COUNCIL FOR INVESTOR RIGHTS AND CORPORATE ACCOUNTABILITY

Via electronic mail (rule-Comments@sec.gov)

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Memorandum by the Staff of the Division of Economic and Risk Analysis

Dear Ms. Countryman:

We are a consortium of institutional investors, known as the Council for Investor Rights and Corporate Accountability ("**CIRCA**") who believe that a well-functioning system of corporate accountability is essential to protect investors and maintain well-functioning, capital markets in the U.S.

This is the fifth comment letter that we have submitted regarding the proposals of the SEC to amend the current beneficial ownership reporting requirements under Section 13(d) of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**") (Release Nos. 33-11030; 34-94211) (the "**13D-G Proposal**") and establish security-based swap reporting requirements (Release No. 34-93784) (the "**Security-Based Swap Proposal**" and together with the 13D-G Proposal, the "**Proposals**"). Our focus of time and resources on the Proposals is due to our conviction that their adoption will cause unprecedented damage to investors, the U.S. capital markets and the U.S. corporate governance system.

We are responding to the Memorandum published by the Securities and Exchange Commission (the "**SEC**") and its staff in the Division of Economic and Risk Analysis ("**DERA**") regarding the Schedule 13D shortened filing period in the 13D-G Proposal (the "**DERA Memorandum**"). While the DERA analysis was thoughtfully prepared, it covered only one of the major issues raised by the Proposals — *i.e.*, the shortening of the Schedule 13D filing period from ten days to five days — and, even on that single issue, was inconclusive regarding whether the proposed changes were warranted or would achieve the SEC's mission to "protect investors, maintain fair, orderly, and efficient markets and facilitate capital formation."[1] The study did not consider whether the Proposals will promote "efficiency, competition and capital formation" in satisfaction of the SEC's statutory goals.[2]

The dearth of analysis regarding investor benefits and market impact by the SEC in the proposing releases for the Proposals and the lack of persuasive evidence regarding investor and market benefits based on the shortening of the filing period in the DERA Memorandum together result in

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[1] *See* The Role of the SEC, SEC Website at https://www.investor.gov/introduction-investing/investing-basics/role-sec.

[2] 15 U.S.C. § 78c(f) ("Whenever pursuant to this chapter the Commission is engaged in rulemaking . . . and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.").

a failure by the SEC to meet its statutory obligations under the Administrative Procedure Act, the Exchange Act and the "major question doctrine." The Proposals should be abandoned.

1. The DERA Memorandum Failed to Address Material Elements of the Proposals

In December 2021, the SEC proposed Rule 10B-1 — the Security-Based Swap Proposal — as part of a package of proposals relating to security-based swaps.[3] The release for the Security-Based Swap Proposal failed to explain why public reporting of security-based swaps was necessary or appropriate in the public interest or explain why the proposal would protect investors and promote efficiency, competition and capital formation.[4] The discussion also, importantly, failed to consider the impact of public reporting on activist investors or the costs to the capital markets in disincentivizing activism. Although this proposal was not included in the currently DERA Memorandum, the SEC recently re-opened the comment period for the Security-Based Swap Proposal and DERA published an additional analysis regarding that proposal.[5] While we intend to comment on the new study, we note that it concludes that over half of the entities surveyed would have been required to report their security-based swaps under Rule 10B-1.[6] That finding suggests that the Security-Based Swap Proposal would have a harmful impact on shareholder activism, but neither that study nor the current DERA Memorandum analyzes how those losses would affect shareholders or the market generally.

The current DERA Memorandum fails to address material elements of the 13D-G Proposal, including a proposal to substantially expand the circumstances under which two or more persons are deemed to have formed a "group" subject to the beneficial ownership reporting obligations under Section 13(d) of the Exchange Act. As we previously noted,[7] the revised "group" definition will almost certainly chill the ability of shareholders to communicate among themselves — not only when a shareholder is an activist but more generally in respect to all interactions between investors. The proposed definition of "group" undermines the ability of activist investors to earn

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3 SEC Rel. No. 34-93784 (Dec. 15, 2021) at 117 [87 FR 6652 (Feb. 4, 2022) at 6691].

4 As we noted in our comment letter of March 21, 2022 to Proposed Rule 10B-1, available here, we agree that the stated purpose underlying the Proposal of facilitating SEC oversight of the security-based swap market was a legitimate objective. However, from a cost-benefit analysis, we noted that this objective could be equally well achieved by requiring non-public security-based swap reporting, as the Commodity Futures Trading Commission (the "**CFTC**") requires for swaps. By structuring a final rule in that manner, the SEC could achieve an important objective without causing the harm to investors and the market that we believe would ensue based on public reporting.

5 *See* SEC Rel.No.34-97762 (June 20, 2023) and Memorandum from the Division of Economic and Risk Analysis available at https://www.sec.gov/comments/s7-32-10/s73210-207819-419422.pdf ("June DERA Memorandum").

6 June DERA Memorandum at 11 ("In summary, under the reporting thresholds in proposed Rule 10B-1, the Schedule 13D Lead Filer in five of the nine Schedule 13D filings considered would have had to report under proposed Rule 10B-1.").

