April 11, 2022

Expanding on the SEC's Proposal to
Modernize Section 13(d) and (g) Beneficial Ownership Reporting

We have today submitted to the SEC comments with respect to its proposed amendments to Regulation 13D-G to modernize the beneficial ownership reporting rules for public markets. Our comment letter is attached. While the SEC's proposed rules and accompanying release reflect a thoughtful, commonsense approach to disclosure reform in this important area, the beneficial ownership reporting regime could benefit from additional updating and evolution in a number of areas, as set out in our comment letter.

We encourage issuers and other stakeholders to support the SEC's rulemaking initiative, including the proposals set forth in our comment letter.

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April 11, 2022

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Comments on Release Nos. 33-11030; 34-94211; File Number S7-06-22

Dear Ms. Countryman:

We are pleased to submit the following comments with respect to the Securities and Exchange Commission's Release Nos. 33-11030; 34-94211; File No. S7-06-22 (the "Release"). We have long been advocates for reform in this area and we have previously petitioned the Commission for rulemaking to modernize aspects of the beneficial ownership reporting rules that are the subject of the Release.[1] The Commission's proposed rulemaking

[1] Petition for Rulemaking Under Section 13 of the Securities Exchange Act of 1934, submitted by Wachtell, Lipton, Rosen & Katz (Mar. 7, 2011), File No. 4-624, available at http://www.sec.gov/rules/petitions/2011/petn4-624.pdf ("WLRK Section 13 Petition"); Letter from Wachtell, Lipton, Rosen & Katz to Elizabeth M. Murphy, Secretary, Securities & Exchange Commission (Apr. 15, 2011), available at https://www.sec.gov/comments/s7-10-11/s71011-2.pdf; letter from Wachtell, Lipton, Rosen & Katz to Ms. Vanessa A. Countryman, Secretary, Securities &

outlined in the Release (the "Proposal") is an important step forward for market transparency and addresses many of the deficiencies in the current rules that inappropriately permit investors to accumulate significant stakes in publicly traded securities in secrecy and profit from information asymmetries at the expense of other market participants. We applaud the efforts of the Commission and the Staff in making the Proposal and creating greater market transparency.

We, however, urge the Commission to take further steps to ensure that Section 13(d) of the Securities Exchange Act of 1934 (as amended, the "Exchange Act") completely fulfills its stated purpose, which is 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."[2] Specifically, we recommend the adoption of the following additional changes to ensure that the amended rules deliver greater accountability, transparency and fairness to the public markets:

- Require initial Schedule 13D filings to be made within one business day, instead of five days, following the crossing of the five percent ownership threshold;

- Institute a moratorium on the acquisition of beneficial ownership of additional equity securities of an issuer by any acquirer required to file a Schedule 13D that would be in effect from the acquisition of a 5% ownership stake until two business days after filing the Schedule 13D;

- Revise the definition of "beneficial ownership" under Rule 13d-3 to include ownership of any derivative instrument that includes the opportunity, directly or indirectly, to profit or share in any profit derived from any increase in the value of the subject security (with exceptions discussed in our petition to the Commission and related writing)[3]; and

- Require groups formed for the purpose of acquiring a substantial equity investment in an issuer in order to influence control of that issuer to ensure that they are, and remain, aware of the equity ownership of the group members in that issuer and not remain willfully blind so as to avoid their disclosure obligations under Section 13(d).

The above recommendations will help bring the Proposal in line with the Commission's proposed rulemaking with respect to security-based swap transactions that would

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Exchange Commission (Sept. 29, 2020), available at https://www.sec.gov/comments/s7-08-20/s70820-7860154-223924.pdf.

[2] *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)).

[3] *See* WLRK Section 13 Petition at 8; *see also* Theodore N. Mirvis, Adam O. Emmerich & Adam M. Gogolak, *Beneficial Ownership of Equity Derivatives and Short Positions – A Modest Proposal to Bring the 13D Reporting System into the 21st Century* (Mar. 3, 2008) ("A Modest Proposal") at 13d-3-3, available at https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.15395.08.pdf.

require a one-day reporting window for applicable equity-based swaps.[4] Our recommendations are also in line with existing comparable disclosure requirements in other sophisticated jurisdictions (including the United Kingdom, Germany, Australia and Hong Kong). Moreover, it has been over a decade since the Dodd-Frank Act modified Section 13(d)(1) of the Exchange Act to expressly permit the Commission to reduce the ten-day beneficial ownership reporting window[5] and the abuses[6] we have witnessed over the past decade only further underscore the urgent need to correct the power and information imbalance between select hedge funds and activist investors and the rest of the investing public, that have allowed the former to benefit from the anachronistic rules at the expense of the latter.

