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Activist Hedge Funds and Academics Wrongly Oppose Fair Reporting of Accumulations of More Than 5% of a Company's Shares

In March 2011, our firm petitioned the SEC to modernize the blockholder reporting rules 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 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, 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 stockholder activists, to the detriment of market transparency and fairness to all security holders. Among other things, the petition proposed that the time to publicly disclose such block acquisitions be reduced from ten days to one business day, given activists' current ability to take advantage of the ten-day window to accumulate positions well above 5% prior to any public disclosure, in contravention of the clear purposes of the statute.

Activist hedge funds and academic commentators have challenged the need for any modifications to the ten-day window, arguing, among other things, that the purported benefits of secret blockholder accumulations mandate that extensive cost-benefit analysis be done before Section 13(d)'s reporting rules are modified in a way that could potentially discourage them. The Harvard Business Law Review will publish one such piece in a forthcoming issue, and its authors have widely promoted the idea that the existing flawed reporting rules promote corporate governance efficiency and benefit participants in the equity capital markets.

In a paper now available as Columbia Law and Economics Working Paper No. 428 we rebut these claims. In fact, there is no sound reason to question the need for the modernization of Section 13(d)'s reporting rules proposed in our petition. The bases advanced by the blockholder interests opposing these important changes run directly contrary to Section 13(d)'s underlying purpose – "to alert the marketplace to every large, rapid aggregation or accumulation of securities." It is widely understood that 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 window obsolete, allowing blockholders to contravene the purposes of the statute by accumulating large, control-implicating positions prior to any disclosure to the market.

Activists and their academic supporters seek to mire any call for reform in regulatory bureaucracy so that nothing ultimately is done, and activists can continue to abuse the gaps in the current system to their advantage. But further delay in implementing the modest modifications proposed in our petition are a disservice to the principles of market transparency and fairness to all market participants that are the foundation of Section 13(d). The time to modernize is now.

Theodore N. Mirvis
Adam O. Emmerich
Eric S. Robinson
William Savitt