligations of call option writers that are unable to deliver stock, suspend OCC remedies available to clearing members exercising those "suspended" contracts, and set prices for cash settlement of those contracts in lieu of stock settlement.

The tender offer for Conoco was the first and only time OCC has set a cash settlement price. Moreover, according to OCC's recently revised policy, OCC will continue to require settlement of all exercises of options contracts through the facilities of correspondent clearing corporations (and not at OCC) during and following cash tender offers for securities underlying options contracts, unless the application of that policy, in the judgment of OCC, would be inequitable or impractical. *See* OCC By-laws, Art. VI, § 19, Interpretations and Policies .01 and .02, as amended October 29, 1982 (SEC File No. SR–OCC–81–8). Therefore, the instances in which the OCC cash settlement remedy will be invoked in the future would appear to be extremely rare.

[42] Due to the sporadic and fragmented nature of this market, *see* note 43 *infra*, it is very difficult to gauge accurately at any particular time the supply of stock that might be available at various price levels if substantial buying interest became known. Thus, if a short squeeze pushes the cash market price above the tender offer price, uncovered call option writers receiving exercise notice assignments may have to pay a significant premium to cover their delivery obligations.

[43] Unlike regular-way trades that are scheduled to settle on T+5, *see* note 10 *supra*, cash market transactions are effected for same-or-next-day settlement. The cash market operates informally, generally through brokers for member firms on the floor of an exchange who communicate indications of interest in buying and selling the stock for accelerated settlement. The terms and prices of

Of course, depository eligibility of the subject company's securities would not remedy the cash market impact from the short squeeze phenomenon. Nevertheless, the Conoco experience clearly indicates that, to the extent automated settlement mechanisms are unavailable during the perod of high volume that usually accompanies a tender offer, there is an increase in the incidence of stock and options settlement "fails" and the number of physical delivery requirements. As a corollary, heavy cash market demand can occur from the required additional buy-in activity to cover these "fails" and from investors' needs to purchase shares to satisfy their tender obligations under guarantees of delivery. The need for immediate delivery of stock to settle cash market trades can place dramatic upward pressure on the cash market price, pushing the cash market price out of skew with the regular-way market price. Those pressures can be relieved during tender offers, to the benefit of all financial institutions, through the full availability and use of all automated clearance and settlement systems.

III. Depository Trust Company's Voluntary Offering Program

The Depository Trust Company, Inc. ("DTC"), a securities depository registered as a clearing agency under the Act, operates, as a service to its participants and bidders, a system for handling within an automated, book-entry environment securities that are the subject of voluntary offers, including tender offers.[44] In general, after a bidder has appointed an agent to which securities are to be tendered (*e.g.*, a forwarding agent or depositary), DTC, the bidder and that agent enter into a letter of agreement on the procedures to be followed in processing through DTC letters of transmittal and securities tendered or to be tendered, subsequent withdrawals of securities or book-entry returns of securities not taken down by the bidder in a prorationing, and payments due participants. The agreed upon procedures, therefore, describe how the bidder's agent and DTC's participants can interact promptly and efficiently, so that book-entry processing, especially movements of securities to the bidder's agent, can continue uninterrupted.[45]

More specifically, under DTC's voluntary offering program, DTC Participants, until the applicable cut-off time,[46] can elect to accept the offer by delivering letters of transmittal to DTC.[47] Participants also deliver to DTC voluntary offering instructions that request DTC to deliver by book-entry to the bidder's agent securities on deposit that are the subject of letters of transmittal.[48] Delivery of securities through DTC is subject to the terms of the offer, the letters of transmittal and the agreement between DTC and the agent. Significantly, instead of arranging for withdrawal of physical certificates for delivery by participants directly to the bidder's agent, DTC effects *book-entry delivery* of securities from participants' *accounts* to an *account* maintained for the bidder's *agent* solely for the purpose of the offer.[49] While the securities so delivered are subject exclusively to the control of the bidder's agent, the agent's agreement with DTC provides that book-entry delivery of securities to the agent's DTC account satisfies the delivery and deposit conditions necessary to accept the bidder's offer.[50]

In order to provide for exercise of withdrawal rights and for prorationing[51] and to provide protection for participants submitting guarantees of delivery on the last day of an offer, securities represented by book-entry positions, which are credited to the account of the bidder's agent, cannot be withdrawn from DTC by the agent until after expiration of the protect period.[52] At that time, the bidder's agent may request DTC to deliver certificates representing the net securities credited to the agent's account as a result of tenders. When certificates are delivered from DTC's inventory,[53] the certificates

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cash trades are usually then negotiated off the exchange floor, although transactions are reported on the consolidated tape with a special designation.

[44] These procedures were noticed for public comment in Securities Exchange Act Release No. 13865 [42 FR 43159 (August 26, 1977)] and were approved by the Division of Market Regulation, pursuant to delegated authority, in Securities Exchange Act Release No. 14208 (November 25, 1977). In addition, in order to provide for some depository processing during tender offers, procedures for bulk deliveries of certificates by depositories to the bidder's agent have been adopted by the Philadelphia Depository Trust Company in Securities Exchange Act Release No. 18967 (August 16, 1982) [47 FR 36742 (August 23, 1982)], and by Midwest Securities Trust Company (*see* MST System, *Operations Handbook*, § 7 (1974)).

[45] DTC's obligation to provide book-entry delivery of the subject company's securities from participants' positions to the bidder's agent is derived from the letter of agreement.

[46] Generally, when the bidder's depositary and fowarding agents are located outside New York City, the cut-off time is 11 a.m. on the day prior to the expiration date. When either of those agents are located in New York City, the cut-out time is 11 a.m. on expiration date.

