

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 87786 / December 18, 2019

ADMINISTRATIVE PROCEEDING
File No. 3-19622

In the Matter of

CRITICAL TRADING, LLC,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT
OF 1934, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS AND
A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Critical Trading, LLC (“Respondent” or “Critical”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-And-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-And-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that

Summary

This matter involves a violation of Exchange Act Rule 14e-4, commonly referred to as the "short tender rule." Under Rule 14e-4, a person participating in a partial tender offer may not tender more shares than its net long position. In July 2016, Lockheed Martin Corp. ("Lockheed") commenced a partial tender offer for shares of its common stock. On August 15, 2016 – the day before the expiration of the partial tender offer – Critical, a broker-dealer registered with the Commission, tendered 55,500 Lockheed shares on its own behalf while having a net long position of only 5,500 shares. In so doing, Critical tendered 50,000 shares in excess of its net long position in Lockheed, thereby unlawfully profiting at the expense of others in the offer and willfully² violating Exchange Act Rule 14e-4.

Respondent

1. Critical Trading, LLC is a broker-dealer registered with the Commission since 2013. Critical's principal place of business is in New York, New York.

Background

2. On July 11, 2016, Lockheed announced a partial tender offer (the "Partial Tender Offer") to facilitate the spin-off of its information-systems-and-global-solutions business to Leidos Holdings, Inc. ("Leidos"). The Partial Tender Offer was structured so that persons tendering shares in the offer would effectively exchange shares of Lockheed for shares of Leidos common stock. Each tendered and accepted Lockheed share was exchanged for shares of Lockheed's subsidiary, Abacus Innovations Corporation ("Abacus"). Then, each Abacus share was effectively converted into one share of Leidos as a result of a merger between Abacus and a subsidiary of Leidos.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

² "Willfully," for purposes of imposing relief under Section 15(b) of the Exchange Act, "means no more than that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). The decision in *The Robare Group, Ltd. v. SEC*, which construed the term "willfully" for purposes of a differently structured statutory provision, does not alter that standard. 922 F.3d 468, 478-79 (D.C. Cir. 2019) (setting forth the showing required to establish that a person has "willfully omit[ted]" material information from a required disclosure in violation of Section 207 of the Advisers Act).

3. Between August 3 and August 11, 2016, Critical purchased 55,500 Lockheed shares. Critical also wrote 500 Lockheed call options, which had a strike price of \$300 and an expiration date of August 19, 2016.

4. On the morning of Friday, August 12, 2016, Lockheed announced the final exchange ratio for the Partial Tender Offer. Each tendered and accepted Lockheed share would be exchanged for 8.2136 Leidos shares. Lockheed would, however, accept only a maximum of 9,369,694 Lockheed shares in the Partial Tender Offer – approximately 3% of Lockheed’s outstanding shares.

5. On the morning of Monday, August 15, 2016, Critical tendered 55,500 Lockheed shares in the Partial Tender Offer. Later that day, the value of the consideration offered for each Lockheed share increased to over \$300, but Critical did not reduce the number of Lockheed shares that it had tendered. Accordingly, because Critical had written 500 Lockheed call options with a strike price of \$300 – a price “lower than the . . . stated amount of consideration offered for” Lockheed shares – Critical’s net long position at the end of that day was only 5,500, which was 50,000 shares fewer than the amount Critical tendered. Rule 14e-4(a)(1)(ii)(D).

6. At 8 a.m. on Tuesday, August 16, 2016, the Partial Tender Offer expired. Because the Partial Tender Offer was oversubscribed, on August 23, 2016 Lockheed accepted approximately 8.05% of the Lockheed shares tendered.

7. By tendering 55,500 Lockheed shares in the Partial Tender Offer, Critical received 36,705 Leidos shares. However, based on Critical’s net long position, it should have tendered only 5,500 Lockheed shares and received only 3,637 Leidos shares. Instead, because Critical tendered 50,000 shares more than its net long position, Critical received 33,068 additional Leidos shares – totaling \$149,224 in profits – at the expense of other participants in the Partial Tender Offer.

Legal Discussion

8. When the Commission promulgated Rule 14e-4, it recognized that partial tender offers present opportunities for abuse. By their nature, “[p]artial tender offers involve risk to securityholders of the subject company that not all of the securities tendered will be accepted. This risk is referred to as ‘proration risk.’” Prohibited Transactions in Connection With Partial Tender Offers, Release No. 34-28660 (Nov. 30, 1990) (final rule) [hereinafter Prohibited Transactions].

9. Exchange Act Rule 14e-4 is “designed to preclude persons from tendering more shares than they own in order to avoid or reduce” their proration risk. Commission Guidance on the Application of Certain Provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and Rules thereunder to Trading in Security Futures Products, Release Nos. 33-8107, 34-46101 (June 21, 2002) [hereinafter Commission Guidance]; *see also* Prohibited Transactions.

10. The Commission stated that Rule 14e-4 “enhances the fairness of the proration process by preventing certain tendering persons from gaining an advantage in the proration pool at the expense of others, and . . . it assures equal application of the proration factor to each tendering person’s net ownership interest in the tendered shares.” Prohibited Transactions; *see also id.*

(citing the Commission’s Advisory Committee on Tender Offers: “Because short and hedged tendering opportunities are available almost exclusively to market professionals, they appear to provide a substantial, unfair advantage to market professionals . . . [which] create[s] too great a risk of undermining public confidence in the integrity of the markets.”).

11. Under Rule 14e-4, a person may tender shares from its own account into a partial tender offer only if “at the time of tender, and at the end of the proration period,” the person has a net long position in the subject security or an equivalent security “equal to or greater than the amount tendered.” Rule 14e-4(b)(1); *see also* Commission Guidance. “The calculation of the net long position must be done both at the time of tender and at the end of the proration period.” Commission Guidance. The rule defines a person’s short position to include, *inter alia*, standardized call options with a strike price “lower than the . . . stated amount of consideration offered for the subject security” that were written by that person after the announcement of the partial tender offer. Rule 14e-4(a)(1)(ii)(D).

12. As set forth above, on August 15, 2016, Critical tendered 55,500 shares of Lockheed in the Partial Tender Offer. Because it had written 500 call options with a strike price of \$300 after the announcement of the Partial Tender Offer, Critical’s net long position was only 5,500 – 50,000 shares fewer than the amount it tendered. Under Rule 14e-4, Critical was prohibited from tendering shares in excess of its net long position. For these reasons, Critical willfully violated Rule 14e-4 of the Exchange Act.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent’s Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Exchange Act Rule 14e-4.

B. Respondent is censured.

C. Respondent shall, within 14 days of the entry of this Order, pay disgorgement of \$149,224, prejudgment interest of \$19,868, and a civil money penalty in the amount of \$50,000 to the Securities and Exchange Commission. The Commission will hold funds paid pursuant to this paragraph in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, transfer them to the general fund of the United States Treasury, subject to Section 21F(g)(3). If timely payment of disgorgement and prejudgment interest is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600, and if timely payment of a civil money penalty is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Critical Trading, LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Antonia Chion, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5720.

D. Regardless of whether the Commission in its discretion orders the creation of a Fair Fund for the penalties ordered in this proceeding, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman
Secretary