FAIR MARKETS AND FAIR DISCLOSURE: SOME THOUGHTS ON THE LAW AND ECONOMICS OF BLOCKHOLDER DISCLOSURE, AND THE USE AND ABUSE OF SHAREHOLDER POWER

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In March 2011, our law firm (Wachtell, Lipton, Rosen & Katz) formally petitioned the Securities and Exchange Commission to modernize the rules promulgated under Section 13(d) of the Securities Exchange Act of 1934. The petition sought to ensure that the reporting rules would continue to operate in a way broadly consistent with the statute's clear purposes, and that loopholes that have arisen by changing market conditions and practices since the statute's adoption over forty years ago could not continue to be exploited by acquirers, to the detriment of the public markets and security holders. Among other things, the petition proposed that the time to publicly disclose acquisitions of over 5% of a company's stock be reduced from ten days to one business day, given investors' current ability to take advantage of the ten-day reporting window to accumulate positions well above 5% prior to any public disclosure, in contravention of the clear purposes of the statute.

In their article The Law and Economics of Blockholder Disclosure*, Professors Lucian A. Bebchuk and Robert J. Jackson Jr. challenge the need for any modifications to the ten-day reporting window. Bebchuk and Jackson argue that, given the purported benefits of blockholder accumulations, extensive cost-benefit analysis should be done before Section 13(d)'s reporting rules are modified.*

We argue that Bebchuk and Jackson offer no sound basis for the cost-benefit analysis they suggest nor any reason to question the need for the modernization of Section 13(d)'s reporting rules proposed in the petition. Specifically, we explain that Bebchuk and Jackson's position follows largely from an erroneous interpretation of the statute's legislative history and that the blockholder interests for which they advocate run directly contrary to Section 13(d)'s underlying purpose—"to alert the marketplace to every large, rapid aggregation or accumulation of securities." We also discuss how developments in market liquidity and trading—which allow massive volumes of public company shares to be traded in fractions of a second—have made the Section 13(d) reporting regime's ten-day reporting window obsolete, allowing blockholders to contravene the purposes of the statute by accumulating vast, control-implicating positions prior to any disclosure to the market. Finally, we explain how corporate governance developments since the passage of the Williams Act offer no reason to fail to update Section 13(d)'s reporting rules. To the contrary, we note that the blockholder reporting rules in other major capital markets jurisdictions only confirm the need to modernize the Section 13(d) reporting regime to ensure that it once again fully achieves the statute's express purposes.

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Introduction

It is the legislative and regulatory policy of the United States that an investor must promptly notify the market when it accumulates a block of publicly traded stock representing more than 5% of an issuer's outstanding shares. This policy reflects the nation's general commitment to transparency in our securities markets and the more specific regulatory judgment that stealth accumulations of large blocks can be unfair to market participants. The policy is codified in Section 13(d) of the Securities Exchange Act of 1934, adopted in 1968.[1] The purpose of Section 13(d) "is to alert the market-place to every large, rapid aggregation or accumulation of securities."[2] The statutory policy rests on the legislative conclusion that shareholders "are

[1] 15 U.S.C. § 78m(d) (2006).
[2] GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d Cir. 1971).

entitled to full disclosure when over 5 percent of their company's stock is to be acquired by an outside group."[3]

The debate this essay hopes to advance concerns how long an acquiring blockholder may hide the news of its 5% accumulation. A little over a year ago, our firm, Wachtell, Lipton, Rosen & Katz, formally petitioned the Securities and Exchange Commission to modernize the long-established Section 13(d) reporting regime. The petition sought to ensure that the reporting rules would continue to operate in a way broadly consistent with the statute's clear purposes and that loopholes that have arisen by changing market conditions and practices since the statute's adoption over forty years ago could not continue to be exploited by acquirers, to the detriment of the public markets and security holders.[4] The changes suggested by the petition would bring the U.S. blockholder reporting regime broadly in line with those of virtually all other major developed economies.

Our petition included the proposal that the disclosure window in the SEC's rules implementing Section 13(d) be reduced from ten days to one business day. This proposal reflects the reality that the mechanics of accumulation that exist today—including exponentially higher trading volumes, electronic trading and the widespread use of derivatives—allow blockholders to accumulate massive stakes in the ten-day window, thereby defeating the statutory purpose of alerting the market to creeping threats to control.[5] The trading world has changed around the rule, with the result that the rule no longer does the work for which the statute was enacted. The petition noted numerous situations in which aggressive investors have taken advantage of the legal loophole to build enormously powerful, control-threatening stakes in their ten-day windows, and further highlighted that other sophisticated securities markets have already taken regulatory steps to reduce the risk of undisclosed rapid accumulations.

Professors Lucian A. Bebchuk and Robert J. Jackson Jr. have attacked the Wachtell Lipton proposal in their article *The Law and Economics of*

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[3] H.R. Rep. No. 91-1655, at 3 (1970).

[4] Letter from Wachtell, Lipton, Rosen & Katz to Elizabeth M. Murphy, Secretary, U.S. Sec. & Exch. Comm'n (Mar. 7, 2011), http://www.sec.gov/rules/petitions/2011/petn4-624.pdf [hereinafter Wachtell Lipton petition or Petition]. NYSE Euronext, the Society of Corporate Secretaries and Governance Professionals and the National Investor Relations Institute recently submitted a similar petition for rulemaking to the SEC, requesting that the SEC shorten the deadline for filing Forms 13F under Rule 13f-1 from 45 days to two business days after the relevant calendar quarter, supporting an increase in the frequency of reporting under Rule 13f-1, and supporting reform of the beneficial ownership reporting rules under Section 13(d). Letter from NYSE Euronext, et al. to Elizabeth M. Murphy, Secretary, U.S. Sec. & Exch. Comm'n (Feb. 1, 2013), http://www.sec.gov/rules/petitions/2013/petn4-659.pdf [hereinafter 13F petition]. The 13F petition accurately details how the 45-day reporting period under Rule 13f-1, like the 10-day reporting period under Section 13(d), has become obsolete, and only serves to undermine the principles of market transparency and engagement between public companies and their shareholders that are a core purpose of the Section 13(f) regime.

[5] *See infra* Part II.A; *see also* Petition, *supra* note 4, at 3–4, 5–6.

Blockholder Disclosure,[6] at conferences, and in blog postings and other writings. Bebchuk and Jackson argue that the secret accumulations currently permitted during the window period, when the market is unaware that the buying blockholder has already crossed the 5% threshold, may lead to short-term market "efficiency" and that large-scale, undisclosed activist accumulations may yield far-ranging benefits to our public companies and investors. They therefore insist that even modest modernization of the current block reporting rules that would in any way reduce the profitability of such undisclosed accumulations be carefully reviewed to weigh the obvious benefits of market transparency and fairness that flow from prompt disclosure of such holdings against the supposed benefits of allowing market participants to operate, and profit, in secret. Bebchuk and Jackson argue that extensive econometric analysis is required before the recommendations set forth in the petition could be adopted.[7]

Missing entirely from Bebchuk and Jackson's account, however, is any explanation of how their position—their conception of how the Section 13(d) reporting rules should operate—is consistent with the clear purpose of the statute. How can the statutory purpose of alerting the market to rapid accumulations of stock be served by a rule that has come to facilitate accumulations before the market is alerted? How can the statutory purpose of transparency be served by a rule that now rewards trading in secret? How can the statutory purpose of ensuring fairness to shareholders at large be served by a rule whose present design benefits blockholders at the expense of other market participants?

