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Proposed Revisions to 13(d) Beneficial Ownership Reporting Rules

Posted by Theodore N. Mirvis, Wachtell, Lipton, Rosen & Katz, on Saturday, March 19, 2016

Editor's note: Theodore N. Mirvis is a partner in the Litigation Department at Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton publication by Mr. Mirvis, Adam O. Emmerich, David A. Katz, Sabastian V. Niles, and Jenna E. Levine. Related research from the Program on Corporate Governance includes The Law and Economics of Blockholder Disclosure by Lucian Bebchuk and Robert J. Jackson Jr. (discussed on the Forum here), and Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy by Lucian Bebchuk, Alon Brav, Robert J. Jackson Jr., and Wei Jiang.

Legislation introduced yesterday [March 17, 2016] in Congress calls for substantial steps to be taken towards increasing transparency and fairness in the public equity markets. If adopted, the Brokaw Act would direct the Securities and Exchange Commission to amend the Section 13(d) reporting rules. The proposed amendments would include shortening the filing window applicable to the acquisition of a 5% stake in an equity security from ten days to two business days and requiring the public reporting of significant "short" positions. The legislation would also broaden the scope of the rules by recognizing that possession of a pecuniary interest in a security constitutes beneficial ownership, and by specifically targeting the covert collusion of activist "wolf packs."

Regardless of who may have sponsored the Brokaw Act, modernizing these rules should appeal to those across the political spectrum who support the efficient and transparent functioning of our equity markets and wish to further the original Congressional intent of the beneficial ownership reporting rules. The financial markets and investors in publicly traded enterprises depend on a well-functioning, efficient market and are not well-served by permitting a small number of large, sophisticated fund managers to manipulate the markets in order to extract short-term gains to the detriment of investors generally. At a time when the SEC and other market actors are requiring greater transparency from public companies, boards and executives, the same policy concerns demand greater transparency with respect to the acquisition of equity securities of public companies by third parties.

The legislation comes at a time when the largest institutional investors are increasingly emphasizing the need for responsible development of long-term, sustainable value by U.S. corporations. In contrast, examples abound in recent years of activist shareholders accumulating large positions by stealth, demanding actions designed to boost short-term returns, and effectively forcing companies to cripple their long-term growth prospects as a result. These same activist investors may not even be economically aligned with other shareholders during the period of their investment, due to the use of derivative arrangements. As we recently discussed, increased transparency and effective action will be critical for companies seeking to earn the

support of the responsible, long-term institutional investor community and decrease their vulnerability to these activist attacks. Fixing the antiquated 13(d) reporting regime is another key piece of this puzzle, and action is long overdue. Sensible modernization of these rules can curb abuses (including those evidenced by reports of activist "tipping" prior to filing a Schedule 13D) while still permitting robust shareholder activism to continue.

We have long advocated that the SEC take steps to modernize the existing reporting regime, which is ripe for abuse and is routinely exploited. Sophisticated investors are able to use long reporting delays and the narrow definition of beneficial ownership to great advantage, at the direct expense of other market participants. Our prior rulemaking petition to the SEC similarly called for a shortened filing window (one business day) and an expanded definition of beneficial ownership, and further suggested the imposition of a "cooling-off period" prohibiting additional investment until proper disclosures have been made.

While the Brokaw Act takes a somewhat different approach to addressing certain of the same concerns, it would represent significant progress towards fairer and more efficient equity markets and strike a blow against short-termism and market abuses. This initiative merits bipartisan support and prompt consideration.