7 *See* CIRCA Comment Letter of April 11, 2022 to the 13D-G Proposal, available here.

a profit on their capital outlay and thereby removes an important incentive for investors to seek to reform non-performing companies.

The DERA Memorandum, similarly, does not address the SEC's proposed adoption of a beneficial ownership rule for specified cash-settled derivatives solely for activists. This proposed rule creates dangerous new lines in the definitions of "ownership" that are likely to cause investor confusion and could have harmful knock-on effects under other control statutes.[8] The failure of the current DERA Memorandum to analyze these proposals is surprising and disappointing given the lack of analysis in the proposing releases, as noted in CIRCA's comment letter.[9] The SEC has an obligation to address the impact of these proposals on investors and the market generally. The cost benefit analysis carried out by the SEC continues to be incomplete— regardless of whether the DERA Memorandum convincingly makes the case for shortening the Schedule 13D filing period, which, as explained below, it does not.

2. The DERA Memorandum did not Adequately Address the Economic Impact of Shortening of the Schedule 13D Filing Period

The DERA Memorandum Failed to Consider the Harm of Entrenching Management

The DERA Memorandum identifies two perceived "harms" that the shortening of the Schedule 13D filing period is designed to address, namely: (i) foregone profit by shareholders who sell their holdings to activists and thereby forego the substantial gains that activist investing often generates and (ii) a resulting lack of trust by investors in markets because they missed out on a good investment opportunity because activists do not have to disclose greater than 5% positions for 10 days.[10] These perceived harms are amorphous, and DERA has not made any attempt to prove or quantify them.[11] In our view, there are substantially more significant and concrete harms, which

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[8] For example, if a pension plan holds an options overlay on its stock investments to protect the retiree from market depreciation and the plan has been critical of the management of the issuers whose stock underlies the options overlay, the plan could be deemed to be an "affiliate" by virtue of the "deemed" ownership through the derivative and, as a result, constrained in its ability to sell securities absent registration by the issuer. This is a surprising and draconian result. At a minimum, the imposition of deemed beneficial ownership should incent investors not to be deemed to be "activists" and, therefore, not to speak with activists or criticize management regardless of how egregious management's conduct might be.

[9] *See* CIRCA Comment Letter of April 11, 2022, available here.

[10] DERA suggests that abnormal trading returns are available to informed traders in the context of an activist accumulation campaign in which main street investors do not share. From this, DERA infers that the presence of the asymmetric information among actively trading market participants raises fairness concerns and causes allocative inefficiency.

[11] For example, the DERA analysis does not include any comparative pricing information regarding the short-term price improvement generated by the activist buyers' participation in the market that is a "benefit" which should be balanced against the perceived "harm" of selling prior to the filing of the Schedule 13D. Similarly, DERA fails to analyze the nature of the sellers and their reasons for selling. As a result, it is not clear that the sellers ever would have retained their holdings, even if they had known that an activist was commencing a campaign. Finally, DERA fails to demonstrate that acceleration of filing deadlines, such as those that have been required in

DERA did not address, that are highly likely to harm investors if the SEC *adopts* the proposal. The harms to be realized due to *adoption* of the shortened filing period include disincentivizing activists from carrying out campaigns against underperforming management, undermining the critical role activists play in holding corporate management and directors accountable and removing the liquidity and price improvement that activists provide to the public markets.

These are critical harms. Elimination of activism will fundamentally change and, in our view, seriously damage, our markets by eliminating management accountability to shareholders. As writer, Matt Levine, of Bloomberg, notes:

> "[A]ctivism is one of the few ways that shareholders can exercise real power over the companies that they theoretically own. . . . [I]f a company's board and managers want to ignore their shareholders, they mostly can. The only ways that shareholders in the U.S. can actually *fire* the board and CEO of a public company are (1) a proxy fight or (2) a hostile takeover . . . [w]hen companies *don't* do the . . . things that shareholders want, there will be . . . activists and proxy fights because *activism is the enforcement mechanism that shareholders use to influence companies*." (emphasis added)[12]

The potential harm to investors and to the capital markets generally from thwarting the ability of activist investors to bring actions against poorly performing managers and corporate directors was not addressed in the current DERA Memorandum or by the SEC or its staff in other publications.[13] Instead, the SEC staff concludes that activism may have positive or negative effects on investors, noting, as to negative impact, that the proposal would harm "suppliers and close competitors of the targeted issuers," and should have a "mixed" impact on debtholders of the targeted issuers. In its evaluation, DERA does not analyze the potential positive impact of activism on equity shareholders and management accountability.[14]

This is not an adequate analysis for the purpose of satisfying the Administrative Procedure Act standard. First, the focus on "suppliers and close competitors of the targeted issuers" is misplaced because that designated group is not one that the SEC is commissioned by the Exchange Act to protect. Second, although debtholders are "investors" and, as a result, part of the class of persons

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other contexts, such as the acceleration of filing deadlines for Forms 3 and 4, have changed the investors' behavior or enhanced their level of trust in the market.