Bebchuk and Jackson have no answers to these questions, and there are none. The fact is that Bebchuk and Jackson do not much like Section 13(d) at all, and they advance a process for evaluating even a modest modernization that is calculated to ensure that the rules fail to keep up with market reality. They aim not to facilitate the effectiveness of the statute, but to thwart it.

The superficial attractiveness and facial modesty of the ultimate stated goal of the professors' article—to ensure that the SEC carefully weighs the

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[6] Lucian A. Bebchuk & Robert J. Jackson Jr., *The Law and Economics of Blockholder Disclosure*, 2 Harv. Bus. L. Rev. 39 (2012).

[7] Bebchuk and Jackson start with the premise that the petition suggests "tightening" the Section 13(d) disclosure rules, seeking to don for themselves and those for whom they advocate the mantle of conservatively protecting the *status quo*. Yes, the Wachtell Lipton petition suggests modifying the beneficial ownership reporting rules, but principally so that they will again have the effect intended at the time of the adoption of Section 13(d). The need for modest adjustment in the rules follows directly from the clear purposes underlying the statute and the massive change in the nature of shareholders and markets during the decades since the rules were first adopted. The rules have stood still while the world has changed. It is not "tightening" for the former to reflect changes in the latter. Indeed, it has become both simple and commonplace for aggressive investors to intentionally structure their acquisition strategies to exploit the gaps created by the current reporting regime. If there is any bias in favor of the *status quo*, properly understood, it must be to require that the rules be modified so that they do not continue to be so easily evaded as to be meaningless, or at least feckless, in many circumstances.

costs and benefits of the reforms sought in the Wachtell Lipton petition—cannot hide its underlying thesis. Bebchuk and Jackson, and the stockholder activists who have articulated similar arguments,[8] have a predisposition in favor of maintaining the current reporting rules for as long as possible for reasons that have nothing to do with protecting the transparency and fairness of the securities markets but instead to advance their own separate views on the corporate governance aspects of large blockholdings.[9] No statute requires the SEC to engage in the sort of analysis Bebchuk and Jackson demand,[10] much less one that is supported by econometric studies on the subjects the professors are interested in.[11] This is particularly the case with respect to our petition, which does not seek the implementation of any new policy or regulatory scheme but rather suggests modest modifications to already implemented SEC rules in order to ensure that those regulations continue to serve the statutory purposes for which they were enacted. In fact, in 2010 Congress specifically authorized the SEC to shorten the filing window, demon-

[8] *See, e.g.*, Memorandum of Scott H. Kimpel, Office of Commissioner Troy A. Paredes (July 20, 2011), http://www.sec.gov/comments/4-624/4624-4.pdf (enclosing presentation from certain members of the Managed Funds Association concerning the Wachtell Lipton petition).

[9] Professor Bebchuk's writings on the topics of corporate governance and shareholder activism are well known and have been widely publicized both in academic journals and in the popular media for many years. Professor Bebchuk has twice been nominated as part of a dissident slate of one such activist blockholder who has frequently taken advantage of the ten-day reporting window to acquire substantially more than five percent of a company's shares prior to filing his initial Schedule 13D. *See* Yahoo! Inc. Definitive Proxy Statement (July 14, 2008), *available at* http://www.sec.gov/Archives/edgar/data/921669/000092847508000257/defc14a071108.txt; Forest Laboratories, Inc. Definitive Proxy Statement (July 18, 2011), *available at* http://www.sec.gov/Archives/edgar/data/38074/000095012311066090/0000950123-11-066090.txt. Professor Bebchuk is also director of the Harvard Law School's Shareholders Rights Project, a program that offers students the opportunity to counsel institutional investors in their efforts to effect corporate governance changes, in particular targeting the S&P 500 companies with shareholder proposals seeking to declassify their boards of directors.

[10] *See* U.S. Gov't Accountability Office, GAO-12-151, Dodd-Frank Act Regulations: Implementation Could Benefit from Additional Analyses and Coordination 9 (2011) ("As part of the rulemaking process, federal financial regulatory agencies are required to conduct a variety of regulatory analyses, but benefit-cost analysis is not among the requirements."); *see also* Memorandum from the Div. of Risk, Strategy, & Fin. Innovation on Current Guidance on Econ. Analysis in SEC Rulemakings to the Staff of the Rulewriting Divs. & Offices 3 (Mar. 16, 2012) ("No statute expressly requires the Commission to conduct a formal cost-benefit analysis as part of its rulemaking activities."); *cf.* Business Roundtable v. SEC, 647 F.3d 1144, 1148–54 (D.C. Cir. 2011) (striking down a new "proxy access" rule adopted by the SEC as being "arbitrary and capricious on its face" on the ground that the SEC had "failed . . . adequately to assess the economic effects of a new rule"). In 2011, a bill was introduced in Congress that would require the SEC to assess the costs and benefits of any intended regulation and to adopt it only on a determination that its benefits justify the costs. The accompanying Report correctly stated that "neither Executive Order 13563 nor statute compels the SEC to weigh the costs and benefits [of] the regulations that it issues" and made clear that the purpose of the bill was to add new and additional requirements to the SEC's rulemaking process. H.R. Rep. No. 112-453, at 5.

[11] *See* Chamber of Commerce v. SEC, 412 F.3d 133, 142 (D.C. Cir. 2005) ("[W]e are acutely aware that an agency need not—indeed cannot—base its every action upon empirical data . . . . The Commission's decision not to do an empirical study does not make that an unreasoned decision.").

strating Congress' recognition of the need for prompt action to remedy abuses of the ten-day reporting period.[12]

Put very simply, the current Section 13(d) reporting regime fails to fulfill its stated purpose: to "alert investors in securities markets to potential changes in corporate control and to provide them with an opportunity to evaluate the effect of these potential changes."[13] Immediate revision is needed for the Section 13(d) rules to once again ensure market fairness and transparency.

The following proceeds in two parts. First, we show that none of the issues identified by Bebchuk and Jackson justify, much less mandate, the sort of cost-benefit analysis they suggest. Specifically, we explain that the recommendations set forth in our petition follow directly from the policy underlying the statute and that the blockholder interests which Bebchuk and Jackson advocate run contrary to the reporting regime's underlying purpose. Second, we explain why changes since the passage of the Williams Act require modifications to the reporting window in the Section 13(d) rules, and we explain why the issues raised by Bebchuk and Jackson provide no basis to question the need for modernization of those rules.

I. No "Policy Analysis" is Needed to Modernize Section 13(d)'s Reporting Rules Consistent with the Statute's Purpose of Ensuring Market Transparency and Full and Fair Disclosure.

Bebchuk and Jackson claim that neither general principles of market transparency nor the underlying purposes of the Section 13(d) reporting regime justify modification of the ten-day reporting window without extensive cost-benefit analysis. But they offer no persuasive reason why such extensive analysis is needed before modernizing the reporting rules consistent with the purposes of the statute.

A. Section 13(d) Reflects an Explicit Congressional Mandate for Market Transparency and the Full and Fair Disclosure of Large Accumulations of Public Company Stock.

Bebchuk and Jackson begin with the claim that the securities laws distinguish between disclosure of information by "insiders"—*i.e.*, companies and their officers, directors, and employees—and disclosure of information

[12] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1866 (2010) (hereafter "Dodd-Frank Act") (modifying Exchange Act § 13(d)(1) to require disclosure "within ten days after such acquisition [of 5% of the relevant class of security], *or within such shorter time as the Commission may establish by rule*") (emphasis added).