[47] Due to the procedures DTC follows in processing participant acceptances of an offer, DTC will not provide for acceptance of offers by submission of letters of transmittal directly to DTC after the applicable cut-off time. *Id.* DTC's procedures do provide, however, for the surrender of securities by book-entry delivery to the agent through DTC after that time and until 11 a.m. on the last day of the protection period, provided the offer can be accepted by delivery of a transmittal letter or like document directly to the agent. Thus, deliveries that were not made prior to expiration can still be effected through DTC until 11 a.m. of the last day of the protection period. In that case, moreover, even though the letter of transmittal is the basic instrument authorizing the delivery and transfer of the subject company's securities from the participant to the bidder and its agent (*see* note 19 *supra*) and even though the letter of transmittal is submitted directly to the bidder's agent, DTC believes that the surrender of securities by book-entry from a participant's account at DTC to the bidder's agent is a legally effective transfer to the bidder's agent under § 8–320 of the Uniform Commercial Code and should satisfy the bidder's deposit requirement. *See* note 57 *infra*.

[48] While DTC undertakes no obligation to examine letters of transmittal or voluntary offering instructions, DTC usually will comply with a participant's instruction only to the extent that participant has a sufficient general free (unpledged) position in its account; otherwise, DTC may reject the insruction.

[49] After making book-entry deliveries of those securities, DTC forwards on that same day to the agent originals or facsimiles of the participants' letters of transmittal and/or voluntary offering instructions. DTC and the agent undertake daily control of all offer and acceptance activity processed through DTC, and DTC's program provides for daily balancing and reconciliation of daily and to-date acceptance figures. A cumulative record of all instructions submitted by each participant is also maintained by DTC.

[50] While DTC does not physically segregate certificates representing securities surrendered by participants and credited to the account of the bidder's agent, DTC does establish a separate account with a "contra security identification" number in the name of the bidder's agent for purposes of recording the cumulative quantity of tender activity by all participants, and that account is subject to the exclusive control of the agent.

[51] *See* Section 14(d)(5) of the Act and Rule 14d–7 [17 CFR § 240.14d–7] (withdrawal rights); Section 14(d)(6) of the Act and Rule 14d–8 [17 CFR 240.14d–8] (pro rata acceptance period, under Rule 14d–8, extends throughout period offer remains open).

[52] If the bider's agent desires certificates registered to a name specified by that agent, the agent may, at any time after expiration of the protect period, make a withdrawal-by-transfer request of DTC (*see* note 5 *supra*) to deliver certificates representing all or a portion of the net securities credited to the agent's account. In that case, DTC will request certificates from the appropriate transfer agent and deliver them to the bidder's agent as soon as DTC receives the certificates from the transfer agent. More than a week may elapse, however, before certificates in proper form and denomination become available for delivery by DTC to the bidder's agent. *See* note 65 *infra*. In addition, under DTC's standard procedures, DTC will not deliver from its vault inventory nominee name certificates (*see* note 5 *supra*) representing the agent's net securities position credited to its account until subsequent to five days after expiration of the protect period. DTC cannot assure that it will be able to deliver appropriately denominated certificates from its inventory prior to that time. If the agent requires earlier deliveries of certificates from DTC's inventory, it must so inform DTC prior to intry into the letter of agreement. Notwithstanding these standard procedures, however, DTC customarily attempts to accommodate early requests for nominee name certificates.

[53] *Id.*

are registered in the name of DTC's nominee (*i.e.*, Cede & Co.) or in street name and are specially endorsed by appointing the bidder's agent as attorney to request transfer on the books of the subject company.[54]

During, or after expiration of, the offer, the agent delivers payment—securities and/or cash—to DTC in respect of securities the bidder's agent has received through DTC and accepted pursuant to the terms of the offer. Payment can be made to DTC at the same time that similar payment is made to persons accepting the offer directly with the bidder's agent. DTC distributes that payment to its participants either through DTC's money settlement system or by book-entry.[55]

Automated voluntary offering procedures such as these provide numerous benefits to depository participants, bidders, depositary agents and others. First, when book-entry services continue uninterrupted during a tender offer, street-side settlement (*i.e.*, settlement between broker-dealers) and customer-side settlement (*i.e.*, settlement between the customer or its agent and the broker-dealer) of any heavy trading activity can occur quickly and efficiently. There is no need for large withdrawals of securities from the depository for settlement purposes. Instead, automated CNS and ID processing can occur,[56] and, as a result, "fails" can be more effectively managed and the need for remedial cash market purchases can be reduced.

Second, because the securities remain eligible for depository services, facilities are provided for processing delivery of tendered securities by depository participants and receipt of those securities by the bidder's agent within a centralized book-entry environment in an economical and orderly manner. These services enable book-entry delivery of securities tendered by participants within a centralized system to the *account* of the bidder's agent.[57] In addition, if the subject company's securities underlying acceptances are part of an automated transfer program, such as the Fast Automated Securities Transfer ("FAST") program,[58] certificates for those securities need not even be forwarded by the securities depository to the bidder's agent after expiration of the offer or at the end of the protect period;[59] instead, if the depositary subscribes to such a program, FAST-type balances can simply be reduced. Further, when a letter of transmittal has been submitted directly to the bidder's agent, securities can be surrendered to the bidder's agent through DTC until the cut-off time on the last day of the protect period without the inventory management problems that would exist were book-entry facilities not available.[60] Processing securities by book-entry delivery among accounts, therefore, keeps securities immobilized, permits optimal certificate control and reduces physical certificate handling by a depository, its participants and the bidder's agent.

Third, participants that have surrendered securities may obtain collateral loans by pledging by book-entry the "contra securities" (*i.e.*, the consideration offered by the bidder) that have been credited to their accounts. These contra securities represent the participants' rights to receive through the depository from the bidder's agent after expiration of the offer either the specified payment for surrendered securities or the return of some or all of the surrendered securities.

Fourth, book-entry movement is available for the withdrawal of previously tendered securities from the agent's account to the general free account of the participant submitting withdrawal instructions and for book-entry return of tendered securities not taken down by the bidder (*i.e.*, when the offer is oversubscribed and pro-rated or cancelled).[61] Thus unlike offers processed without depository services, physical certificates need not be shipped back to tendering shareholders.

