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June 27, 2023

Via Electronic Mail

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

Re: **File No. S7-06-22; Reopening of Comment Period for Modernization of Beneficial Ownership Reporting; Release Nos. 33-11080; 34-97405**

Dear Secretary Countryman:

We write in response to the above-cited release, which reopens the comment period on Release No. 33-11030, *Modernization of Beneficial Ownership Reporting* (Feb. 10, 2022). The Commission took that step to allow comment on a new Division of Economic and Risk Analysis ("DERA") Memorandum, dated April 28, 2023, entitled "Supplemental data and analysis on certain economic effects of proposed amendments regarding the reporting of beneficial ownership" (the "DERA 13(d) Memorandum").[1] As explained below, the DERA 13(d) Memorandum suffers from serious analytical flaws and does not justify the changes in existing law that are promoted by the Commission in the 13(d) Rulemaking Proposal.[2]

This submission also supplements our prior comment letters[3] regarding the 13(d) Rulemaking Proposal and Commission's proposal to adopt Rule 10B-1, which, as we have

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[1] Attachment to Release Nos. 33-11080; 34-97405; File No. S7-06-22 (Apr. 28, 2023).

[2] File No. S7-06-22; Modernization of Beneficial Ownership Reporting, Release Nos. 33-11030, 34-94211 (Feb. 10, 2022) (the "13(d) Rulemaking Proposal"). All citations herein to the 13(d) Rulemaking Proposal utilize the pagination of the "Conformed to Federal Register version" that is posted on EDGAR.

[3] *See* Letter from Richard B. Zabel, General Counsel & Chief Legal Officer, Elliott Investment Management L.P., to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, dated April 11, 2022, re: Release Nos. 33-11030, 34-94211 (Apr. 11, 2022) (our "Original 13(d) Comment Letter"); Letter from Richard B. Zabel, General Counsel & Chief Legal Officer, Elliott Investment Management L.P., to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, dated August 18, 2022, re: Effect of *West Virginia v. EPA*, 142 S. Ct. 2587 (2022), on Pending Release Nos. 34-93784, 33-11030, and 34-94211 (August 18, 2022) (our "First Supplemental 13(d) Comment Letter"); and Letter from Richard B. Zabel, General Counsel & Chief Legal Officer, Elliott Investment Management L.P., to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, dated November 18, 2022, re: Response to the Comment Letter Submitted by Wachtell, Lipton, Rosen

observed previously, are interrelated.[4] We believe our 13(d) Comment Letters demonstrate significant shortcomings of the 13(d) Rulemaking Proposal, including the significant threat the proposal, if adopted, would pose to activism and thus to the vibrancy and efficiency of the U.S. financial markets. Our review of the DERA 13(d) Memorandum has only reinforced the seriousness of our concerns.

Elliott Investment Management L.P. ("Elliott") is a leading multi-strategy investment advisor and one of the oldest firms of its kind under continuous management. Elliott invests in a wide range of areas in order to protect and grow the assets of our investors, which include approximately 101 educational endowments, more than 180 foundations, and more than 100 private and public pension plans, among others, which are often advised by their own dedicated advisors. Elliott's active investments in public equities have become one of our most significant and impactful efforts, resulting over the past decade in more than 140 disclosed engagements with public companies, and more in which our dialogue with the company remained private. The views expressed herein are those of Elliott, and are not expressed as views of any other firm or person.[5]

We also submit for the Commission's consideration, as Exhibit A hereto, a supplemental report (the "Lewis Report") from Professor Craig M. Lewis, the Madison S. Wigginton Professor of Finance at Vanderbilt University's Owen Graduate School of Management, Professor of Law at Vanderbilt Law School, and a former SEC Chief Economist and Director of DERA. Professor Lewis's prior tenure as Director of DERA affords him unique insight into the flaws contained in the DERA 13(d) Memorandum, as well as in the original cost-benefit analysis that was provided

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and Katz on October 4, 2022 (our "Second Supplemental 13(d) Comment Letter" and, together with our Original 13(d) Comment Letter and our First Supplemental 13(d) Comment Letter, our "13(d) Comment Letters").