[13] Wellman v. Dickinson, 682 F.2d 355, 365–66 (2d Cir. 1982) (citing GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d Cir. 1971)).

by other market participants, whom they characterize as "outsiders." From this (highly questionable) distinction, they purport to glean a capital markets policy principle that, in contrast to "insiders," "outsiders" are generally not required to disclose their ownership positions or trading practices. Bebchuk and Jackson therefore urge that a "careful policy analysis" be undertaken before burdening such "outsiders" with enhanced disclosure obligations.[14]

While there is no need here to detail the various, context-specific ways in which Congress and the SEC have chosen to regulate various forms of "insider" and "outsider" disclosure, including, importantly, when material information can be kept confidential and when it must be disclosed, it suffices to say that there is no baseline principle that requires immediate disclosure of all material information by companies or shareholders, insiders or outsiders, nor is Section 13(d) the only regime requiring information to be disclosed by "outsiders." Rather, there are specific rules and doctrines that have been developed over the course of nearly 80 years of legislating, rule-making and adjudication. Included among those regimes are rules requiring disclosure by market participants—"outsiders" in the language of Bebchuk and Jackson—through the 13D regime, through the 13F regime, through reporting by 10% shareholders in the Section 16 regime (which is identical to such reporting by a company's officers and directors) and through direct regulation of money managers and other market participants under a variety of other SEC and exchange rules.[15]

But whatever the merit of Bebchuk and Jackson's claim generally, it has no relevance to the Wachtell Lipton petition. There is no question that the point of Section 13(d) is to require disclosures by what Bebchuk and Jackson call "outsiders." As they concede, [16] Section 13(d) incontrovertibly creates an express and affirmative policy of disclosure for material accumulations of public company stock by market participants who have no relationship with a company other than their substantial ownership in its stock. That Congress has sometimes chosen to regulate differently, or not at all, in other transactional contexts, including with respect to such "outsiders," is simply irrelevant as to whether and to what extent Section 13(d) continues to achieve the purposes for which it was explicitly enacted. The ten-day period provided for in the Section 13(d) rules was fixed in the era of "snail mail" and paper filings; it did not "balance" transparency in equity markets against some

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[14] Bebchuk & Jackson, *supra* note 6, at 42–43.

[15] *See* 15 U.S.C. § 78m(d) (2012); 15 U.S.C. § 78m(f) (2012); 15 U.S.C. § 78p(a) (2012); 17 C.F.R. § 275.203-1 (2012); NYSE Rule 431 (2012).

[16] Bebchuk & Jackson, *supra* note 6, at 43 (for purchases by "outsiders" of public-company stock, "the general principle is that, *outside the specific exception established by the Williams Act*, buyers of shares are not required to disclose their purchases to the market—even when that information would be of interest to others") (emphasis added). This statement is inaccurate as it ignores Section 16 under the Exchange Act and the rules adopted by the SEC thereunder, which require all 10% shareholders to report their purchases and sales of securities within two business days—the same reporting requirement that a company's directors and officers are subject to under Section 16.

other important public value in opposition to transparency, but was rather a reflection of what was reasonably possible before the commonplace usage of computers and digital communications. No cost-benefit analysis is necessary to understand that the clear and explicit Congressional mandate for market transparency and fairness fully justifies modifications to the Section 13(d) reporting regime necessary for it to again achieve its purposes.

B. Section 13(d) is Specifically Designed to Protect Investors, Not the Blockholder Interests Advanced by Bebchuk and Jackson.

Bebchuk and Jackson also claim that a cost-benefit analysis is required to assess the modifications proposed in our petition to ensure that any such modifications meet the objectives of Section 13(d). That is because, in Bebchuk and Jackson's account, Congress did not really intend in Section 13(d) to require disclosure of all rapid accumulations of public company stock.[17] Rather, Congress supposedly intended to strike a "balance" between the interests of companies and their management on the one hand and control-seeking investors on the other. A crucial ingredient in this "balance," assert Bebchuk and Jackson, was to allow investors to accumulate beneficial ownership interests in excess of 5% prior to having to publicly disclose their position.[18] In their view, Congress supposedly intended to allow blockholders across-the-board to buy up as much as they could during the ten-day window between crossing the 5% line and the requirement of public disclosure.

To support their position, Bebchuk and Jackson rely almost exclusively on the fact that Senator Williams's original bill proposed requiring that an accumulating investor disclose its position before crossing the 5% beneficial ownership threshold, a mandate that ultimately was not included in the statute.[19] Bebchuk and Jackson claim that the lack of inclusion of any advance-notice provision evidences a "legislative compromise" to allow activists to accumulate large stakes during the ten-day disclosure window.[20]

This claim is both without support and inaccurate. The lack of inclusion of an advance-notice provision had nothing to do with facilitating pre-disclosure accumulations by blockholders, nor did the debate surrounding the advance-notice provision reflect a policy divide within Congress. Rather, as the SEC noted in its report to the Senate on Senator Williams's original bill, the animating concern regarding any advance notice provision was a technical and practical one as to the administrative burden such an advance-notice obligation would place on would-be beneficial owners.[21] As the SEC noted,

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[17] *See id.* at 46.
[18] *See id.* at 44–46.
[19] *See id.* at 44.
[20] *Id.* at 46.
[21] *Memorandum of the Securities and Exchange Commission to the Committee on Banking and Currency, U.S. Senate, on S.2731*, 89th Congress, *reprinted in* 112 Cong. Rec. 19003,

in "some types of situations . . . compliance with an advance notice requirement would be impossible, such as acquisitions by inheritance or by gift of which the recipient had no advance notice."[22] There is no evidence whatsoever that an advance notice requirement was dropped out of solicitude for the interests or claimed beneficial side-effects of blockholders, much less that the design reflected any judgment or intention to facilitate buying over 5% prior to public disclosure. Secret accumulations were the very evil that the statute sought to protect against.

Bebchuk and Jackson also rely on the fact that Congress initially considered a seven-day reporting window before ultimately landing on the ten-day window set forth in the statute.[23] According to Bebchuk and Jackson, Congress rejected a seven-day window so that large blockholdings would not be unduly discouraged.[24] But this reading of the legislative history is again wishful thinking. Congress's decision to impose a ten-day reporting window had nothing to do with facilitating pre-filing accumulations, but reflected only Congress's recognition of the administrative burden that would have been imposed by a seven-day deadline to prepare and file the Schedule 13D, which, given commercial and technological realities that existed in 1968, would have included the time required to mail the Schedule 13D to the SEC's office.[25] The suggestion that Congress acted to protect the interests of blockholders and to facilitate undisclosed buying during the window is chimerical.

Bebchuk and Jackson's position that the statutory scheme reflects a "balance" between "the benefits that the holders of large blocks of stock convey upon public investors and the need for disclosure of these blocks"[26] similarly relies on a distorted reading of the legislative history. Indeed, although Bebchuk and Jackson make much of a few carefully excerpted remarks made by Senator Williams regarding the "balance" they claim was struck between corporate insiders on the one hand and blockholders on the

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19004 (1966) ("The Commission foresees difficulty in requiring 20 days advance notice of a proposed acquisition in excess of 5 per cent and believes that a statement filed not more than 5 days after the acquisition would be less burdensome to beneficial owners who become subject to it. Indeed, we envision some types of situations in which compliance with an advance notice requirement would be impossible . . . .").

[22] *Id.*

[23] Bebchuk & Jackson, *supra* note 6, at 45.

[24] *Id.*

[25] *See Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings Before the Subcomm. on Securities of the S. Comm. on Banking and Currency*, 90th Cong. 136 (1967) (statement of Stanley Kaplan, Professor, University of Chicago) ("Requiring the filing of a statement of data specified by Section (1) of the bill within seven days after the acquisition of 10% of equity securities seems to provide an unduly short time for preparation of a document of that magnitude and significance. It will take longer to prepare and check such a document properly; if the bill is passed, the time interval should be increased.").

