The Harvard Law School Forum on Corporate Governance and Financial Regulation

Activist Abuses Require SEC Action on Section 13(d) Reporting

Posted by Theodore Mirvis, Wachtell, Lipton, Rosen & Katz, on Monday March 31, 2014

Editor's Note: Theodore N. Mirvis is a partner in the Litigation Department at Wachtell, Lipton, Rosen & Katz. The following post is based on a Wachtell Lipton memorandum by Mr. Mirvis, Andrew R. Brownstein, Adam O. Emmerich, David A. Katz, and David C. Karp. Work from the Program on Corporate Governance about about Section 13(d) and blockholder disclosure includes The Law and Economics of Blockholder Disclosure by Lucian Bebchuk and Robert J. Jackson, Jr., discussed on the forum here.

Three years ago we petitioned the SEC to modernize the beneficial ownership reporting rules under Section 13(d) of the Securities Exchange Act of 1934 (see our rulemaking petition, our memos of March 7, 2011, April 15, 2011, March 3, 2008 and our article in the Harvard Business Law Review). Since we filed our petition, activist hedge funds have grown more brazen in exploiting the existing reporting rules to the disadvantage of ordinary investors.

The Wall Street Journal this week documented several, though not all, of the types of market abuse and manipulation that the current outmoded reporting rules permit and facilitate. The existing rules give activists an over-long 10-day period before they are required to report crossing the 5% ownership threshold in publicly traded companies. According to *The Wall Street Journal*, during the 10-day reporting window, activist hedge funds are "tipping" each other regarding their plans as they coordinate wolf-pack attacks, while ordinary investors and the targeted companies are left in the dark. When finally made, the 13(d) reports are often market-moving. This delivers outsized returns to the activist and those they tip, while injuring investors who are deprived of the same knowledge.

In an era of high frequency trading, the 10-day reporting window adopted by the Williams Act in 1968 simply makes no sense. It is time for the SEC to act on our petition to shorten the reporting window to one day, to adopt a "cooling-off period" of two business days following the public filing of an initial Schedule 13D, during which acquirers would be prohibited from acquiring additional beneficial ownership, and to modernize the definition of "beneficial ownership" under the Section 13 reporting rules to prevent activists from acquiring significant influence and control using a

variety of stealth techniques and derivative instruments to evade Section 13D reporting requirements.

The SEC must also act now to shorten the reporting period for institutional investors under 13(f), as proposed by NYSE Euronext, the Society of Corporate Secretaries and Governance Professionals and the National Investor Relations Institute (see our February 7, 2013 post).

These changes are necessary to protect investors and ensure the integrity and fairness of U.S. public securities markets. Only by comprehensively modernizing the reporting rules can the SEC reinvigorate the investor protections originally intended by the Williams Act and prevent the kinds of brazen abuses reported this week.