12 Matt Levine, *The SEC Wants to Stop Activism*, BLOOMBERG OPINIONS (Mar. 24, 2022, 1:35 PM), https://www.bloomberg.com/opinion/articles/2022-03-24/the-sec-wants-to-stop-activism.

13 In our view, the only true alternatives to corporate governance activism are (i) bankruptcy reorganizations and (ii) mergers and acquisitions. In light of this, elimination of activism — or, at a minimum, reduction of the effectiveness of activists to carry out shareholder campaigns against failing managers — is significant because there is not a good replacement to carry out the watchdog function.

14 Comment letter of David H. Webber, Boston University School of Law, to the SEC, Regarding Modernization of Beneficial Ownership Reporting, Release Nos. 33-11030; 34-94211 (Apr. 11, 2022) ("Webber Comment Letter") ("Whatever problems we may face in America, we should all agree that an overabundance of corporate accountability is not one of them.").

whom the SEC must also consider under its statutory mandate, the impact of the proposal on long-term equity shareholders, who are the owners of the targeted issuers and important intended beneficiaries of SEC regulation, is only cursorily discussed.[15] The analysis does not does not attempt to balance the loss to long-term shareholders of higher returns due to activist campaigns against the reduction of the perceived harms.[16] Third, DERA does not address the risks to corporate accountability or to shareholders and the market generally arising from the Proposals (as a whole) and the possibility that the Proposals will allow poorly-performing management and directors to permanently entrench themselves—to the detriment not only of shareholders but also to the detriment of other constituencies, such as workers and organized labor.[17] The SEC is required to address this "harm" and it has not done so—either through the DERA Memorandum or in the releases for the Proposals.

<u>DERA Failed to Address the Positive Price Impact of Activism on Long-Term Shareholders</u>

Activism is one of the few investment strategies where a single actor or group does all the work and provides all of the capital for the broader group of investors but receives only a portion of the

[15] For example, in the 43 times in which the DERA Memorandum discussed shareholders and shareholder value in the DERA Memorandum (excluding the 6 times that the term shareholder simply appeared in the title of an article cited by DERA), 30 of the references relate to shareholders selling to activists, 6 relate to long-term shareholders of the target company, 4 relate to shareholders of competitors of the issuers, and 3 relate to general, non-value related references to "shareholders." The DERA Memorandum also buries apparent conclusions regarding the value of activism on increases in shareholder value in the middle of discussions regarding shortening of the Schedule 13D filing period without analyzing the consequences of this value. *See, e.g.,* DERA Memorandum at 19 ("For example, while certain benefits of the shortened deadline would be preserved in cases where the filer adapts by simply proceeding with a smaller stake, academic studies have found that lower levels of activist ownership are associated with smaller increases in shareholder value.").

[16] *See* DERA Memorandum at 19. DERA's lack of discussion regarding the potential loss of long-term shareholder value due to a decline in activism appears to stem in part from DERA's determination that it cannot predict how activists will react to the proposal. *See id.* at 11 ("Further, we are unable to ascertain the likelihood of the potential impacts on activism discussed in this section because we cannot predict with a reasonable degree of certainty how activists and other market participants would respond to the proposed changes."). This information gap seems odd given the large number of comment letters from activist investors informing the SEC that the proposal would make them less likely to carry out activist campaigns.

[17] *See* Webber Comment Letter ("I also have written about pension fund efforts on behalf of worker representation and worker pay, efforts that the Proposed Beneficial Ownership Rules could chill, not only when a shareholder activist already is involved at a targeted company but more generally because of the risk that investors could be deemed a member of a "group" with a shareholder activist after the fact. Advocates for workers should not labor under a cloud of such uncertainty and risk. In addition, workers who invest in the stock market, either through pension plans or in their own personal accounts, benefit from shareholder activism to the extent it is associated with increased financial returns."); *but see* Michelle Celarier, *The Ferocious Well-Heeled Battle Against the SEC's New Rules on Hedge Fund Activism*, INSTITUTIONAL INVESTOR, Jun. 21, 2022, available here. ("I find any potential confusion about the labor movement's position on hedge fund disclosure surprising given that even a cursory search of the AFL-CIO's website would find an executive council statement going back to 2007 that was highly critical of activist hedge funds and particularly the secrecy around it," says Brandon Rees, deputy director of corporations and capital markets at the AFL-CIO.").

reward. Other shareholders can ride freely on the activist's efforts and receive a substantial portfolio of the economic benefits. We are not aware of any other trading strategy where the bulk of the benefits are shared with shareholders that do not invest capital in the strategy. The DERA Memorandum fails to adequately quantify the benefits to long-term shareholders of the target issuer in the form of substantially higher share prices.[18] The SEC should direct DERA to correct this oversight.