[26] Bebchuk & Jackson, *supra* note 6, at 45–46.

other,[27] Senator Williams made clear that, at bottom, the bill that would later become the Williams Act "is *solely* designed to require full and fair disclosure for the benefit of investors."[28] As Senator Williams himself recognized, whatever "balance" his bill would strike, the fact that the new disclosure requirements would pose major obstacles for certain powerful investors who would rather accumulate large blocks of an issuer's stock cloaked in anonymity was considered and expressly rejected as "but a small price to pay for adequate investor protection."[29] There was no weighing of the supposed good (or bad) impacts on blockholdings. There was a focused attention on improving transparency in our trading markets.

Here is the truth of the matter: nothing in the words or legislative history of the Williams Act suggests that the ten-day disclosure window established in 1968 was designed to allow activists to accumulate large stakes at discounted prices, unbeknownst to and to the detriment of counterparties and the market. To the contrary, the purpose of the Williams Act was to promptly arm market participants with information concerning potential changes in corporate control in order to allow them to make more informed investment decisions.[30] The stealth accumulations at below-market prices sought to be fostered by Bebchuk and Jackson—which, as the professors concede, transfer value from public investors to activists—were precisely what was to be *prevented* by Section 13(d).[31] As Manuel F. Cohen, then-Chairman of the SEC, put it:

[27] *See id.* at 45 (quoting 113 Cong. Rec. 24,664 (1967)) (pointing out that Senator Williams said that the new bill took "extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids").

[28] 113 Cong. Rec. 24,664 (1967) (emphasis added); *see also id.* ("There are . . . some areas still remaining where full disclosure is necessary for investor protection but not required by present law.").

[29] *See id.* ("While the bill may discourage tender offers or other attempts to acquire control by those who are unwilling to expose themselves to the light of disclosure, this is but a small price to pay for adequate investor protection.")

[30] S. Rep. No. 90-550, at 3 (1967) ("The bill is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case."); *see also id.* at 4 ("The bill would correct the current gap in our securities laws by amending the Securities Exchange Act of 1934 to provide for full disclosure in connection with cash tender offers and other techniques for accumulating large blocks of equity securities of publicly held companies."); H.R. Rep. No. 90-1711, at 8 (1968) ("The purpose of section 13(d) is to require disclosure of information by persons who have acquired a substantial interest, or increased their interest in the equity securities of a company by a substantial amount, within a relatively short period of time.").

[31] *See* H.R. Rep. No. 90-1711, at 4 (1968) ("The persons seeking control, however, have information about themselves and about their plans which, if known by investors, might substantially change the assumptions on which the market price is based. The bill is designed to make relevant facts known so that shareholders have a fair opportunity to make their decision."); *id.* at 3–4 ("But where no information is available about persons seeking control, or their plans, the shareholder is forced to make a decision on the basis of a market price which reflects evaluation of the company based on the assumption that the present management and its policies will continue."); GAF Corp., 453 F.2d at 717 (without prompt disclosure, "investors cannot assess the potential for changes in corporate control and adequately evaluate the company's worth").

> But I might ask, how can an investor evaluate the adequacy of the price if he cannot assess the possible impact of a change in control? Certainly without such information he cannot judge its adequacy by the current or recent market price. That price presumably reflects the assumption that the company's present business, control and management will continue. If that assumption is changed, is it not likely that the market price might change?[32]

Thus, while for administrative purposes Congress may have declined to impose an advanced notice requirement in Section 13(d), there is simply nothing to suggest that the post-trigger reporting window was designed to facilitate stealth accumulations.

Indeed, within two years of the Williams Act's passage, Congress amended Section 13(d) to *lower* the disclosure threshold from 10% to 5%[33] precisely because the statute's prior disclosure trigger too easily allowed investors to accumulate potentially control-implicating, and market moving, positions of up to 10% without market disclosure.[34] As the Senate Report on the amendment stated, the "reduction for [sic] 10 to 5 percent would provide public disclosure of impending corporate takeovers at a more meaningful level. . . . These acquisitions may lead to important changes in the management or business of the company and the shareholders should be fully informed."[35] Congress's desire for investors to be "fully informed"—and, indeed, more fully informed than was possible with a 10% trigger level—would of course be entirely undermined if investors could accumulate those same positions during the statute's reporting window by making use of changed trading technologies and accumulation techniques.

In this connection it also is significant to note that blockholders who have already filed a Schedule 13D after crossing the 5% threshold and becoming subject to the Section 13(d) reporting regime are obligated to promptly amend their filing "[i]f any material change occurs in the facts set forth in the Schedule 13D . . . including . . . [a]n acquisition or disposition of . . . one percent or more" of the relevant securities.[36] "Prompt" in the context of a change of 1% or more in ownership is the following business

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[32] *Takeover Bids: Hearing on H.R. 14475 and S. 510 before the Subcomm. on Commerce and Finance of the H. Comm. on Interstate and Foreign Commerce,* 90th Cong. 12 (1968) (statement of Hon. Manuel F. Cohen, Chairman, U.S. Sec. & Exch. Comm'n).

[33] Act of December 22, 1970, Pub. L. No. 91-567, 84 Stat. 1497 (1970).

[34] *See* H.R. Rep. No. 91-1655, at 3 (1970) ("An investment of between 5 and 10 percent of the securities of a company can have a significant impact on the public markets for that company's stock. *Shareholders of the target company are entitled to full disclosure when over 5 percent of their company's stock is acquired by an outside group.*") (emphasis added); *Additional Consumer Protection in Corporate Takeovers and Increasing the Securities Act Exemptions for Small Businessmen: Hearing on S. 336 and S. 3431 Before the Subcomm. on Sec. of the S. Comm. on Banking and Currency,* 91st Cong. 1 (1970) ("Ten percent of the stock of large corporations, indeed even 5 percent, can . . . have a significant impact on corporate control.").

[35] S. Rep. No. 91-1125, at 3 (1970).

[36] 17 C.F.R. § 240.13d-2(a) (2012).

day. [37] It defies logic for the reporting rules to correctly recognize that fully and fairly informing the market of blockholder activity requires immediate disclosure of an increase in ownership from, for example, 5% to 6%, but to impose no filing obligation whatever for ten days following first crossing the 5% threshold, regardless of the ownership level reached.

In summary, "the purpose of section 13(d) is to alert the marketplace to every large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control . . . ."[38] Notwithstanding Bebchuk and Jackson's strained if not simply inaccurate reading of the Williams Act's legislative history, that legislative history nowhere suggests that Congress intentionally designed the Section 13(d) disclosure regime to foster the stealth accumulations during the ten-day reporting window for which the professors advocate. And it even less justifies requiring some sort of extensive cost-benefit analysis before modernizing the relevant reporting rules to do the job that Congress so obviously intended them to do.

C. The Purported Benefits of Blockholders Identified by Bebchuk and Jackson Provide No Basis for the Cost-Benefit Analysis They Seek.

Having imagined for Congress an intent to facilitate secret accumulations by blockholders, Bebchuk and Jackson at least show their true colors when they caution that "tightening the rules that apply to blockholders can be expected to reduce the incidence of outside blocks as well as blockholders' investments in monitoring and disciplining management."[39] The result, Bebchuk and Jackson contend, would be "increased agency costs, and managerial slack," to the detriment of investors.[40] Bebchuk and Jackson thus urge that the potential reduction in these blockholder accumulations—resulting from the impaired ability to acquire shares at below-market prices[41]—and the purported governance benefits from their "monitoring" be taken into account when considering the regulatory modernization proposed by the Wachtell Lipton petition.[42] The professors essentially assert that the current state of affairs—in which blocks far in excess of the 5% reporting threshold can be acquired during the reporting window, leaving the markets trading in ignorance, and allowing blockholders to emerge from the mist of anonymity already holding positions large enough to affect the balance of

[37] *See* In the Matter of Cooper Labs., Inc., Exch. Act Rel. No. 22,171, 49 S.E.C. 368, 374 (June 26, 1985) (finding that, under Rule 13d-2's mandate that required Schedule 13D amendments be filed "promptly," filer should have amended its Schedule 13D on the next business day after selling more than 1% of the issuer's stock).