4 As noted in our Original 13(d) Comment Letter, we believe that many of the issues with the 13(d) Rulemaking Proposal also apply to the Commission's proposal to adopt new Rule 10B-1 under the Securities Exchange Act of 1934, File No. S7-32-10; Proposed 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 (Dec. 15, 2021) (the "10B-1 Rulemaking Proposal"). While the Commission recently adopted the other rules that were proposed in the 10B-1 Rulemaking Proposal, it stated that it was "not finalizing Rule 10B-1 . . . as it continues to consider comments received" (Release No. 34-97656 at p. 8). In addition, the Commission recently reopened the comment period for the 10B-1 Rulemaking Proposal to afford the opportunity to comment upon an additional memorandum, dated June 20, 2023, submitted by DERA entitled "Supplemental data and analysis regarding the proposed reporting thresholds in the equity security-based swap market" (the "DERA 10B-1 Memorandum" and, collectively with the DERA 13(d) Memorandum, the "DERA Memoranda"). *See* Attachment to Release No. 34-97762; File No. S7-32-10 (June 20, 2023). Given that the Commission has released the DERA 10B-1 Memorandum shortly before the comment deadline for the DERA 13(d) Memorandum, we are effectively prevented from commenting on both DERA Memoranda in a single comment letter. While we discuss aspects of the interrelationship between the 13(d) Rulemaking Proposal and the 10B-1 Rulemaking Proposal, including how the potential combination of the Commission's 13(d) and 10B-1 Rulemaking Proposals would compound the problems created by each Rulemaking Proposal individually, in this comment letter, we are forced by the timing of the Commission's release of the DERA 10B-1 Memorandum to submit our comments on that document separately. For further background on our concerns with the 10B-1 Rulemaking Proposal, *see* Letter from Richard B. Zabel, General Counsel & Chief Legal Officer, Elliott Investment Management L.P., to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, re: Release No. 34-93784 (March 21, 2022) (our "10B-1 Comment Letter").

5 While we only speak for ourselves and not on behalf of other activists in this letter, in several instances we share our views regarding how the activist market operates generally. Those observations are intended to reflect not only how we operate, but also how, in our experience, peer activists operate as a general matter.

as part of the Commission's 13(d) Rulemaking Proposal (as to which Professor Lewis commented as part of our Original 13(d) Comment Letter[6]).

1. **Overview**

The DERA 13(d) Memorandum and the 13(d) Rulemaking Proposal both rest on the same flawed premise: that shareholder activism harms the U.S. capital markets as a general matter, and a subset of investors specifically – thus warranting fundamental changes to longstanding SEC regulations.[7] As with the Commission's analysis in the 13(d) Rulemaking Proposal, the DERA 13(d) Memorandum simply assumes that activism causes those "harms," but does not provide any supporting evidence.

A careful analysis of the data in the DERA 13(d) Memorandum reveals that activism does *not* cause the harms posited by the Commission and in fact benefits investors and fortifies the securities market. Indeed, the empirical evidence discussed in the DERA 13(d) Memorandum *disproves* the Commission's assumption about activism and nullifies the purported basis for regulatory intervention.

We also note that the DERA 13(d) Memorandum's focus appears to be on the Commission's proposal to shorten the filing deadline for an initial Schedule 13D from 10 days to five days after a person acquires more than 5% of a covered class of equity securities. There is no discussion of other significant aspects of the 13(d) Rulemaking Proposal, including the proposal to redefine the concept of "group" as it relates to Section 13(d) or the proposal that cash-settled equity derivatives be deemed to confer beneficial ownership of the underlying securities for purposes of Section 13(d).[8] We objected to both of these proposals in our Original 13(d) Comment Letter. The DERA 13(d) Memorandum contains broad and unsubstantiated claims regarding investor behavior, investor "harm", and alleged market malfunctions, often using pejorative or otherwise inappropriate labels in a result-oriented manner – mirroring the 13(d) Rulemaking Proposal's arguments in support of these additional rule changes. We are thus concerned that the Commission may be using a Trojan horse approach, intending to rely upon portions of the DERA 13(d) Memorandum to justify conclusions concerning aspects of the 13(d) Rulemaking Proposal other than the shortening of the Schedule 13D filing deadline, despite DERA's explicit admission that it is unable to perform an economic analysis regarding those issues.