3. DERA does not provide Compelling Arguments for Shortening the 13D Filing Period

Information Asymmetry does not justify Truncating the Filing Deadline for Schedule 13D

DERA states that shareholders selling to an activist between the proposed Schedule 13D filing deadline and the current Schedule 13D filing deadline are harmed due to the fact they do not price the shares they are selling as a result of "information asymmetry," *i.e.*, the selling shareholders do not know that the buyers are planning to launch an activist campaign. DERA suggests that allowing activists to buy stock for an additional five days without disclosing that the buyer is an activist is unfair because the activist's campaign may drive up the value of the issuer's stock price. DERA assumes that these selling investors might make different pricing and trading decisions with respect to the securities being purchased by the activist if there were earlier-disclosed information. In our view, the fact that activists develop their own investment strategy and do not offer it up to others free of charge is neither unfair nor inefficient. Basic market functions, like efficient price discovery and liquidity, are premised on the fact that buyers and sellers have differing views on value and engage in trading to express those views, with a hope to profit. The motive for activists to expend the considerable time and resources they do researching investment opportunities is driven by a desire to achieve strong investment returns. As far as fairness concerns go, all buyers and sellers in the market understand the other may have a significantly different view of a security's value and may have good (or bad) reasons for it. That said, so long as neither of the counterparties to a securities transaction has material non-public information about the issuer (which activists do not)[19] and the trade does not result in an undisclosed coercive back-ended two-tiered tender offer and forced merger, neither group of investors should be forced to disclose to the other anything prior to transacting.

Traders' views are idiosyncratically formed by each market participant and informed by that person's strategy, intelligence and available resources. Each investor may act or refrain from acting with full personal autonomy. The U.S. has a free market that tends toward efficiency in the long-term, where willing buyers and willing sellers generally are not forced to disclose their thinking to each other in advance of trading opposite one another.

[18] Although many representatives of organized labor disagree, we agree with the findings of academic studies showing that activism also benefits workers by forcing managers to invest in the issuer rather than using corporate resources to pay themselves. *See* Webber Comment Letter and the citations in the letter.

[19] In the case of activists, we can confidently make this statement because activists are not part of management and are by definition adverse to the insiders who maintain the material non-public information.

In the context of large-block traders who form fundamental views on values premised on corporate change, asymmetric information is not only not a bad thing but is necessarily a good thing. Activist investing improves overall social utility by moving capital and talent to their highest and best uses.

This is not a new or radical idea. In the now-famous paper *"On the Impossibility of Informationally Efficient Markets*"[20] professors Sanford Grossman and Joseph Stiglits demonstrated that, because gathering information about financial assets costs money or time, market prices cannot be perfectly efficient for, if they were, there would be no incentive for people to go out and pay those costs to gather data. These concepts are elementary to all retail and professional investors. Good ideas are hard to come by and cost a lot of time and money to advance.[21]

The Grossman-Stiglits story of cost associated with developing information and the need for financial reward to engage in the work is the actual, real-life dynamic that exists in the context of an activist's campaign.[22] An activist typically finds an underperforming target company whose stock price appears to be undervalued relative to its potential. Armed with only public information and its own private plans, through the application of hard work, time, expense and analysis, the activist typically forms a high-conviction thesis that the target company's business can be changed for the better. In addition to or separate from proposing specific value-unlocking transactions, the activist may recruit new and more capable executives and/or directors or have some other notion on the direction of the enterprise that will increase value. If the activist reckons that the result of those changes will be a higher stock price, it will step into the market and buy shares in the company. The incentive for the activist to carry out its activities is the potential to earn a profit from its strategy. Activists, investing their own capital, should not be expected to follow activist strategies if required to disclose their stake in a target company because they will be front-run and lose the opportunity to profit from -- and allow their own investors to profit from -- their own capital outlay and investment ideas.

The early filing approach imposed by the Proposals disadvantages activists over value-investors without any basis for doing so.[23] For example, to the extent that an investor could know before

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20 *See* Sanford J. Grossman & Joseph E. Stiglitz, *On the Impossibility of Informationally Efficient Markets*, 70 AM. ECON. REV. 393 (1980), available here.

21 Grossman and Stiglitz received a Nobel Prize for their work on asymmetric information in 2001.

22 This dynamic has been long understood. See Daniel R. Fischel, Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers, 57 TEX. L. REV. 1, 14 (1978) (noting that "the Williams Act, by imposing on outside[] [investors] a quasi-fiduciary duty of disclosure . . . greatly reduces the incentive" to make a large-block investments). See also Jonathan R. Macey & Jeffrey M. Netter, Regulation 13D and the Regulatory Process, 65 WASH. U. L.Q. 131, 132 (1987) (noting that "[t]o the extent that bidders must turn over to target shareholders the fruits of their research and disclose their insights as to the true value of the target firm, such bidders lose not only their incentive to undertake such research but also their incentive to acquire the skills necessary to locate undervalued firms.").