[38] GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d Cir. 1971).

[39] Bebchuk & Jackson, *supra* note 6, at 47.

[40] *Id.* at 51.

[41] Throughout we refer to accumulations below market price; we mean of course below the price that would exist if the market were informed of the accumulation.

[42] *See id.* at 51.

corporate control—is actually the best of all possible worlds, and that these stealth accumulations promote efficiency.[43]

The foundation of Bebchuk and Jackson's position is the conceit that blockholders can be effective in "monitoring and disciplining management,"[44] thereby reducing so-called "agency costs and managerial slack." According to Bebchuk and Jackson, these benefits are purportedly evidenced by the stock price bounce typically seen in response to activist 13D filings.[45] But this "evidence" suggests nothing more than that activist 13D filers often agitate for some corporate change—for example, a sale of the company or recapitalization—that may be expected to have a short-term, positive effect on a company's stock price. Not one of the studies that Bebchuk and Jackson cite provides any firm evidence that activists are actually effective in monitoring management, or that the companies they target are in need of such monitoring, much less that their actions facilitate long-term wealth maximization over the opportunistic, short-term behavior that favors the activists' narrow, self-enriching agenda.[46] In fact, one study cited by Bebchuk and Jackson for the proposition that outside blockholders are beneficial to investors found a "lack of statistically meaningful reaction" in a company's stock price to so-called governance-related activism,[47] and another found that the

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[43] *See id.* at 47–49. While this is not the proper forum to debate the nature of corporations and boards, Bebchuk and Jackson entirely ignore that disclosure of blockholder stakes not only furthers market transparency, but also informs boards of directors, allowing them to assess and respond to potentially control-implicating accumulations for the benefit of all shareholders.

[44] *See id.* at 47.

[45] *See id.* at 47–48.

[46] *Cf., e.g.*, Lynn Stout, The Shareholder Value Myth 66–73 (2012) (discussing the conflicts between the interests of short-term, institutional shareholders and long-term corporate values); Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed For The Long Term Unless Their Powerful Electorates Also Act And Think Long Term?*, 66 Bus. Law. 1, 12, 23 (2010) ("[I]t is increasingly the case that the agenda setters in corporate policy discussions are highly leveraged hedge funds, with no long-term commitment to the corporations in which they invest. . . . When the electorate has a fleeting interest in the fate of the polity, one would think that it would be more, not less, important to ensure that changes with long-lasting effect be designed and motivated by a desire to promote the best long-run, not short-term, outcome."); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. Pa. L. Rev. 653, 681–82 (2010) (discussing the advent of "new blockholders" of "[a]ctivist hedge funds" who are "impatient shareholders, who look for value and want it realized in the near or intermediate term"); John Kay, The Kay Review of UK Equity Markets and Long-Term Decision Making 19 (July 2012) (discussing the negative effects of "short-termism" on long-term corporate performance), *available at* http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf.

[47] Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. Fin. 1729, 1731 (2008); *see also* Stuart Gillan & Laura Starks, *The Evolution of Shareholder Activism in the United States*, J. of App. Corp. Fin., Winter 2007, at 67 ("Virtually all studies of long-term operating performance have reported no statistically significant changes in the operating performance of [companies targeted by activists]."); Jonathan M. Karpoff, The Impact of Shareholder Activism on Target Companies: A Survey of Empirical Findings (Sept. 10, 2001) (unpublished manuscript) (surveying literature and finding that shareholder activism generally has "negligible impacts on share values and earnings"), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=885365.

profitability and cash flow from operations of activist targets actually deteriorates.[48] Similarly, the same studies cited by Bebchuk and Jackson for the contention that announcements of proxy fights are associated with a short-term bump in share prices also suggest a *negative* effect on long-term share price performance in situations where the activist actually succeeds in gaining board representation.[49]

Moreover, Bebchuk and Jackson's view of outside blockholders as the crucial means to monitor supposedly inefficient and selfish management, in light of the collective action problems associated with an otherwise fragmented shareholder base, ignores the reality of modern shareholding. Today, powerful institutional investors hold the vast majority of the shares of the nation's largest corporations.[50] These institutions already have the power and the motivation to monitor management and seek the corporate governance and other changes they deem beneficial.[51] Indeed, institutional investors—along with advisory firms such as Institutional Shareholder Services and organized groupings of investors such as The Council of Institutional Investors—have had substantial influence on corporate governance in recent

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[48] April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN. 187, 223 (2009).

[49] Lisa F. Borstadt & Thomas J. Zwirlein, *The Efficient Monitoring Role of Proxy Contests: An Empirical Analysis of Post-Contest Control Changes and Firm Performance*, 21 FIN. MGMT. 22, 23 (1992) ("A dissident victory does not necessarily improve the long-term share price performance of the firm."); David Ikenberry & Josef Lakonishok, *Corporate Governance Through the Proxy Contest: Evidence and Implications*, 66 J. BUS. 405, 407 (1993) ("[I]n proxy contests where dissidents obtain one or more seats, abnormal returns following resolution of the contest are significantly negative."); *see also* ELAINE BUCKBERG & JONATHAN MACEY, REPORT ON EFFECTS OF PROPOSED SEC RULE 14A-11 ON EFFICIENCY, COMPETITIVENESS AND CAPITAL FORMATION 9 (2009) ("Several empirical studies establish that when dissident directors win board seats, those firms underperform peers by 19 to 40% over the two years following the proxy contest.") (cited in Bus. Roundtable v. SEC, 647 F.3d 1144, 1151 (D.C. Cir. 2011)).

[50] Since the time the current beneficial ownership reporting rules became law, in 1968, the corporate and shareholder landscape in the United States has changed dramatically. In 1968, approximately 10% of the equity in U.S. publicly traded firms was held by institutional shareholders, and shareholders on average held their positions for a period of about 5 years. *See* John Van Reenan & Philippe Aghion, et al., *Innovation and Institutional Ownership*, VOX (March 20, 2009), http://www.voxeu.org/article/innovation-and-institutional-ownership (citing statistics from the Federal Reserve Board of Funds Report); *NYSE Facts and Figures*, NYXDATA.COM, http://www.nyxdata.com/nysedata/asp/factbook/viewer_edition.asp?mode=table&key=268&category=14. Today, the individual, long-term shareholder is all but extinct. The shareholder rosters of the largest U.S. corporations are dominated by institutional shareholders, comprising approximately 75% of the shares outstanding, with average holding periods of around three months. *See* MATTEO TONELLO AND STEPHAN RABIMOV, THE 2010 INSTITUTIONAL INVESTMENT REPORT: TRENDS IN INSTITUTIONAL INVESTOR ASSETS AND EQUITY OWNERSHIP OF U.S. CORPORATIONS 27 (2010) (showing that "[d]uring the last twenty years, institutional investors have steadily expanded their presence in the stock ledger or the 1,000 largest U.S. corporations," a figure that stood at 73.0% at the end of 2009); John Melloy, *Investing Dying as Computer Trading, ETFs & Dark Pools Proliferate*, CNBC.COM (Jan. 4, 2011, 2:57 PM), http://www.cnbc.com/id/40907838/Investing_Dying_as_Computer_Trading_ETFs_Dark_Pools_Proliferate.