Initial Schedule 13D Filing Window

As we have previously noted in our comment letters and petition to the Commission, the current reporting window under Rule 13d is far too long, enabling the continued trading of millions of shares before market-moving information is eventually revealed to the public.[7] In today's world, where significant purchases of public securities can be executed in a matter of seconds and where voting and economic interests can be further amplified through the use of derivative securities, five days can be an eternity.[8] If the Commission adopts a five-day window for Schedule 13D filings, the rules will still substantially fail to serve the purpose of the Williams Act to require the timely release of information to the investing public with respect to the accumulation of substantial ownership of an issuer's voting securities.[9] In today's trading environment, a five-day filing window continues to provide hedge funds and activist shareholders ample time to accrue significant stakes in an issuer and improperly exploit, and profit from, information asymmetries at the expense of other public investors.

We also respectfully ask the Commission to draw a distinction between short-term profiteering (which benefits a small minority of activist shareholders at the expense of other

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[4] Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions, Release No. 34-93784; File No. S7-32-10 (Dec. 15, 2021).

[5] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1375 (2010); see in particular §§766(e) and 929R.

[6] *See* Theodore N. Mirvis, Andrew R. Brownstein, Adam O. Emmerich, David A. Katz and David C. Karp, *Activist Hedge Fund Abuses Require Immediate SEC Action to Modernize Section 13(d) Reporting Rules and Ensure Fair Reporting of Substantial Share Accumulations* (Mar. 28, 2014), available at https://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.23259.14.pdf.; Susan Pulliam et al., *Activist Investors Often Leak Their Plans to a Favored Few: Strategically Placed Tips Build Alliances for Campaigns at Target Companies*, Wall Street J. (Mar. 26, 2014), available at https://www.wsj.com/articles/activist-investors-often-leak-plans-to-peers-ahead-of-time-1395882780.

[7] WLRK Section 13 Petition at 3.

[8] As noted below, if the Commission were to adopt a moratorium on additional purchases from the acquisition of a 5% ownership stake until two business days after filing the Schedule 13D, the five-day period is less important and most acquirors will likely file their Schedule 13D earlier in order to avoid prolonging the moratorium.

[9] S. Rep. No. 550, 90th Cong. 1st Sess. 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.").

public investors) and long-term value creation. While a Schedule 13D filing by an activist may often lead to an immediate bump in the issuer's stock price, there remains no compelling evidence that activist interventions deliver long-term value to shareholders.[10] Accordingly, we urge the Commission to be cautious in determining whether investors seeking to change or influence control of issuers ought to be further incentivized by a longer reporting window, as suggested in the Release. In any event, the shortening of the Schedule 13D window, as the Commission notes, is more likely to adversely affect short-term behaviors than long-term oriented activism—shortening the reporting window to one day will only help to further deter opportunistic short-term trading.

We further note that the compliance costs of the Proposal are unlikely to be unduly burdensome, in a manner that outweighs the benefits, on covered shareholders given technological developments during the fifty years since the rules were introduced, including the automation of trading reporting. The type of investor that acquires a 5% stake in a public company and may become subject to Schedule 13D will almost certainly be well-resourced and experienced enough to make prompt filings, especially as a Schedule 13D filing can be substantially completed prior to crossing the reportable threshold. We also note that, in recent years, the Commission has moved to shorten the reporting window for other key periodic reports, including Current Reports on Form 8-K,[11] Statements of Changes in Beneficial Ownership for officers, directors and 10% shareholders,[12] and disclosures in compliance with Regulation FD.[13] We note that the compliance window for each of these disclosures, together with the Commission's proposed disclosures relating to equity-based swaps,[14] ranges from the same day to four business days—all shorter than the proposed five-day window for Schedule 13D filings. Given the Commission's trend toward encouraging more immediate disclosure of material information to investors and the speed at which information travels through today's markets, we urge the Commission to adopt a one business day window for Schedule 13D filings.

Moratorium on Acquisitions After 5% Threshold is Crossed

As we have previously noted in our comment letters and petition to the Commission,[15] we regard a moratorium on acquiring beneficial ownership of any additional equity securities of an issuer from the acquisition of a 5% ownership stake until two business days after filing the Schedule 13D as necessary to address informational asymmetries and to

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[10] *See* John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 565–66 (2016); *see also* Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1896–97 (2017).