Fifth, when book-entry facilities are available and when most tenders are submitted by depository participants in the form of street-name or nominee name securities, a shortened protection period may be possible for those securities (*e.g.*, only a few days may be needed to correct any errors that occur in the processing of participants' instructions, especially those that may have been submitted on the day prior to expiration of an offer[62]). In that case, the usual full eight day protection period often may not be necessary, since book-entry processing obviates the need not only for participants to withdraw physical certificates but also for the depository to present jumbo certificates for transfer and breakdown into smaller denominations to satisfy those withdrawal requests.

Sixth, depository services provide facilities for expedited payment—securities and/or cash—by the depositary or transfer agent to DTC and, through DTC's money settlement system or by book-entry, to participants.[63] For

[54] Occasionally, when the bidder's agent wants certificates quickly, DTC delivers street-name stock, duly endorsed.

[55] Since DTC has custody of the physical securities and since they are registered in the name of its nominee, distributions are, in the first instance, issued by the bidder's agent to DTC's nominee and then distributed by DTC to the appropriate participant. In the case of a cash payment for securities tendered, facilities exist for the prompt delivery of cash to DTC (*e.g.*, through the Federal Reserve wire system), and payment can then be made promptly by DTC to participants. In the case of an exchange of securities, any newly issued securities, in order to accommodate participants, can be deposited in DTC for book-entry distribution to the tendering party, even though those securities are not otherwise depository eligible.

[56] *See* notes 28–33 supra and accompanying text.

[57] Under §§ 8–320(1) and (3) of the Uniform Commercial Code, book-entry delivery is a legally effective transfer to the bidder's agent and, accordingly, should satisfy the bidder's deposit requirement.

[58] In order to provide participants with speedy withdrawals of certificates, DTC developed the FAST program. Under this program, instead of retaining at the depository FAST issue certificates registered to the participant in street name, these securities are left with transfer agent banks in the form of "balance" certificates for each issue. A "balance certificate" or "window certificate" is a physical certificate either evidencing the number of securities registered in the nominee name of the securities depository that are shown from time to time on the records of the issuer and are being held by the transfer agent or evidencing the issuer's duties to perform the obligation shown from time to time on the records of the issuer (*i.e.*, a book-keeping entry on the records of the issuer maintained by the transfer agent). The balance certificate is adjusted daily to reflect deposit and withdrawal activity. For routine withdrawals-by-transfer under the FAST program, transfer agents can fulfill participant requests within the normal three to four business day turnaround time. *See* Rule 17Ad–2(a), (b) under the Act [17 CFR 240.17Ad–2(a), (b)] and *see* note 65 *infra*. For urgent COD withdrawals, transfer agents that subscribe to FAST must make certificates available overnight and twice each business day on two hours' notice for pickup by the depository or can mail them directly to the participant's customer. The FAST program, therefore, enables participants to obtain transfer services with minimal delay through their securities depositories. Other depositories have developed similar programs.

[59] *See* note 52 *supra*.

[60] *See* note 16 *supra*.

[61] These procedures also may ensure compliance with the obligation in Rule 14e–1(c) under the Act to return promptly after termination or withdrawal of an offer securities deposited but not accepted. *See generally* Securities Exchange Act Release No. 15548, 16 SEC Docket 973, 1006 & n.104 (February 5, 1979), 44 FR 9956, 9957 & n.104 (February 15, 1979) ("The Commission believes that [Rules 14e–1(c)] would protect investors by ensuring that deposited securities are not tied up for an unreasonable length of time * * * after termination of a tender offer").

[62] *See* notes 46 & 47 *supra*. The customary protection period, however, will be required when the depository must await delivery of certificates that have been presented for transfer by a participant (*e.g.*, a broker-dealer) on behalf of a customer for registration in the name of the depository's nominee and when that participant has requested the depository to "cover" the guarantee of delivery while awaiting receipt of that certificate representing tendered securities.

[63] These settlement and delivery procedures may help ensure that a bidder meets its prompt payment obligation under Rule 14e–1(c) of the Act [17 CFR § 240.14e–1(c)].

example, in U.S. Steel Corporation's tender offer for Marathon Oil Co., DTC processed payments to participants from Banker's Trust Co. (the bidder's agent participating in DTC) of over $622 million in same-day funds on the first payment date. These funds were credited to tendering participants' accounts that day in DTC's clearinghouse (next-day) funds settlement system and invested ovenight by DTC; income received on the investment by DTC was allocated among, and credited to, those participants' accounts.[64]

Finally, unlike tender offers processed without depository services, in whch the bidder must request transfer of thousands of certificates from individual shareholders, the bidder (or its agent) can receive from the depository a few large denomination certificates, registered in the name of the bidder or the depository's nominee, representing all securities of the subject company tendered by participants through the depository. Accordingly, the bidder will not incur the usual protracted post tender offer physical processing time needed by the subject company's transfer agent to accomplish transfer of those certificates to the bidder.[65]

In the Commission's view, therefore, programs such as DTC's voluntary offering program beneficially integrate tender offer activity into the national clearance and settlement system.

IV. Proposed Rule 17Ad-14

A. *Introduction.* The processing problems and trading market impacts that can occur during large tender offers are complex in cause and effect. Intricate and diverse systems that ordinarily operate smoothly can become entangled in manual processing, confusion and delay. The Commission believes that, to ensure investor confidence and to avoid paperwork, market and capacity crises, the existing, sophisticated and reliable components of the national clearance and settlement system must be available during tender offers. The Commmssion, therefore urges the securities processing industry and affected financial institutions to recognize and publicize the benefits of increased securities depository usage and to work together to assure that securities processing activities during tender offers become fully integrated into the national system for prompt and accurate clearance and settlement of securities transactions.

Toward that end, the Commission also urges clearing corporations to concentrate their cooperative efforts toward resolving the problems associated with differing buy-in and liability notice rules and procedures.[66] Resolution of those problems not only would eliminate considerable confusion among broker-dealers attempting to resolve "fails" but more importantly would greatly reduce the accompanying financial uncertainty.