[51] *E.g.*, Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 822 (1992).

years, having sought and achieved, *inter alia*, "say on pay,"[52] a substantial reduction in standing shareholder rights plans,[53] a substantial reduction in the prevalence of staggered boards,[54] widespread adoption of majority voting for directors,[55] and rules facilitating proxy access.[56] Putting aside the merits of these developments, they serve as powerful and undeniable evidence that institutional shareholders already play a substantial role in the governance of modern public companies. As compared with 1968, no one can sensibly dispute that stockholder power and the means to deploy it has increased substantially.

But even putting aside the highly-debatable question of whether large block positions in excess or vastly in excess of 5% promote governance efficiency and long-term value creation,[57] Bebchuk and Jackson's insistence that the benefits of blockholder disclosure be comprehensively studied prior to modifying the current ten-day reporting window is entirely at odds with the purpose of the statute. Bebchuk and Jackson assert that requiring prompt disclosure at the 5% level would disincentivize activist investors from acquiring block positions because such disclosure would cause the market price of the subject securities to increase, and the activist would be unable to profit sufficiently from acquiring additional shares at price levels that do not reflect market knowledge of the activist's presence in the security.[58] But it is the stated policy of our public securities markets—through the Section 13(d) disclosure regime—to "alert investors in securities markets to potential changes in corporate control and to provide them with an opportunity to

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52 17 C.F.R. § 240.14a-21(a) (2012).

53 According to figures available at SharkRepellant.net, at year-end 2011, only 10% of S&P 500 companies had a shareholder rights plan, down from approximately 45% as recently as the end of 2005. *Poison Pills in Force Year Over Year*, SHARKREPELLANT.NET (last visited Oct. 13, 2012).

54 According to figures available at SharkRepellant.net, at year-end 2011, only 25% of S&P 500 companies had a staggered board, down from 47% as recently as the end of 2005. *S&P 500 Classified Board Trend Analysis*, SHARKREPELLANT.NET (last visited Oct. 13, 2012).

55 *See* Yonca Ertimur, Fabrizio Ferri & David Oesch, *Does the Director Election System Matter? Evidence from Majority Voting* (May 2012), *available at* http://ssrn.com/abstract=1880974.

56 *E.g.*, 17 C.F.R. § 240.14a-8 (2012).

57 The Financial Times reported recently that, as a result of an unprecedented degree of communication and co-operation among institutional shareholders, individual blockholders often no longer even need accumulate a 5% stake in order to effectively impact corporate management and policy. The Financial Times noted that would-be blockholder activists are having discussions with major shareholders before approaching a company or filing a 13D, and that "[b]ecause funds can now achieve influence without building up large stakes on their own, the number of activist 13D filings – which investors are required to submit to regulators when they acquire a stake of more than 5 per cent – understates the true extent of their influence . . . . [M]any activists refrain from crossing the threshold – which means their stake, and their discussions with the board, need never become public." *See* Dan McCrum & David Gelles, *Finance: Stirrers and Shakers,* FIN. TIMES, Aug. 22, 2012, at 5. Whether further regulatory reform or enforcement is needed in light of such activities is a topic for another day.

58 *See* Bebchuk & Jackson, *supra* note 6, at 50.

evaluate the effect of these potential changes."[59] Section 13(d)'s disclosure mandate is simply not designed to help activists obtain extra-market returns, whether framed as a "control premium" or not,[60] through undisclosed accumulations of stock at the expense of unsuspecting market participants. Bebchuk and Jackson make a category error when they insist that the impact of more or less blockholdings on corporate governance be studied and contrasted with the value of market transparency that Congress has already decided upon. There is simply no need for the SEC to consider the "costs" of discouraging the stealth accumulations that the statute was designed to prevent.[61]

II. Modernization of the Ten-Day Reporting Window is Clearly Needed.

Bebchuk and Jackson also resist the notion that developments since the passage of the Williams Act justify modifications to Section 13(d)'s ten-day reporting window. First, Bebchuk and Jackson refuse to accept that changes in modern capital markets and trading dynamics have made the ten-day reporting window obsolete. Second, Bebchuk and Jackson contend that corporate governance developments have imposed increased costs on blockholders, warranting caution in imposing additional costs through modifications of the Section 13(d) reporting rules. Finally, Bebchuk and Jackson argue that blockholder disclosure requirements in other jurisdictions around the world fail to justify the modifications sought in the Wachtell Lipton petition in light of differences in U.S. rules applicable to takeover situations. None of these arguments are persuasive.

A. *Modern Capital Markets Allow for Far Faster Accumulations of Public Company Shares Than at the Time of the Williams Act.*

It cannot seriously be contested that changes in capital markets and trading technologies make rapid accumulations of stock much easier today than in 1968, when the Williams Act was enacted.

At the time of the Williams Act, accumulations of even 10% of a company's stock within the span of a week were unheard-of, except in extraordinary circumstances.[62] Average trading volumes were dramatically lower than

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[59] Wellman v. Dickinson, 682 F.2d 355, 365–66 (2d Cir. 1982) (citing GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d Cir. 1971)).

[60] *See* Bebchuk & Jackson, *supra* note 6, at 51–53.

[61] *See supra* Parts I.A–B.

[62] *Cf.* Advisory Comm. on Tender Offers, SEC, Report of Recommendations (1983) [hereinafter Tender Offer Advisory Committee Report], *reprinted in* Fed. Sec. L. Rep. (CCH) No. 1028 (Extra Edition) xvi, 22 ("Since the Williams Act was adopted in 1968, acquisition practices have undergone fundamental changes, many in response to significant developments in the environment – *financial, technological, social and legal* – in which such acquisitions have taken place. . . . The 10-day window between the acquisition of more than a

they are today, causing rapid market accumulations at the time of the Williams Act to have a much more substantial impact on trading prices.[63] Swaps and other derivatives were not yet commonly used to obtain economic exposure to public securities. Thus, there was no reason to think that the ten-day disclosure window then imposed for administrative reasons would facilitate rapid, stealth accumulations far in excess of the reporting thresholds, thereby allowing activists to acquire massive stakes without public disclosure.[64]

The reality today is starkly different. The markets for publicly traded securities are astonishingly liquid. In the 1960s, the average daily trading volume for the entire S&P 500 was about 7.7 million shares; today, the average trading volume is over 4 billion shares.[65] Indeed, modern computerized trading allows massive volumes of shares to trade in a matter of microseconds.[66] Moreover, the increased use of derivatives has accelerated the ability of investors to rapidly accumulate economic exposure to public company stocks. Investors can now accumulate stakes of well over 10% within the ten-day reporting window, without any disclosure to the market and with limited effect on trading prices during the ten-day window.[67]

Bebchuk and Jackson do not legitimately attempt to refute this. Instead, they fault the Wachtell Lipton petition for highlighting only four "anecdotes" where such abusive accumulations have occurred, claiming that such evidence is insufficient to justify the rule change demanded.[68] But whether or not the examples identified in the petition are "typical" or represent some systematic abuse of the Section 13(d) disclosure requirements, or even whether some market participants choose to disclose their position earlier than the ten-day window,[69] misses the point. That these rapid, undisclosed accumulations can occur *at all* demonstrates definitively that the Section

5% interest and the required filing of a Schedule 13D was found to present a substantial opportunity for abuse, as the acquirer 'dashes' to buy as many shares as possible between the time it crosses the 5% threshold and the required filing date.") (emphasis added).

[63] *See NYSE Facts and Figures*, *supra* note 50.

