Title: **A SOLUTION TO THE PALM—3COM SPINOFF PUZZLES**

Speaker: **Chester S. Spatt**
Carnegie Mellon University and NBER

Importance: Why this matters:

Market commentators use spinoffs such as this one to suggest markets are irrational. A proper analysis using of all of the data demonstrates that arbitrage opportunities did not exist. In fact, the "high" price of Palm could not be arbitraged away.

Investigation: "Speaker analyzed XXX data to address the questions yyy, zzz, etc."

Investigated whether the pricing of 3Com after the announcement of the spinoff of Palm was irrational. Conventional wisdom was that the price of 3Com after it announced the spin-off of Palm reflected a negative value for the rest of 3Com. That would violate rational markets and no arbitrage assumptions. By examining the cost of borrowing shares required for shorting, and imputing the forward price of Palm from options prices, the author demonstrated that the law of one price was not violated. The stub-value of 3Com was always positive.

Innovation: Are there new techniques of interest in the data or approach to the problem?

When studying events like this, one must look closely at security lending fees. At times the annualized cost of borrowing was 50% or higher. Put-call parity allows us to impute forward prices, which should be used for analysis. The implied forward price gave sensible forecasts.

Insights: 1-2-3, what are the three most important things the speaker offered?

1. The law of one price was not violated. Commentators that used this as an example of irrational markets did not perform the proper calculations. Relative share prices and co-movements were sensible once security lending fees and spin-off timing uncertainty were included in the analysis.

2. Shorting fees may consume expected arbitrage profits. In situations like this, the cost of borrowing stocks can be quite high, limiting the ability to short the spinoff.

3. Use option prices to estimate the forward price of the spinoff.

Audience rating: 3.82