[11] Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, Release Nos. 33-8400, 34-49424; File No. S7-22-02 (Mar. 16, 2004).

[12] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Release Nos. 34-46421, 35-27563, IC-25720; File No. S7-31-02 (Aug. 27, 2002).

[13] Selective Disclosure and Insider Trading, Release Nos. 33-7881, 34-43154, IC-24599; File No. S7-31-99 (Aug. 15, 2000) (adopting Regulation FD).

[14] *Supra* note 3.

[15] *Supra* note 1.

ensure the public markets have sufficient time to assess and react to the potential impact of the Schedule 13D disclosure. With the current ten-day reporting lag, investors can—and frequently do—continue to accumulate significant stakes that enhance their ability to influence and acquire potential control over an issuer without the knowledge of the issuer and other shareholders.[16] Even with a one-day reporting lag, investors can still accumulate significant interests without the knowledge of the broader market. Indeed, the very brief "cooling-off" period we propose is akin to the ten business day cooling off period applicable to passive investors switching from Schedule 13G filers to Schedule 13D filers; its purpose being to "prevent further acquisitions or the voting of the subject securities until the market and investors have been given time to react to the information in the Schedule 13D filing."[17] In 1987, then-Chairman David Ruder of the Commission proposed that the filing deadline be reduced to five business days and that the filing person be prohibited from acquiring additional securities until the filing was made.[18]

The Commission states in the Proposal that "[i]n proposing to establish new timeframes for filing reports, we are mindful of the need to balance the market's demand for timely information against the administrative burden placed upon a filer to adequately and accurately prepare that information."[19] It is unclear why, at the same time that the Commission is establishing a one business day filing deadline for material amendments to Schedule 13D, the Commission believes that five days are needed to prepare the initial filing. But, if the Commission were to adopt its proposed five-day initial filing period for Schedule 13D, implementing our recommended moratorium on additional trading until two business days after filing would be even more critical, as it could significantly address the informational asymmetries provided by the reporting delay.

The Commission also references in the Proposal the legislative history that in enacting the Williams Act, Congress considered the interests of both issuers and persons making takeover bids. However, there is no specific evidence that the length of the ten-day window was based on a balancing of such interests rather than just the pragmatic and administrative issues associated with making such a filing in 1968.[20] Indeed, in 1983, the Advisory Committee on Tender Offers established by the Commission cited the ten-day window as "a substantial opportunity for abuse, as the acquiror 'dashes' to buy as many shares as possible between the

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[16] *Id.* at 3.

[17] Amendment to Beneficial Ownership Reporting Requirements, Release No. 34-39538; File No. S7-16-96 (Jan. 12, 1998).

[18] Statement of David S. Ruder, Chairman of the Securities and Exchange Commission, Before the House Subcommittee on Telecommunications and Finance, Sept. 17, 1987; Statement of Charles C. Cox, Acting Chairman of the Securities and Exchange Commission, Before the Senate Committee on Banking, Housing and Urban Affairs, June 23, 1987 ("[The] Commission could also support legislation to require that a Schedule 13D be filed within five business days of crossing the 5 percent threshold, and that a prohibition on further purchases be imposed until the filing requirement is satisfied.").

[19] Release at 14.

[20] The article cited in the Proposal relies only on circumstantial evidence that would equally apply to every subsection included in the final version of the Williams Act, without any direct evidence that Congress crafted the ten-day window for that purpose. *See* Lucian A. Bebchuk and Robert J. Jackson Jr., *The Law and Economics of Blockholder Disclosure*, 2 HARV. BUS. L. REV. 39, 44-47 (2012).

time it crosses the 5% threshold and the required filing date."[21] The Commission should act to correct such abuses, not to incentivize them by permitting further purchases after crossing the 5% threshold prior to filing the Schedule 13D.

Definition of Beneficial Ownership

While the Commission's proposal to deem holders of certain cash-settled derivatives as beneficial owners of the reference securities goes some way in addressing the myriad of avenues in which an investor can acquire influence and control over an issuer, many loopholes remain open. Investors have used—and continue to use—swaps and other equity derivatives, including long and short position swaps and derivatives (cash-settled and otherwise) to exert voting influence and control over issuers in a manner that is neither captured under the existing beneficial ownership definition nor under the proposed amendments to Rule 13d-3. The influence of such instruments can be substantial: the instruments decouple economic ownership from voting rights and provide investors the ability to quickly morph from mere economic ownership to economic ownership and voting rights.[22] In addition, the counterparties to these arrangements often hedge their positions by buying or selling the underlying securities, further impacting the trading of such securities.