[64] *Cf.* Tender Offer Advisory Committee Report, *supra* note 62 (recognizing that because "[t]he evolution of the market and innovation in takeover techniques may from time to time produce abuses," "[t]he regulatory framework should be flexible enough to allow the Commission to deal with such abuses as soon as they appear.").

[65] Jason Voss, CFA, *Fact File: S&P 500 Volume Data*, CFA Inst. Blog (May 2, 2012), http://blogs.cfainstitute.org/investor/2012/05/02/fact-file-sp-500-volume-data/.

[66] Nathaniel Popper, *On Wall Street, the Rising Cost of Faster Trades*, N.Y. Times, Aug. 13, 2012, at A1 (observing that, due to technological innovation, the "speed and complexity of the markets have continued to change at a rapid pace—with trade times now measured in millionths of a second . . . .").

[67] *See, e.g.*, Andrew Ross Sorkin, *Big Investors Appear Out of Thin Air*, N.Y. Times Dealbook (Nov. 1, 2010, 8:25 PM), http://dealbook.nytimes.com/2010/11/01/sorkin-big-investors-appear-out-of-thin-air/; Maxwell Murphy, *How Bill Ackman Stalked J.C. Penney*, Wall St. J. Deal Journal (Oct. 8, 2010, 3:50 PM), http://blogs.wsj.com/deals/2010/10/08/how-bill-ackman-stalked-jc-penney/.

[68] Bebchuk & Jackson, *supra* note 6, at 54.

[69] *See id.*

13(d) reporting rules are subject to abuse and no longer fulfill the purposes of the statute.[70] No detailed "study" is required to recognize this fact.

Indeed, there is a conspicuous tension in Bebchuk and Jackson's arguing, on the one hand, that blockholder accumulations during the ten-day reporting window are desirable and necessary to promote beneficial corporate monitoring such that any reform that would lead to the slightest reduction of this behavior should be rejected and, on the other hand, that such abusive accumulations during the ten-day reporting window are few and far between. Even if Bebchuk and Jackson are correct that abusive accumulations are rare, that is no reason to suggest that they should be unregulated, and even less of one to suggest that allowing them to occur without regulation or disclosure is important to the successful operation of our capital markets and the market for corporate control. Something cannot be both rare in occurrence but essential to good corporate governance.

B. Modern Corporate Governance Dynamics Provide No Reason to Decline to Modernize the Section 13(d) Reporting Rules.

Bebchuk and Jackson also insist that changes in the legal landscape for corporate governance warrant caution in proceeding with any modifications to the ten-day disclosure window. The authors' primary claim is that the advent and continued implementation of shareholder rights plans—including plans with triggers of as little as 10% or 15%—create powerful impediments to large stock accumulations and therefore have tipped the corporate governance balance in favor of incumbents.[71] This claim is not only irrelevant to the issue of whether or not to modernize the Section 13(d) reporting rules but entirely ignores recent corporate governance developments at U.S. public companies.

In fact, the number of U.S. public companies with poison pills in place has substantially *decreased* in recent years. At year-end 2011 only 10% of S&P 500 companies had a shareholder rights plan in place, down from 45% as recently as the end of 2005.[72] And while Bebchuk and Jackson note that any company without a pill can as a practical matter immediately implement an "off-the-shelf" plan to block further accumulation by an activist after they appear on the scene,[73] that is clearly irrelevant to the disclosure regime

[70] As was noted in the petition, the SEC has long recognized that changes in capital market trading and technologies have fostered abuse of the ten-day reporting window. *See* Tender Offer Advisory Committee Report, *supra* note 62; *see also* Letter from Harold M. Williams, Chairman, SEC, to the Senate Banking Comm. (Feb. 15, 1980) [hereinafter Williams Letter]; *Hearings Before the Subcomm. on Telecomm. and Finance of the House Comm. on Energy and Commerce Concerning Pending Legislation Regarding Contests for Corporate Control*, 100th Cong. 2 (1987) (statement of David S. Ruder, Chairman, U.S. Sec. & Exch. Comm'n).

[71] *See* Bebchuk & Jackson, *supra* note 6, at 55–57.

[72] SharkRepellant.net, *supra* note 53.

[73] Bebchuk & Jackson, *supra* note 6, at 57.

at issue here. Any accumulation already achieved prior to public disclosure cannot be prohibited or reversed by a later adopted rights plan. An "off-the-shelf" pill that by definition would not be implemented until public disclosure of a large share accumulation offers no impediment to the rapid, stealth accumulations prior to filing a Schedule 13D seen in recent years of up to, and even more than, 20% of a company's stock.

At any rate, the fact that in certain circumstances blockholders may be limited in the size of their accumulations by poison pills provides no basis to allow those blockholders to acquire those positions in secret. Section 13(d) is designed to mandate full disclosure of *all* rapid accumulations of stock. A board's theoretical ability to implement poison pills is no excuse to allow investors to continue to abuse the ten-day reporting window.[74]

C. Disclosure Requirements in Other Major Capital Markets Jurisdictions Validate the Need to Modify the Reporting Window under the Section 13(d) Rules.

As noted in the petition, *nearly every major capital markets jurisdiction in the world has a far shorter disclosure window than ten days*, including the United Kingdom, Germany, France, Italy, Spain, Switzerland, Australia, and Hong Kong:

- Australia generally requires disclosure of any position of 5% or more within two business days.[75]
- The United Kingdom requires disclosure of acquisitions in excess of 3% of an issuer's securities within two trading days.[76]
- Germany requires a report "immediately," but in no event later than four trading days after crossing the acquisition threshold.[77]
- France requires disclosure within four trading days after crossing the acquisition threshold.[78]

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[74] Bebchuk and Jackson claim that "[c]ompanies have also been adopting poison pills with 'continuing director' provisions triggered when a majority of directors is replaced with new directors not approved by the incumbents, thereby discouraging outside blockholders from attempting to run a proxy fight for a majority of the seats on the board." Bebchuk & Jackson, *supra* note 6, at 57. Bebchuk and Jackson offer no evidence of such "discouragement." Such "dead hand" pills are in fact exceedingly rare and have been explicitly rejected by a number of courts, including importantly in Delaware. *See, e.g.*, Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1287 (Del. 1998) (rejecting pill where "no newly elected board could redeem the Rights Plan for six months after taking office, if the purpose or effect of the redemption would be to facilitate a transaction with an 'Interested Person' (one who proposed, nominated or financially supported the election of the new directors to the board)"); Carmody v. Toll Bros., Inc., 723 A.2d 1180 (Del. Ch. 1998) (rejecting pill with continuing director provision).

[75] Corporations Act 2001 (Cth) § 671B (Austl.).

[76] Disclosure Rules and Transparency Rules, Ch. 5 (U.K.).

[77] Gesetz über den Wertpapierhandel [Securities Trading Act], Sept. 9, 1998, BGBL. I at 2708, as amended, pt. 5 (Ger.).

[78] AMF General Regulations, art. 223-14; Code de Commerce, art. R.233-1 (Fr.).