23 For these purposes, we include not only the shortened filing deadline for Schedule 13D but also the proposed 1 business day reporting deadline when specified thresholds are exceeded under the Security-Based Swap Proposal.

other investors the successful trading ideas of an investor like Warren Buffett, George Soros or former Fidelity portfolio manager Peter Lynch, the investor would share in a higher percentage of the profits. There is the same level of "information asymmetry" evident in the market in which these value investors operate as there is with activists. Notwithstanding that fact, the SEC is not proposing to require Warren Buffett, George Soros or Peter Lynch to disclose their purchases exceeding 5% to the public under the same accelerated time frame as an activist. An activist would be required to file within five days of the purchase date whereas a value-investor would not be required to file until five days (or, in the case of a "qualified institutional investor, such as registered fund, five business days) after the end of the month in which the purchase was made (or up to thirty-eight days later). The preference by the SEC in the filing deadline for one group of investors over another is not supported by DERA's cost benefit analysis and, troublingly, is directly contrary to the balance of interests that Congress articulated when it adopted the shareholder beneficial ownership requirements under the Williams Act.[24]

<u>The Proposed Changes do not Address the Purposes of the Williams Act and DERA provides no Analysis regarding why this is the case</u>

The DERA Memorandum fails to consider how the proposed changes may impact campaigns for corporate change and control and the regulatory purposes contemplated by the Williams Act, including the careful balance Congress sought to achieve between the interests of management and the interests of shareholders. The Williams Act was adopted to regulate hostile cash tender offers that forced shareholders to tender their shares on a compressed time table and without adequate disclosure.[25] The Act was not designed to thwart the ability of shareholders or other investors to wage campaigns for corporate change. Instead, in connection with the adoption of the Williams Act, Congress expressly "recognized that takeovers of underperforming companies could benefit shareholders and the economy as a whole."[26] Senator Williams, who sponsored the legislation, indicated that, in designing the bill, Congress had "taken extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids."[27]

Contrary to the state of play in 1968 when the Williams Act was adopted, there are effectively no unsolicited tender offers carried out in today's market.[28] The DERA Memorandum attempts to address the point that the impetus for Schedule 13D is no longer a threat by noting that the state of

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[24] The Legislative history underlying the Williams Act indicates that Section 13(d) was intended to require disclosure only in the face of a potential coercive action, such as a back-end merger. Statements in hearings indicate that, other than in this limited situation, regulation was intended to provide for a "free and open auction market where buyer and seller normally do not disclose the extent of their interest and [avoid] prematurely disclosing the terms of privately negotiated transactions." 113 Cong. Rec. 854, 856 (1967).

[25] Andrew E. Nagel et al., *The Williams Act: A Truly "Modern" Assessment,* HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 22, 2011), available at https://corgov.law.harvard.edu/wp-content/uploads/2022/10/The-Williams-Act-A-Truly-Modern-Assessment.pdf.

[26] *Id.*

[27] Louis Loss, Joel Seligman & Troy Paredes, V SECURITIES REGULATION 6.D.2 (6th ed. 2021) (*quoting Piper v. Chris-Craft Indus. Inc.*, 430 U.S. 1, 22, 26-31, 35 (1977), *quoting* 113 Cong. Rec. 24664 (1967).

[28] *Id.*

the art has evolved such that investors seek to influence corporate governance through minority stakes rather than full control. [29]This observation misses the point.

Instead, DERA failed to consider how the proposed changes -- including the shortening of the Schedule 13D filing period -- would further the statutory purposes underlying the Williams Act, including by providing a realistic mechanism for shareholders to hold underperforming management accountable. Contrary to the direction of Congress to balance the interests of management with that of shareholders, the SEC's proposal appears to provide a clear advantage to underperforming management to defeat shareholder campaigns by requiring an earlier tip-off of investment strategy by an activist investor. For example, the major observation made by DERA about the difference in today's market for corporate control as compared to that at the time of the enactment of the Williams Act is that significant players in this market generally seek minority equity stake instead or full control, as they used to.[30] In discussing the significance of this trend, DERA cites a study showing "the increased use of low-threshold poison pills."[31] Instead of questioning how the growth of such defenses to the new activist investing strategy would achieve a balance between management and shareholders, DERA states that it is "unable to ascertain the likelihood of the potential impacts on activism … because we cannot predict with a reasonable degree of certainty how activists and other market participants would respond to the proposed changes."[32] That conclusion sounds disingenuous – at least in respect to the benefit the proposal will provide to management, as recognized in the references by DERA to low-threshold poison pills.

<u>Changes in Communication and Trading Do Not Justify Truncating the Filing Deadline</u>

The DERA Memorandum hints at reasons that might justify revisiting Schedule 13D's filing deadline. The justifications provided by DERA include (i) faster and easier communication in 2023 as compared to 1968, when the Williams Act was adopted, and (ii) electronic trading and advances in order execution and trading (including dark pools) as compared to 1968. DERA fails to provide an explanation as to why either would justify an earlier filing threshold.

The DERA Memorandum's references to changes in technology as a basis for the shortened filing period do not bear any nexus to the conclusion that filings should be made sooner. Schedule 13Ds were historically filed on paper and available to market participants only in-person in the SEC's

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[29] DERA notes that "there have been significant changes in the technological, market, and regulatory environment since the enactment of the Williams Act" but does not explain what these changes are or how these changes (particularly, the disappearance of the hostile tender offer that Schedule 13D was designed to address) support shortening the Schedule 13D reporting period. *See* DERA Memorandum at 9-10. DERA notes that communications are now easier and faster and the introduction of electronic trading, advances in order-splitting and other trade execution optimization techniques as well as the risk of dark pools may facilitate faster stock accumulation. None of those observations has any connection to prevention of hostile tender offers and maintaining a balance between the interests of management and the interest of shareholders.