In addition, the Commission believes that automated systems of securities depositories should routinely be availabe and used during all tender offers for depository elighible securities. In that regard, the Commission has received correspondence on several occasions from DTC discussing the benefits of automated depository tender offer services and the problems presented to the financial community when those depository securities are unavailable. In that correspondence, DTC has urged the Commission to adopt a rule requiring bidders to make arrangements with qualified securities depositories for purposes of book-entry delivery of securities during tender offers.[67]

The Commission would prefer that bidders and their agents voluntarily participate in depository tender offer programs. The Commission believes that the economies, efficiences and safeguards associated with these programs make them highly desirable to bidders, depositaries, transfer agents and the investing public alike. The Commission recognizes, however, that the one-time transactional nature of tender offers may mean that many bidders and their attorneys and advisers do not properly familiarize themselves with and use the automated facilities of the national clearance and settlement system. For that reason, and because there can be significant adverse impact from the unavailabilty of automated depository services for the subject company's securities during a tender offer, including market confusion and singificant financial exposure for major securities firms and banks, the Commission believes that some near-term resolution of these problems is required. As a precautionary measure, therefore, and to focus further the attention of bidders, their attorneys and advisers and the securities processing industry on the need to employ automated securities depositories services during tender offers, the Commission is proposing for comment a rule that would require a bidder's "tender agent" to establish and maintain at all qualified registered securities depositories holding the subject company's securities specially designated accounts for purpose of receiving by book-entry the delivery of tendered securities from depository participants.[68]

B. *Description of Rule 17Ad-14.* Under the proposed rule, no registered transfer agent may act in any capacity as a "tender agent" for a bidder (*i.e.*, as a forwarding agent, depositary,[69] disbursing or paying agent, or transfer or exchange agent [70]) unless that agent

[64] Thus, participants' "float" was not left idle, but instead earned interest while participants awaited receipt. *See* DTC *Newsletter*, January 1982, at 3. When an automated voluntary offering program is not available, participants may not receive early payments as quickly as other tendering shareholders, and any funds received would have to be handled and invested individually by participants.

[65] Transfer agents are afforded a certain period of time under the federal securities laws (the so-called "turnaround rules") within which to accomplish transfer. Pursuant to Rule 17Ad-2(a) of the Act [17 CFR 240.17Ad-2(a)], a registered transfer agent (except when acting as an outside registrar) must trunaround within three business days of receipt at least 90 percent of all routine items received for a month. An item is considered "routine" if, among other thing, it does not involve a tender offer or exchange. *See* Rule 17Ad-1(i)(5) of the Act [17 CFR 240.17Ad-1(i)(5)]. If an item is classified as "nonroutine," the usual three business day turnaround time does not apply. Instead, although that item must be turned around as soon as possible, *see* Rule 17Ad-2(e) [17 CFR 240.17Ad-2(e)], turnaround time may involve several days. In addition, the normal processing time of 24 hours for performance of the registrar function may need to be included, *see* Rule 17Ad-2(b) [17 CFR 240.17Ad-2(b)], before transfer is accomplished. *See generally* 17Ad-1(d) [17 CFR 240-17Ad-1(d)].

[66] *See* notes 34-38 *supra* and accompanying text.

[67] *See*, letter to the Honorable Harold M. Williams, Chairman, SEC, from William T. Dentzer, Jr., Chairman of the Board of Directors and CEO, DTC, dated January 17, 1980; and letter to George Fitzsimmons, Secretary, SEC, from Edward J. McGuire, Jr., Counsel, DTC, April 13, 1979 (SEC File No. S7-770).

[68] In the past, the term "tender offer" has been applied to certain acquisitions that commonly are referred to as "unconventional" tender offers. *See, e.g., Wellman* v. *Dickinson*, 475 F. Supp. 783 (S.D.N.Y. 1979); *S-G Securities Inc.*, v. *Fugua Investment Co.*, 466 F. Supp. 1114 (D. Mass 1978); *In re Paine Weber Jackson & Curtis, Inc.*, SEC File No. 3-6074 (administrative law judge's initial decision) (block trade). Generally, however, bidders engaged in unconventional tender offers do not employ "tender agents" and, therefore, would not be subject to proposed Rule 17Ad-14. In addition paragraph (d) of the proposed rule provides the Commission with the authority to exempt certain offers under specified terms and conditions when the Commission deems it appropriate to do so.

[69] *See* note 13 *supra*. Proposed Rule 17Ad-14 will not apply to depositaries that are not also registered transfer agents. In that regard, however, a depositary that acts as a tender agent, particularly in the case of an exchange offer, may fall within the definition of "transfer agent" in Section 3(a)(25) of the Act and may be required to register as a transfer agent before it can act as a tender agent. *See* § 17A(c)(1) of the Act.

[70] When the bidder makes an exchange offer (*i.e.*, an offer of securities in the bidder's company for securities of the subject company), the bidder's transfer agent issues certificates for securities in the bidder's company or surviving company in exchange for the subject company's securities and may be requested by the bidder to make any cash

establishes with all qualified registered securities depositories [71] within two business days after the tender or exchange offer is commenced [72] specifically designated accounts for purposes of receiving book-entry the delivery of tendered securities from depository participants.[73]

By requiring tender agents to maintain an account with a securities depository during the course of an offer, regular-way securities processing activity can continue uninterrupted. As discussed above,[74] there are several benefits that flow from ensuring depository eligibility of the subject company's securities and especially from the ability to deliver securities by book-entry movement.[75] With respect to tendered securities, depository participants can accept offers and satisfy a bidder's deposit requirement by book-entry delivery of securities; the bidder's as well as participants' accounts can simultaneously be credited and debited, usually on the same day as receipt of participant offering instructions; offers may be accepted on or near the expiration date, and the need for extended protection periods may be reduced; securities may be withdrawn by participants more efficiently and expeditiously;[76] securities not taken down or tendered in excess of the proration percentage may be returned in a timely manner;[77] and bidders can make payment for tendered securities through depository settlement systems.