- Italy requires that disclosure be made "without delay," and in any event within five trading days of the transaction that gave rise to the obligation.[79]
- Spain requires that an investor who crosses the 3% threshold disclose such holdings within four trading days.[80]
- Switzerland requires disclosure of a 3% beneficial interest within four trading days.[81]
- Hong Kong securities laws require a report within three business days of the acquisition of a "notifiable interest" under the law.[82]

There is no reason why the United States should afford less protection to market participants from rapid, undisclosed accumulations of stock—without any limit—than investors have in other countries with well-developed capital markets. Bebchuk and Jackson nonetheless argue that ownership triggers and disclosure windows alone "offer[ ] an incomplete picture of the overall effect of legal rules on the role of blockholders in corporate governance" and that such other legal rules should be considered in connection with any determination whether to restore the Section 13(d) reporting regime to its intended effect, which would bring U.S. disclosure rules for large block accumulations in line with those of other countries.[83]

Specifically, Bebchuk and Jackson denigrate the U.S. corporate governance landscape, alleging that it "tilts the playing field against blockholders further than the law in any other advanced economy . . . [because the] United States is the only country in which incumbents can use shareholder rights plans to impose a ceiling on the size of the stakes that can be purchased by outside blockholders that incumbents do not favor."[84] Bebchuk and Jackson ignore that corporate governance rules generally and the regime of law and customary norms applicable to defense against unsolicited takeovers and activist shareholders are today ably regulated by a very well-developed and carefully balanced body of law articulated in the statutes and decisions of several states, most particularly by the Court of Chancery and the Supreme Court of Delaware.[85] Putting aside whether that is relevant to

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[79] Article 121 of the Regulation implementing Italian Legislative Decree No. 58 of 24 Feb. 1998 (It.).

[80] Royal Decree 1362/2007 art. 35 (Spain).

[81] Bundesgesetz über die Börsen und den Effektenhandel [Federal Act on Stock Exchanges and Securities Trading], Mar. 24, 1995, SR 954.1, art. 20; Verordnung der Eidgenössischen Finanzmarktaufsicht über die Börsen und den Effektenhandel [Ordinance of the Swiss Financial Market Supervisory Authority on Stock Exchanges and Securities Trading], Oct. 25, 2008, SR 954.193, art. 22 (Switz.).

[82] 证券及财务条例 》 第十五部 [Part XV of the Securities and Futures Ordinance] (promulgated by the Securities and Futures Commission, effective Apr. 1, 2003) (H.K.).

[83] Bebchuk & Jackson, *supra* note 6, at 58.

[84] *Id.* at 58–59.

[85] Bebchuk & Jackson also fail to note or acknowledge that the United States is marked by an exceedingly low incidence of controlled companies, pyramids and cross ownership as compared to other major securities markets, affording shareholders generally and blockholders in

the blockholder accumulation issue addressed in the petition, Bebchuk and Jackson present an incorrect caricature of the attitude of boards of U.S. public companies. It is incontrovertible that directors today are most decidedly not wantonly exercising their authority and discretion to "tilt the playing field" against shareholders, but are—with rare exceptions—highly attuned to shareholder interests and maximizing long-term value for the benefit of shareholders.

Bebchuk and Jackson are also wrong in suggesting that the legality of poison pills in the United States as compared to other countries creates a less robust market for corporate control or is otherwise contrary to the interests of shareholders generally. Although Bebchuk and Jackson paint the poison pill as an entrenchment device, shareholder rights plans play a crucial corporate governance role by, among other things, protecting shareholders from coercive, partial or two-tier tender offers, preventing creeping acquisitions of control, and enabling well-advised boards to craft and implement long-term value-creating business plans, with a modicum of protection for long-term shareholders seeing the expected fruit of that labor rather than having it expropriated by an opportunistic bidder able to win the support of short-term minded market professionals. Most other major capital markets jurisdictions have mandatory takeover bid requirements that play nearly identical functions.[86] These non-U.S. regulatory regimes preclude blockholders from obtaining certain ownership thresholds without making a tender offer for all shares of that company's stock, thus preventing blockholders from gaining creeping control or subjecting shareholders to coercive offers, and often contain strong price requirements, relating to prices paid in block-building exercises or prices in the market during relevant measurement periods. These mandatory takeover laws therefore substantially limit the stakes activists can

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the United States a particularly great opportunity and ability to influence the vast majority of corporate boards and management. *See* Lucian Arye Bebchuk, Reinier Kraakman & George G. Triantis, *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Cost of Separating Control from Cash-Flow Rights*, *in* CONCENTRATED CORPORATE OWNERSHIP 295 (Randall K. Morck, ed. Univ. of Chic. Press, 2000).

[86] *E.g.,* Corporations Act 2001 (Cth) §§ 606, 611, 616 (Austl.); City Code on Takeovers and Mergers, Rule 9 (U.K); Securities Law of the People's Republic of China Art. 88 (China); Bundesgesetz über die Börsen und den Effektenhandel [Federal Act on Stock Exchanges and Securities Trading], Mar. 24, 1995, SR 954.1, art. 32 (Switz.); Wertpapiererwerbs- und Übernahmegesetz [Securities Acquisition and Takeover Act], December 20, 2001, BGBL. I at 3822, as amended, pts. 4–5 (Ger.); Decree on Public Takeover Bids §§ 24–26 (Neth.); Royal Decree on Takeover Bids of 27 Apr. 2007, Moniteur Belge [M.B.] [Official Gazette of Belgium] of May 23, 2007 (Belg.); Financial Instruments and Exchange Act art. 27-2 (Japan); Sec. & Exch. Bd. of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, §§ 3, 4, 7, 8 (India); Brazilian Corporations Act, §§ 257–262 (Brazil); Federal Law on Joint Stock Companies, art. 84.2. Most of these foreign jurisdictions have additional rules that substantially regulate blockholder accumulations. For example, many countries require a bidder to either "put up or shut up"—that is, announce either a firm intention to bid or not to bid within a specified period of time from when the bidder was publicly identified—and further require that a bidder have unconditional financing when the bid is ultimately launched. *See e.g.,* City Code on Takeovers and Mergers, Rule 2 (U.K.); AMF General Regulation, arts. 223-32–223-35 (Fr.); Decree on Public Takeover Bids, §§ 2a, 7, 9a, 12, 16 (Neth.).

seek, and otherwise regulate the behavior of blockholders in ways entirely absent from the U.S. environment, which is partially offset by the use of rights plans in the United States. Differences between corporate governance rules in the United States and other jurisdictions simply provide no reason for the United States to lag behind other countries in its blockholder disclosure regime, and certainly no justification whatsoever for not modestly reforming the Section 13(d) reporting rules to comport with the intended purpose of the statute.

Conclusion

It has now been almost forty-five years since the passage of the Williams Act. The need for transparency and full and fair disclosure for the proper functioning of our capital markets is no less acute today than it was in 1968. But changes in modern capital markets—now orders of magnitude faster and more liquid than during the era of Senator Williams—have made the current Section 13(d) reporting rules obsolete and subject to abuse. These changes have not gone unnoticed by activists. They have used these loopholes to acquire substantial positions during the ten-day reporting window, unbeknownst to both counterparties and the market, and in direct contravention of Section 13(d)'s overarching aim to "alert investors in securities markets to potential changes in corporate control and to provide them with an opportunity to evaluate the effect of these potential changes."

Bebchuk and Jackson nonetheless resist modernization of the reporting rules. The professors urge that studies be done and that costs and benefits be assessed before any revisions to the reporting rules are made. But the "comprehensive examination" urged by Bebchuk and Jackson is neither prudent nor legally required, and their call for consideration of the potential impact on the profitability and effect of blockholdings is nothing but a distraction from the already identified overriding policy goal of market transparency and fairness to all market participants. It is a call to sacrifice our long-accepted goals of market transparency and fairness on the altar of endless and ultimately inconclusive academic debate about the costs and benefits of shareholder activism. Bebchuk and Jackson's position is simply a way to mire any call for reform in regulatory bureaucracy so that ultimately nothing is done and activists can continue to abuse the gaps in the current system to their advantage. Further delay in implementing the modest modifications proposed in the Wachtell Lipton petition would do a disservice to the principles of market transparency that are the foundation of Section 13(d). The time to modernize is now.