[30] *Id.* at 10.

[31] *Id.* at n. 20.

[32] *Id.* at 11.

public reading room. The advent of electronic filings and the internet have contributed significantly to the speed in which the information reaches market participants. The fact that information travels more quickly today suggests that the problem that the SEC has identified when reviewing the original regulation has actually been addressed by technology. If a faster delivery of information to other market participants is the purpose of shortening the filing period, that goal has been accomplished through the advent of the internet and of smart phones as well as the SEC's adoption of the EDGAR system. Once filings are accepted and made available by the SEC, the content becomes immediately available to all market participants.

Electronic trading and its attendant elements, such as dark pools, are also important market developments since the Williams Act's passage but in no way justify truncating the filing deadline. These changes have not made it easier, faster or less expensive to build a stakehold in a target company. In fact, the developments have impeded the ability of activists to accumulate positions. In today's marketplace, the danger of being front-run is far greater than it was in 1968. Systematic and algorithmic traders may pick up activists' buying signals and drive up prices during the activists' stake accumulation phase. The fact that the average level of beneficial ownership stakes reported in Schedule 13D filings has not meaningfully changed in recent decades, which DERA indicates is the case, provides support for the thesis that establishment of stakeholds has not become easier. As a result, market developments do not appear to support the SEC's thesis that a truncated filing deadline is necessary or appropriate.

<u>Failure to Account for Positive Price and Volume Impacts for Selling Shareholders</u>

The DERA analysis characterizes the trading between the activists and the investors selling stock to them as harmful to the sellers because these shareholders are unknowingly giving up their right to participate in the profitable investment strategy of the activist. Even if this thesis would justify a shorter disclosure period, which we do not believe it would, the trading provides clear benefits to the sellers and the market generally in the form of liquidity, volume and, potentially, price improvement. While on the one hand, a selling shareholder might think twice before selling if it knew an activist was on the other side of the trade, if there were no activist in the first place the would-be seller might not have the opportunity to sell at all or to sell at the price provided by the activist buyer. These are tangible benefits that should have been and were not weighed by DERA against the perceived harms caused to selling shareholders by activist buyers.

DERA buries findings that support non-adoption of the proposed truncated filing period into statements and footnotes at the end of the Memorandum. For example, in the last paragraph of the DERA Memorandum, after hypothesizing (without any supporting evidence) that earlier reporting by activists on Schedule 13D "*could* enhance trust in the securities markets" and speculating (again, without any supporting evidence) that failure by the SEC to require such earlier Schedule 13D reporting by activists "*may lead* market makers to charge wider bid-ask spreads and thus reduce liquidity," DERA concedes that activist buying if the current period were maintained *would benefit liquidity needs* of selling shareholders.[33] These benefits are discussed in a more direct, less hedged manner than the perceived harms, which suggests that, in fact, DERA believes that the

33 *Id.* at 27.

benefits may outweigh the harms. This reading is consistent with DERA's quantitative findings in which it estimates the value of the benefits of the proposed changes to shareholders to be approximately $93 million[34] and estimates the harm to shareholders from the proposed shortening of the Schedule 13D filing period to be approximately $810 million[35] – almost 10 times higher.

DERA's discussion at the end of the study regarding the liquidity provided by activists also notes that the sellers may be institutions and not retail investors.[36] In light of these findings (which DERA does not refute), there is no evidence that retail market participants would experience any harmful effects from maintenance of the status quo because they unknowingly sell to activists, whereas DERAs estimates of lost profits due to abandonment of activist campaigns suggests that retail investors *would* suffer substantial losses if the proposed changes were adopted. Moreover, regardless of the identity of the selling shareholder, it is possible that any such shareholder is selling because it needs cash and thus may be helped and not harmed by the availability of activist buyers. Sellers seeking liquidity would also be expected to be indifferent to disclosure of the buyer's intent in purchasing the shares.

4. DERA Does not Analyze Whether the Benefits claimed to underlie the Proposal Outweigh the Costs

It is unclear whether DERA believes that the claimed benefits of the proposed rule change outweigh the costs. For example, DERA cites empirical evidence that indicates, on the whole, that the occurrence of an activist engagement is correlated with value creation rather than value destruction over the intermediate and long-term.[37] However, the DERA Memorandum analyzes only the alleged short-term harms of activists on selling shareholders, which DERA focuses heavily on to support the proposed shortening of the Schedule 13D filing period, and it fails to analyze how shortening of the Schedule 13D filing period impacts intermediate and long-term gains to investors as a result of activist campaigns.