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6 *See* Lewis, Review of the Economic Analysis for Proposed Rule Amendments to Modernize Beneficial Ownership Reporting (Apr. 11, 2022), submitted as Exhibit B to our Original 13(d) Comment Letter (the "Original Lewis 13(d) Report").

7 As we have noted previously, the Commission's characterization of the proposed changes to Section 13(d) as mere "modernizations" is misleading. *See* Part V.A. of our Original 13(d) Comment Letter. The 13(d) Rulemaking Proposal constitutes a fundamental change to longstanding law, which is neither warranted on a substantive basis, nor justified on an economic basis.

8 DERA admits in the DERA 13(d) Memorandum that while they have attempted to quantify the costs and benefits of the proposal to shorten the Schedule 13D filing deadline from the point of view the impact on activist campaigns, DERA cannot quantify the costs or benefits of the other components of the 13(d) Rulemaking Proposal:

> [W]e note that this analysis reflects one aspect of the overall potential impact of the proposed amendments, and that other effects of the proposed amendments may not be readily quantified.

DERA 13(d) Memorandum at p. 11.

We continue to urge the Commission to abandon or significantly amend the 13(d) Rulemaking Proposal. We also urge the Commission not to rely upon broad and unsubstantiated assertions in the DERA 13(d) Memorandum, as opposed to evidence-based and reasoned decision-making as required by the Administrative Procedure Act, to justify any action that the Commission may elect to take with regard to the 13(d) Rulemaking Proposal.

2. The Commission Has Failed to Acknowledge or Evaluate the Interaction of the 13(d) Rulemaking Proposal and the 10B-1 Rulemaking Proposal

As noted above, our 13(d) Comment Letters speak to the cumulative impact that the 10B-1 Rulemaking Proposal and the 13(d) Rulemaking Proposal would have if both were adopted by the Commission. Given the relationship between the two proposals, and the apparent refusal of the Commission to proceed incrementally, we have urged the Commission to evaluate the cumulative costs and benefits of the proposals, in addition to assessing each of them on a stand-alone basis.[9] The Commission has failed to do so, and thus cannot evaluate whether the cumulative adverse impact of the two proposals will be greater than the sum of the cumulative adverse impacts of each proposal. This "blind empirical leap" seems to us an irresponsible risk for a regulator to take with what is a well-functioning market.

The serial release of the two DERA Memoranda is yet another example of the Commission's unwillingness to evaluate the cumulative impact of these proposed rulemakings. In addition, by releasing the DERA 10B-1 Memorandum a mere week before the closing of the comment period for the DERA 13(d) Memorandum, the Commission precludes the submission of comment letters evaluating these proposals on a collective basis prior to the deadline for comment on the DERA 13(d) Memorandum. This pattern of scattershot releases and cramped timing for responses continues even though it has been the source of much criticism from the market, academics and Congress throughout this process.[10] It calls into question the Commission's responsiveness to serious process as well as substantive issues that have been raised throughout. We urge the Commission to include in the comment letter file for the 13(d) Rulemaking Proposal all comment letters received regarding the DERA 10B-1 Memorandum, to ensure that analyses of the interaction of the two proposals are considered for both proposed rulemakings.