With respect to settlement of trades on national securities exchanges in the subject company's securities, continued depository eligibility of those securities would ensure that clearing agencies could more readily clear and settle those transactions on an automated basis through guaranteed settlement systems.[78] In addition, broker-dealers could more readily meet settlement obligations because the number of multiple physical deliver and receive obligations and thus the number of "fails" would be reduced.

Proposed Rule 17Ad–14, therefore, by ensuring continued depository eligibility of the subject company's securities, would reduce the strain on existing systems for accepting deposits and delivery of securities being tendered and for clearing and settling transactions in those securities that occur within the national market system. The Commission believes that, should the industry not progress expeditiously toward the voluntary use of automated depository tender offer systems, adoption of proposed Rule 17Ad–14, by removing demonstrated impediments to tender offer and trade processing in the subject company's securities, may become a necessary step in integrating tender offers into the national clearance and settlement system which, under Section 17A(a) of the Act, the Commission is directed to facilitate.

V. Statutory Authority

Rule 17Ad.14 is being proposed pursuant to Sections 2, 11A(a)(1)(B), 14(d)(4), 15(c)(3), 15(c)(6), 17A(a), 17A(d)(1), and 23(a) of the Securities Exchange Act of 1934 [15 U.S.C. 78b, 78k–1(a)(1)(B), 78n(d)(4), 78o(c)(3), 78o(c)(6), 78q–1(a), 78–1(d)(1) and 78w(a)]. The Commission believes that the proposed tender agent rule, Rule 17Ad–14, is necessary for the protection of investors and is consistent with the public interest.

Congress, in the Securities Acts Amendments of 1975, found, among other things, that the prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership, was necessary for the protection of investors, that inefficient clearance and settlement procedures imposed unnecessary costs on investors and persons facilitating transactions on behalf of investors, and that uniform standards and procedures for clearance and settlement reduce those costs and increase protection for investors and persons facilitating transactions on behalf of investors.[79]

As part of the Securities Acts Amendments of 1975, Congress also enacted Section 17A(d)(1) of the Act, which prohibits registered transfer agents and registered clearing agencies from engaging in any activity in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. In light of the need to further the purposes of Section 17A(a)(1) of the Act in the context of tender offers and the need for increased investor protection when processing transactions in securities of the subject company during tender offers,[80] the Commission believes that it is appropriate to propose for comment Rule 17Ad–14.

In addition, the Commission believes that Rule 17Ad–14 will help maintain fair and orderly markets in the trading of the subject company's securities during a tender offer.[81] Because clearance and settlement in the subject company's securities will be less strained during a tender offer, market liquidity for those securities should be enhanced.

Finally, Section 14(d)(4) authorizes the Commission to prescribe rules regarding solicitations or recommendations to accept or reject a tender offer or requests or invitations for tenders. In soliciting tenders and acceptances of an offer, the bidder through its tender agent will need to provide for deposit and delivery of the subject company's securities at qualified registered securities depositories by establishing accounts with those depositories.

The Commission believes that the costs, if any, to bidders of complying with proposed Rule 17Ad–14 will be minimal. Currently, bidders do not incur any charges by DTC when using its voluntary offering programs. Instead, costs for operating these programs are allocated among DTC participants using these services. The Commission anticipates that depositories offering these programs will continue to assess tender offer service charges to

net payments for the difference in value of those securities. Certificates representing the subject company's securities are then presented by the bidder to the subject company's transfer agent for cancellation and issuance of new certificates registered to the bidder.

[71] A "qualified" registered securities depository is a registered clearing agency that, at the time a tender offer is commenced under Rule 14d–2 of the Act [17 CFR 240.14d–2] has an automated tender offer processing program approved by the Commission pursuant to Section 19 of the Act that provides for book-entry delivery of the subject company's securities. Ultimately, the Commission hopes that all registered securities depositories will have procedures that provide for book-entry delivery of the subject company's securities from depository participants to the bidder's depositary.

[72] Unless the context would otherwise require, "commencement" of an offer will be determined under Rule 14d–2 of the Act [17 CFR 240.14d–2].

[73] Persons or entities that are not participants in securities depositories will continue to tender their securities either directly to the bidder's forwarding agent or depositary or indirectly through a "piggy-backing" arrangement with a correspondent that is a depository participant. Moreover, even under the proposed rule, a depository participant can choose to tender its securities directly to the agent.

[74] *See* discussion *supra* at 31–36.

[75] The Commission expects that, absent very compelling reasons, securities depositories would not "exit" the subject company's securities from their systems following commencement of an offer. Indeed, when filing processing procedures with the Commission to qualify under the rule, *see* note 71 *supra*, the depository must specify the circumstances under which that could occur.

[76] *See* Section 14(d)(5) of the Act and Rule 14d–7 thereunder.

[77] *See* Section 14(d)(6) of the Act and Rule 14d–8 thereunder. *See also* note 61 *supra*.

[78] *See* discussion *supra* at 15–26.

[79] *See* Section 17A(a)(1) of the Act.

[80] *See also* Sections 17A(b)(3)(A) (safeguarding funds and securities), 17A(b)(3)(F) (safeguarding funds and securities and removing impediments to a national clearance and settlement system) and 17A(e) under the Act (immobilization of certificates for settlement purposes).

[81] *See* Section 2 of the Act.

participants on the basis of participant usage.[82]

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

VI. Text of Proposal

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

In accordance with the foregoing, the Commission proposes to amend Part 240 of Chapter II of Title 17 of the Code of Federal Regulations as follows:

By proposing § 240.17Ad–14 be added to read as follows:

§ 240.17Ad–14 Tender Agents.

(a) *Establishing book-entry depository accounts.* When securities of a subject company have been declared eligible by one or more qualified registered securities depositories for the services of those depositories at the time a tender or exchange offer is commenced, no registered transfer agent shall act on behalf of the bidder as a forwarding, depositary, transfer, exchange, disbursing, paying or other agent in connection with the tender or exchange offer, unless that agent has established, within two business days after commencement and maintains throughout the duration of the offer, with all qualified registered securities depositories holding the subject company's securities, specially designated accounts for purposes of receiving from depository participants by book-entry delivery securities being tendered pursuant to transmittal letters and other documentation.