5. Comments on DERA's Methodology

The DERA study does not capture all of the available information available in the marketplace regarding activist campaigns. Rather than relying exclusively on its independent analysis and newly-created database, we suggest that the SEC staff test its data and analysis against the 13D Monitor Activist Campaign database. This database is focused on issuers with equity market capitalizations in excess of $100 million and tracks all activist campaigns (and excludes corporate

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34 *Id.* at 26.

35 *Id.*at 19 and n. 53 (noting that the a rough estimate can also be obtained using other statistics to obtain an estimate of about $840 million, which would establish an even larger gap between the losses expected to be suffered by shareholders and the perceived benefits of the shortened Schedule 13D filing period).

36 *Id.* at 27 n. 78.

37 As noted above, although the DERA Memorandum references evidence of mixed impacts debtholders of target issuers and impacts on shareholders of non-targeted firms, it is unclear whether or how these observations figured into DERA's analysis.

action Schedule 13D filings) since 2006. It is a neutral platform relied upon by activists and management alike. The database includes a more comprehensive dataset on non-corporate action filings and activist campaigns than that created by DERA.

Data insufficiency aside, we note that the DERA Memorandum notes that its data set of activist campaigns suggests that most activists complete their purchases of target company stock by the fifth day after the Schedule 13D filing requirement has been triggered. The implication of this conclusion is that, if the Schedule 13D reporting deadline were shortened to five days (rather than the current ten), the impact might be minimal. Despite the intuitive appeal of this logic, we are not convinced that the data DERA uses to support this finding is representative of the broader market, and we believe that more data and further study is required. We suggest that DERA expand its analysis to focus on campaigns where the activist filer continued its purchases throughout the ten-day window and reported initial beneficial ownership stakes of 10% or more.

We believe that the resulting analysis will show that the activists drove volume and price substantially higher during the 60 days prior to the Schedule 13D filing, with marked increases in prices after the filer crossed the 5% beneficial ownership trigger (but prior to the Schedule 13D filing). In many cases, we expect that the data will show the prices paid to selling shareholders by the activists were more favorable that those available in the market prior to commencement of purchasing activities by the activists.[38] In our view, it is not accurate to conclude that selling shareholders are harmed when they receive liquidity and favorable pricing for their shares — as we believe is the case in many situations in which activists seek to establish a stakeholder in the time period leading up to the Schedule 13D filing.

6. The DERA Memorandum Does not Satisfy the Required Statutory Standards to Adopt the Proposals

Under the Administrative Procedure Act, a court may set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," that is "unsupported by substantial evidence," or that is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."[39] An agency's decision is arbitrary and capricious if, among other things, the agency "[did not] examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made," "entirely failed to consider an important aspect of the problem," or "offered an explanation for its decision that runs counter to the evidence before the agency."[40]

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[38] DERA's estimate of the impact on increases in market prices in the target company's stock prior to filing of the Schedule 13D are likely understated based on the fact that DERA did not include data regarding security-based swaps.

[39] 5 U.S.C. § 706(2)(A), (C), (E).

[40] *Motor Vehicle Mfgs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

For agency action to be supported by "substantial evidence," the agency must articulate a reasoned explanation for its decision.[41] In addition, merely "'[s]tating that a factor was considered'—or found—'is not a substitute for considering' or finding it."[42] The agency must also afford adequate consideration to every reasonable alternative presented for its consideration[43] and respond to all "relevant" and "significant" public comments.[44]

Similarly, the Exchange Act requires the SEC to consider a proposed rule's impact on the protection of investors, the efficiency of the markets, competition and capital formation.[45] The SEC has a statutory obligation to determine the economic implications of a rule. For example, the United States Court of Appeals for the District of Columbia invalidated SEC Rule 14a-11, which required public companies to provide shareholders with information about shareholder-nominated candidates for the board of directors, because, among other reasons, the SEC failed adequately to consider the Rule's effect upon efficiency, competition and capital formation, as required by Section 3(f) of the Exchange Act.[46] The Court found that the SEC had made speculative predictions and relied on empirical studies that were insufficient or unpersuasive, discounted numerous studies that reached an opposite conclusion and failed to respond to substantial problems raised by commenters.[47]

Finally, in *West Virginia v. EPA,* the U.S. Supreme Court applied the "major question doctrine" to invalidate emission caps set by the Environmental Protection Agency.[48] The Court explained that federal regulation must be based on "clear congressional authorization" if it (i) involves matters of great political significance; (ii) regulates a significant portion of the national economy; or (iii) intrudes into an area that is the particular domain of state law.[49]

Contrary to the requirements of the Administrative Procedure Act, the DERA Memorandum does not provide the requisite "substantial evidence" to support the Proposals as a whole or even the portion of the Proposals relating to shortening of the Schedule 13D filing period. As noted above, DERA failed to consider the impact of the proposal on activism or on corporate accountability or the benefits provided to selling shareholders and the market generally through liquidity and improved pricing. In addition, DERA failed to consider reasonable alternatives to all of the

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[41] *Id.*

[42] *Gerber v. Norton*, 294 F.3d 173, 185 (D.C. Cir. 2002).

[43] *Pub. Citizen v. Steed*, 733 F.2d 93, 103-04 (D.C. Cir. 1984).