As we have stated in the past, the definition of "beneficial ownership" should encompass ownership of any derivative instrument that includes the opportunity, directly or indirectly, to profit or share in any profit from any increase in the value of the subject security.[23] Specifically, our view is that derivative instruments should include, subject to limited exceptions discussed in our petition to the Commission and related writing:[24]

> Any option, warrant, convertible security, stock appreciation right or similar right with an exercise or conversion privilege or a settlement payment or mechanism at a price related to an equity security, or similar instrument with a value derived in whole or in part from the value of an equity security, whether or not such instrument or right shall be subject to settlement in the underlying security or otherwise.

Beneficial ownership should also extend to short positions in a security, as we view such positions as having the same potential as long positions to influence the trading of the subject security. Only through a proper and coherent definition of beneficial ownership can we be assured that investors who enter into arrangements that have the same economic effect and

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[21] Advisory Committee on Tender Offers, SEC, Report of Recommendations (July 8, 1983), reprinted in Fed. Sec. L Rep. (CCH) No. 1028 (Extra Edition) 22.
[22] Henry T. C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006), and Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 Iowa J. Corp. L. 681 (2007).
[23] WLRK Section 13 Petition at 8.
[24] *See supra* note 3.

market impact as ordinary trading will be subject to the same level of disclosure under Rule 13d-3.

Prohibition of Circumvention by Willful Blindness

Some hedge funds pursue activism by creating special purpose vehicles through which they create a formal group of investors, often in the form of a limited partnership or limited liability company, who may pool their resources to acquire a large enough investment in a public issuer to assume or influence control. This is squarely within the language and spirit of the group concept as defined. Section 13(d)(3) states: "When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a ''person'' for the purposes of this subsection." Although the statute and rules promulgated by the Commission do not limit the filing obligations to shareholders of the issuer, certain judicial pronouncements have narrowed the "group" required to file to those members who own shares.[25]

It appears that some activist hedge funds seek to avoid the filing obligation of the group they are putting together by avoiding asking members of their group whether they are shareholders of the issuer and sometimes allowing them to subsequently become shareholders without having to inform them of their trading in the shares (although the organizing activist investor is leading the group and thus responsible for the group's securities law compliance). This "willful blindness" enables the group to accumulate larger undisclosed positions in the issuer than if they knew of all group members' trading and can lead to filings being made later than they should be and not including all required information. This also relates to the Commission ensuring that director candidates nominated by a 13D filer are included as group members, whether or not they are also investors in the special purpose vehicle (or the activist investors' general fund).

The Commission should close this loophole and end this abuse by requiring any person building a group through a special purpose vehicle for the purpose of acquiring an investment in a public issuer to influence its control to ensure that it is at all times aware of the holdings of the members in the group (that is, the investors in the vehicle who are investing for that purpose) so that the group can fulfill its obligations under Regulation 13D. Willful blindness should not be an excuse for noncompliance.

* * *

We applaud the Commission's work in proposing much needed amendments to modernize aspects of the beneficial ownership reporting rules that have become increasingly outdated since the passage of the Williams Act over half a century ago and which have provided significant opportunities for abuse by hedge funds and activist investors at the expense of the

[25] *See, e.g., Hemispherix Biopharma, Inc.* v. *Johannesburg Consolidated Investments,* 553 F.3d 1351 (11th Cir. 2008).

broader investing public. We urge the Commission to take this opportunity to incorporate our recommendations, which are necessary to mitigate the ongoing practice of stealth and ambush accumulations of significant direct and derivative stakes in U.S. public companies. In an age where trades are made in nanoseconds and reported automatically, the Proposal, even as modified with our recommendations, should hardly present a burden to the sophisticated shareholders who typically cross the 5% ownership threshold.

We appreciate this opportunity to submit, and the Commission's consideration of, our comments on the Release. We ask the Staff to contact any of Theodore N. Mirvis, Eric S. Robinson, Adam O. Emmerich, David A. Katz, Trevor S. Norwitz, William D. Savitt, Sabastian V. Niles or Carmen X. W. Lu at (212) 403-1000 should it have any questions.

Very truly yours,

Wachtell, Lipton, Rosen & Katz

Wachtell, Lipton, Rosen & Katz