(b) *Exclusions.* The provisions of this rule shall not apply to tender or exchange offers (1) that are made for a class of securities of a subject company that has fewer than (i) 500 securityholders of record for that class, or (ii) 500,000 shares of that class outstanding; or (2) that are made exclusively to securityholders of fewer than 100 shares of a class of securities.

(c) *Definitions.* For purposes of this rule, (1) the terms "subject company," "business day," "securityholder," and "transmittal letter" shall be given the meaning provided in § 240.14d–1(b); (2) unless the context otherwise requires, a tender or exchange offer shall be deemed to have commenced as specified in § 240.14d–2; (3) the term "bidder" shall mean any person who makes a tender or exchange offer or on whose behalf a tender or exchange offer is made; and (4) a "qualified registered securities depository" shall mean a registered clearing agency that has rules and procedures approved by the Commission pursuant to Section 19 of the Act that provide for book-entry delivery of the securities of the subject company to the transfer agent through the facilities of that securities depository.

(d) *Exemptions.* The Commission may exempt from the provisions of this rule, either unconditionally or on specified terms and conditions, any registered transfer agent, tender or exchange offer, or class of tender or exchange offers, if the Commission determines that an exemption is consistent with the public interest, the protection of investors, the prompt and accurate clearance and settlement of securities transactions, the maintenance of fair and orderly markets, or the removal of impediments to a national clearance and settlement system.

VII. Request for Comments

Any interested person wishing to submit comments on proposed Rule 17Ad–14, as well as on other matters that might have an impact on the proposal contained herein, is requested to do so. Moreover, the Commission is specifically soliciting comments with respect to the following:

(1) Why have existing depository voluntary offering programs not been used in some tender offers? If such programs have not been used because of certain limitations or drawbacks, what are those limitations and drawbacks and how can they be corrected or eliminated to ensure use of depository voluntary offering programs?

(2) Instead of the approach taken in proposed Rule 17Ad–14, would it be more appropriate to impose a requirement directly on the *bidder* to establish and maintain an account at a securities depository during the pendency of a tender offer for purposes of accepting deposits and delivery of securities being tendered? If so, provide your reasons.

(3) Should a rule requiring depository usage apply to all tender offers? If not, which types or sizes of tender offers and why?

(4) Once a bidder has established an account with the securities depository for purposes of accepting tendered securities by book-entry delivery, should that securities depository be permitted under any circumstances to declare the subject company's securities ineligible for depository services after the tender offer is announced? If so, under what circumstances?

(5) Should proposed Rule 17Ad–14 require the bidder's agent to establish and maintain an account with one or more, rather than all, qualified securities depositors? If the rule operates in that way, should other qualified securities depositories be precluded from declaring the subject company's securities ineligible and be required to use the depository interfaces for book-entry tender? If not, why not?

(6) What effect, if any, would depository voluntary offering procedures and the proposed rule give have on the timing of certain critical events that occur in connection with a tender offer—such as, accrual of voting rights by the bidder for tendered securities and the time period for payment by the bidder of the offered consideration? In that regard, would § 8–320 of the UCC or comparable state law alter the timing of the bidder's right to vote the subject company's securities? In addition, what effect, if any, would depository voluntary offering procedures or the proposed rule have on the bidder's or the subject company's strategy or tactics in making and defending against a tender offer, respectively?

VIII. Regulatory Flexibility Act Certification

Section 603(a)[83] of the Administrative Procedure Act,[84] as amended by the Regulatory Flexibility Act (the "Flexibility Act"),[85] generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules or proposed rule amendments to determine the impact of that rulemaking on "small entities."[86] Section 605(b) of the Flexibility Act, however, specifically exempts from that requirement any proposed rule or proposed rule amendment for which the Chairman of the Commission certifies that, if adopted, would not have a "significant economic impact on a substantial number of small entities."

Entities likely to be affected by proposed Rule 17Ad–14 include bidders, banks and broker-dealers that are depository participants, clearing agencies and registered transfer agents. While a few of these entities may meet the definitions of "small business" or "small organization" established by the Commission for purposes of the Flexibility Act, none of those entities will experience a significant economic impact. Bidders, which will have accounts established on their behalf at securities depositories for purposes of receiving delivery from depository

[82] In order to obtain Commission approval as a qualified registered securities depository under proposed Rule 17Ad–14, each securities depository will be required to submit to the Commission as part of its tender offer processing plan filed under Section 19 of the Act a schedule of fees to be charged participants. Any changes to those fees will have to be re-filed pursuant to Section 19(b) of the Act and Rule 19b–4 thereunder [17 CFR 240.19b–4].

[83] 5 U.S.C. 603(a).

[84] 5 U.S.C. 551, *et seq.*

[85] Pub. L. No. 95–354 (September 19, 1980), 94 Stat. 1164, reprinted in [1980] U.S. Code Cong. & Ad. News 1169.

[86] Although Section 601(b) of the Flexibility Act defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission published its final definitions on the terms "small business" and "small organization" in Securities Act Release No. 6380 (February 4, 1982) [47 FR 5215].

participants, and banks, which participate in securities depositories, generally are not "issuers" or "persons" that are "small businesses" as defined in the Commission's rules under the Flexibility Act.[87] Bidders making tender offers for the securities of subject companies eligible for depository services and bank depository participants commonly have assets execeeding $3,000,000.[88]

In addition, most broker-dealer participants in depositories that will be tendering securities for delivery will not be "small businesses" or "small organizations" for purposes of the Flexibility Act.[89] For those few broker-dealer participants that might be deemed "small" for that purpose, on the basis of current charges to broker-dealer participants for tendering securities through a securities depository, the Commission believes that they will not individually experience any significant economic impact from either reduced tender or trade processing costs. Rather, any operational and financial benefits to accure from proposed Rule 17Ad–14 will be experienced in the aggregate by the brokerage industry as a whole.