[44] *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35 n.58 (D.C. Cir. 1977).

[45] *See supra* n. 2.

[46] *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

[47] *Id.*

[48] *West Virginia et al., v. Environmental Protection Agency et al*., 142 S. Ct. 2587 (2022).

[49] *Id.* at 2595.

Proposals, such as, in respect to the Security-Based Swap Proposal, a requirement that filings be made to the SEC but remain non-public (consistent with the CFTC's parallel rule).

Contrary to the requirements of the Exchange Act, the DERA analysis fails to adequately consider the potential harm to investors from the Proposals, due to a decrease in or elimination of activist investing, harm to the market based on the liquidity provided by activist investors and adverse impact on capital formation and competition based on possible deterioration in the quality of corporate management without the watchdog role played by activists. DERA's focus on harm to mostly institutional selling shareholders misses many of the key constituencies that will be harmed by the Proposals, including retail investors.

As we discussed in detail in our previous comment letter,[50] the Proposals implicate the "major question doctrine," because they would materially adversely impact investor activism, which would have a substantial impact on the capital market and national economy, and because they impact the exercise of shareholder ownership rights under state law. In light of this, the SEC is required to have "clear authority" to adopt the Proposals, which it does not for the reasons discussed in our previous comment letter.[51]

As a result of these failures, the Proposals should not be adopted at this time.

7. Conclusion

Activist investors play a crucial role in the financial markets by identifying and investing in undervalued companies. They often achieve this by leveraging publicly available information, conducting their own thorough due diligence and proposing change.

Fundamentally, however, activists seek to increase the value of the companies in which they invest. They are not selling assets with hidden flaws or trading on inside information. Rather, they bring new, positive information to the market. Activism, therefore, expands the potential gains for all shareholders, not just those who sell their shares to the activist.

The SEC in the proposing releases and the SEC staff in DERA Memorandum have not quantified these benefits and the damage to those benefits that should be expected if the Proposals (or any portion of them) were adopted. In addition, neither the proposing releases nor the DERA Memorandum has stated whether the benefits of activism outweigh the potential costs, despite citing substantial evidence of value creation due to activism.

These and all of the analyses we have highlighted are required to be carried out by the SEC prior to adoption of the Proposals (or any portion). In particular, prior to taking any action on the Schedule 13D disclosure changes or any of the other portions of the Proposals, the SEC needs to evaluate (which it has not yet adequately done): (i) the impact of all of the Proposals on activism and the long-term benefits that DERA acknowledges are associated with activism; (ii) the

[50] CIRCA Comment Letter of September 8, 2022, available here.

[51] *Id.*

potentially adverse impact on corporate accountability due to the decline or elimination of activism due to adoption of the Proposals; and (iii) the market benefits resulting from what the SEC characterizes as asymmetrical informational trading, including increased liquidity, volume and pricing, and balance of those benefits against the perceived harms identified by the SEC and DERA. More analysis is also needed regarding the question of whether the SEC has the authority (which we do not believe it does) to take the actions it proposes, given the intent expressed by Congress regarding the purpose of the Williams Act (which was intended to prevent coercive tender offers and not to eliminate activism, as the Proposals appear intent to do) and the SEC's statutory mandates to protect investors, maintain fair, efficient and orderly markets and facilitate capital formation (which, we believe would be harmed and not benefited by the Proposals).[52] Finally, the SEC should analyze the new guidance provided by the Supreme Court after the SEC's publication of the Proposals that prohibits the SEC from establishing and adopting regulations, such as the Proposals, unless it has "clear authority" from Congress to do so, which we believe it does not.[53]

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We appreciate the opportunity to provide additional comments to the SEC on the Proposals and to comment on the DERA Memorandum. We would be very happy to discuss our views with the SEC or its staff. Should you have any questions, please feel free to contact me at 202-350-0919 (milan@tigerhillpartners.com) or our Counsel, Willkie Farr & Gallaher LLP, P. Georgia Bullitt, at 212-728-8250 (gbullitt@willkie.com), Bob Stebbins, at 212-728-8736 (rstebbins@willkie.com), Russell Leaf, at 212-728-8593 (rleaf@willkie.com) or Tariq Mundiya, at 212-728-8565 (tmundiya@willkie.com).

Sincerely Yours,

Milan Dalal

Milan Dalal

cc: Chair Gary Gensler
Commissioner Hester M. Peirce
Commissioner Caroline A. Crenshaw
Commissioner Mark T. Uyeda
Commissioner Jaime Lizarraga

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52 As noted above, in our view, investors will be harmed by adoption of the Proposals because long-term shareholders will lose the corporate governance benefits and increase in corporate returns provided by activist campaign and shareholders seeking to sell their interests will lose the liquidity, volume and pricing provided by activists. Similarly, we believe that the Proposals will have an adverse impact on the markets by reducing liquidity and opportunities for price appreciation provided by activists. Finally, we believe that capital formulation will be less efficient because of deterioration in the quality of corporate managers absent the presence of activists, which could cause investors to lose trust in the public markets.

53 *See supra* n. 50.