Further, no securities depository having a voluntary offering program in effect, so as to be a "qualified" securities depository under proposed Rule 17Ad-14, would be deemed a "small business" clearing agency.[90] While only one of the four active registered securities depositories has established an automated program for the benefit of its participants,[91] and even though the other three securities depositories could establish such programs, none of these four existing securities depositories at which accounts would be established would have funds or securities of less than $200 million under its custody and control, and accordingly, none would qualify as "small" under the Flexibility Act.

Finally, few registered transfer agents that might act on behalf of bidders as depositaries or as other agents will be considered "small businesses" for the purposes of the Flexibility Act.[92] Bidders making tender offers for securities that are depository eligible probably will use, if not require, the services of much larger tender or transfer agents. Even if a "small" transfer agent were appointed as a depositary, the cost, if any, associated with establishing an account with a securities depository on behalf of the bidder would seem to be relatively insignificant,[93] and in any event, to the extent they are incurred at all, will be borne by the bidder or that depository's participants.[94]

Since the Commission does not believe, therefore, that proposed Rule 17Ad–14 will have significant economic impact on a substantial number of small entities, and since the Commission believes that a Regulatory Flexibility Act certification is appropriate, the Chairman of the Commission has certified that proposed Rule 17Ad–14, if adopted, would not have a significant economic impact on a substantial number of small entities.

By the Commission.

George A. Fitzsimmons,

Secretary.

April 15, 1983.

Regulatory Flexibility Act Certification

I, John S. R. Shad, Chairman of the Securities and Exchange Commission, hereby certify pursuant to 5 U.S.C. § 605(b) that the proposed rule, Rule 17Ad–14, set forth in Securities Exchange Act Release No. 19678, if promulgated, will not have a significant economic impact on a substantial number of small entities—namely, issuers, persons, broker-dealers, clearing agencies and transfer agents that are "small businesses" or "small organizations" as defined in Commission Rule 0–10 [17 CFR § 240.0–10]. Specifically, bidders engaged in tender offers are not charged by securities depositories for using automated tender offer services. Moreover, the number of banks and broker-dealers, which are depository participants, that might be deemed "small" for purposes of the Regulatory Flexibility Act is not substantial; and the economic impact, if any, on those entities is insignificant because of their limited involvement in tender offers to which the proposed rule would apply and because there will be no change, as a result of the proposed rule, in the level of charges they currently incur when using depository services in connection with tender offers. Furthermore, the rule would not have a significant economic impact on a substantial number of subject companies that are "small

[87] For purposes of the Flexibility Act, no separate definition of "small business" has been provided in the case of a "bidder" or a "bank." The Commission has defined "issuer" and "person" in 17 CFR 240.0–10(a), however, to be as follows:

For the purposes of Commission rulemaking in accordance with the provision of Chapter Six of the Administrative Procedure Act (5 U.S.C. 601 *et seq.*), and unless otherwise defined for purposes of a particular rulemaking proceeding, the term 'small business' or 'small organization' shall—(a) When used with reference to an issuer or a person, other than an investment company, under Section 12, 13, 14, 15(d) or 16(b) of the Securities Exchange Act of 1934, mean an 'issuer' or 'person' that, on the last day of its most recent fiscal year, had total assets of $3,000,000 or less.* * *

[88] Even if some bidders or bank participants were deemed "small businesses," that number would not be substantial and the economic impact on those entities would be negligible. For example, the cost, if any, to be incurred by a bidder having its tender agent establish an account with a securities depository is likely to be insignificant when measured against other costs of the tender offer (*e.g.*, legal, accounting, printing, etc). In addition, while voluntary offering procedures and the proposed rule might result in a bidder forgoing income on a certain percentage of the "float" that otherwise could be earned during a more gradual or incremental payout to tendering securityholders, bidders currently using depository offering procedures make lump-sum payments to depository participants at the same time similar payments are made to tendering securityholders that are not depository participants. Moreover, Rule 14e–1(c) [17 CFR 240.14e1(c)] provides that, as a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of Section 14(e) of the Act, a bidder shall not fail promptly to pay the consideration offered after termination of the tender offer. Accordingly, any economic impact on bidders under the proposed rule would not be appreciable.

The charges currently assessed participants for using despository securities processing services are not significant. Further, no feasible non-cost alternative to proposed Rule 17Ad–14 apparently exists at this time for resolving the problems associated with depository ineligibility of the subject company's securities.

The proposed rule would not have a significant economic impact on a substantial number of subject companies that are "small businesses" because few companies, if any, that are small businesses and whose securities are depository eligible are the subjects of tender offers.

[89] Section 240.0–1(c) states that "small business" and "small oranization":

When used with reference to a broker or dealer, mean a broker or dealer that: (1) Had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to § 240.17a–5(d) or, if not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) Is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in this section.

[90] Section 240.10–0(d) states that "small business" and "small organization," when used with reference to a clearing agency, mean a clearing agency that:

(1) Compared, cleared and settled less than $500 million in securities transactions during the preceding fiscal year (or in the time that it has been in business, if shorter);

(2) Had less than $200 million of funds and securities in its custody or control at all times during the preceding fiscal year (or in the time that it has been in business, if shorter); and

(3) Is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in this section.

[91] *See* note 11 *supra*.

[92] Section 240.0–10(h) provides that "small business" and "small organization," when used with reference to a transfer agent, mean a transfer agent that:

(1) Received [fewer] than 500 items for transfer and [fewer] than 500 items for processing during the preceding six months (or in the time that it has been in business, if shorter);

(2) Maintained master shareholder files that in the aggregate contained [fewer] than 1,000 shareholder accounts or was the named transfer agent for [fewer] than 1,000 shareholder accounts at all times during the preceding fiscal year (or in the time that it has been in business, if shorter); and

(3) Is not affiliated with any person (other than a natural person) that is not a small business or small organization under this section.

[93] *See* note 88 *supra*.

[94] See note 82 *supra* an accompany text.

businesses" because few companies that are small businesses and whose securities are depository eligible are the subjects of tender offers. Finally, any small transfer agent that might be appointed by a bidder to act as a depository or other agent in connection with a tender offer will not incur significant costs, if any, because the cost of using a securities depository for book-entry delivery of tendered securities, for the most part, is borne by participants in the securities depository and not by the transfer agent.

Dated: April 15, 1983.

John S. R. Shad,

Chairman.

[FR Doc. 83-10923 Filed 4-22-83; 8:45 am]

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DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Part 271

[Docket No. RM79-76-177 (Ohio-2 Addition)]

High-Cost Gas Produced From Tight Formations, Ohio; Proposed Rulemaking

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Federal Energy Regulatory Commission is authorized by section 107(c)(5) of the Natural Gas Policy Act of 1978 to designate certain types of natural gas as high-cost gas where the Commission determines that the gas is produced under conditions which present extraordinary risks or costs. Under section 107(c)(5), the Commission issued a final regulation designating natural gas produced from tight formations as high-cost gas which may receive an incentive price (18 CFR 271.703). This rule established procedures for jurisdictional agencies to submit to the Commission recommendations of areas for designation as tight formations. This Notice of Proposed Rulemaking by the Director of the Office of Pipeline and Producer Regulation contain the recommendation of the State of Ohio that the Berea Sandstone and the "Second Berea" zone of the Bedford Shale be designated as a tight formation under § 271.703(d). The proposed rule incorporates this recommended tight formation with the previously designated Berea Sandstone and "Second Berea" tight formation of Athens, Gallia, Meigs, Morgan, Muskingum, and Perry Counties, Ohio.

DATES: Comments on the proposed rule are due on June 3, 1983. Public hearing: No public hearing is scheduled in this docket as yet. Written requests for a public hearing are due on May 4, 1983.

ADDRESS: Comments and requests for hearing must be filed with the Office of the Secretary, 825 North Capitol Street, N.E., Washington, D.C. 20426.

FOR FURTHER INFORMATION CONTACT: Leslie Lawner, (202) 357-8511, or Webster Gray, (202) 357-8731.

SUPPLEMENTARY INFORMATION:

Issued: April 19, 1983.

I. Background

On January 12, 1983, the State of Ohio Department of Natural Resources, Division of Oil & Gas (Ohio) submitted to the Commission a recommendation, in accordance with § 271.703 of the Commission's regulations (45 FR 56034, August 22, 1980), that the Berea Sandstone and the "Second Berea" zone of the Bedford Shale located in portions of Athens, Belmont, Meigs, Monroe, Morgan, Noble, and Washington Counties, Ohio, be designated as a tight formation. Pursuant to § 271.703(c)(4) of the regulations, this Notice of Proposed Regulation is hereby issued to determine whether Ohio's recommendation that the Berea Sandstone and the "Second Berea" zone of the Bedford Shale be designated a tight formation should be adopted. Ohio's recommendation and supporting data are on file with the Commission and are available for public inspection.

II. Description of Recommendation

Ohio has recommended that the Berea Sandstone and the "Second Berea" zone of the Bedford Shale found in specified townships in Athens, Belmont, Meigs, Monroe, Morgan, Noble, and Washington Counties, Ohio, be designated as a tight formation. The recommended area comprises approximately 2,073 square miles and is an eastward extension of an area where the Berea Sandstone and the "Second Berea" have previously been designated as a tight formation. The recommended interval is a depositional unit of early Mississippian age, and lies on the northwestern flank of the Appalachian Basin in southeastern Ohio. It consists of interbedded sandstones, siltstones, and shales which dip gently to the southeast, toward the axis of the Appalachian Basin. The recommended interval is bounded above by the base of the Lower Mississippian Sunbury Shale (called "Coffee Shale" by drillers) and below by the top of the Upper Devonian Ohio Shale.

The depth to the top of the interval ranges from approximately 1,250 feet to 2,375 feet. The Berea Sandstone (called "First Berea" or "Berea Grit" by drillers) ranges from 10 to more than 40 feet in thickness, and is the uppermost formation in the recommended interval. The "Second Berea" is a drillers' term for a siltstone-sandstone lens near the base of the Bedford Shale, with a maximum thickness of 20 feet. The "Second Berea" is separated from the Berea Sandstone by approximately 10 to 50 feet of red and gray shales and siltstones.

III. Discussion of Recommendation

Ohio claims in its submission that evidence gathered through information and testimony presented at a public hearing held December 17, 1982, by Ohio on this matter demonstrates that:

(1) The average *in situ* gas permeability throughout the pay section of the proposed area is not expected to exced 0.1 millidarcy;

(2)The stabilized production rate, against atmospheric pressure, of wells completed for production from the recommended formation, without stimulation, is not expected to exceed the maximum allowable production rate set out in § 271.703(c)(2)(i)(B); and

(3) No well drilled into the recommended formation is expected to produce more than five (5) barrels of oil per day.

Ohio further asserts that existing State and Federal Regulations assure that development of this formation will not adversely affect any fresh water aquifers.

Accordingly, pursuant to the authority delegated to the Director of the Office of Pipeline and Producer Regulation by Commission Order No. 97, issued in Docket No. RM80-68 (45 FR 53456, August 12, 1980), notice is hereby given of the proposal submitted by Ohio that the Berea Sandstone and the "Second Berea" zone of the Bedford Shale, as described and delineated in Ohio's recommendation as filed with the Commission, be designated as a tight formation pursuant to § 271.703.

IV. Public Comment Procedures

Interested persons may comment on this proposed rulemaking by submitting written data, views or arguments to the Office of the Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, N.E., Washington, D.C. 20426, on or before June 3, 1983. Each person submitting a comment should indicate that the comment is being submitted in Docket No. RM79-76-177 (Ohio-2 Addition) and should give reasons including supporting data for any recommendations. Comments should include the name, title, mailing