We also note that the DERA 13(d) Memorandum continues the Commission's use of certain pejorative and inappropriate terminology that is found in both the 13(d) Rulemaking Proposal and the 10B-1 Rulemaking Proposal. This terminology includes multiple references to "opportunistic traders" as a derogatory label for trading on information that is not known to the market generally. It also includes invocations of "information asymmetry" suggesting that different views regarding a company's prospects requires public disclosure prior to trading as if

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9 To that end, our Original 13(d) Comment Letter included, as an exhibit, the full text of our Rule 10B-1 Comment Letter (including the two experts' reports submitted therewith), to ensure that our discussion of the issues with that rulemaking was included in the Commission's comment letter file on the 13(d) Rulemaking Proposal.

10 The Commission's utilization of aggressively brief comment periods for these and other rulemaking proposals has been objected to by a number of commenters. In the context of the 10B-1 Rulemaking Proposal, these objections included a request submitted by bipartisan members of Congress that the comment period be extended (see www.sec.gov/comments/s7-32-10/s73210-20112652-265433.pdf) and a separate comment letter from us making the same request (see Letter from Richard B. Zabel, General Counsel & Chief Legal Officer, Elliott Investment Management L.P., to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, dated January 13, 2022). As the Commission did not respond to these requests, we did not formally request an extension of the similarly brief comment period for the 13(d) Rulemaking Proposal.

such information were material non-public information coupled with a duty to disclose. Notably, there is not corresponding pointed language about irresponsible, non-performing or governance-abusing companies, managers and directors. We do not seek such countervailing pointed language; we seek unbiased analysis. We discuss our concerns with this terminology below. Our concerns with these concepts in the DERA 13(d) Memorandum apply equally to both the 10B-1 and 13(d) Rulemaking Proposals.

3. **The DERA 13(d) Memorandum Suffers from Two Fundamental Deficiencies**

The DERA 13(d) Memorandum relies on two flawed definitions that undermine DERA's analysis in its entirety.

A. Definition of "Prominent Activists"

DERA uses the term "Prominent Activist" throughout the DERA 13(d) Memorandum and defines that term by reference to the FactSet SharkRepellent database. Specifically, the DERA 13(d) Memorandum equates "Prominent Activist[s]" with entities classified by the database as a "Sharkwatch 50" activist investor.[11] While Elliott is correctly included in that database as an activist of prominence, the database is riddled with errors. For example, according to FactSet, Elliott has *zero* assets under management and *zero* equity assets.[12] This is obviously incorrect (the thumbnail description of Elliott on page 2 above, which is identical to that contained in each of our 13(d) Comment Letters, clearly refers to the breadth and scope of our operations). Two other quite prominent activist investors (TCI Fund and Icahn) also both show as having zero assets under management. And a number of activists that are well-known as prominent participants in this space are not on the list.

In addition to these glaring errors, of the 50 "Prominent Activists" in the FactSet database, 14 are no longer in operation or have not engaged in activism for at least four years (including one entity that reorganized under Chapter 11 of the Bankruptcy Code in 2019),[13] three operate exclusively outside of the United States (and thus are not relevant to an analysis of the effects of activism on the U.S. markets), and seven engage solely in specific narrow subsets of activism (relating to closed-end mutual funds or regional banks) involving entities with far smaller capitalizations than is typical for the activist firms that we believe the Commission is focused upon in the 13(d) Rulemaking Proposal.[14] These are such superficial errors that it raises the question of whether DERA performed even a cursory check that the data they were relying on was accurate and current.

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11 We note that there are only 49 entities on the list that is cited by DERA, and the link to that list is no longer operative.

12 The following is a screenshot of an extract of the FactSet data as to our firm:

SharkWatch 50 (Key Activists)							
Name	Key Individual(s)	Equity Assets ($mil)	AUM ($mil)	Total Campaign	High Impact	Open	Closed
Elliott Management Corp.	Paul Elliott Singer	0	0	232	156	6	226

13 Pershing Square, Greenlight Capital, Wynnefield Capital, Raging Capital, Highland Capital, Osium Partners, FrontFour Capital, Privet Fund, Red Mountain Capital, VIEX Capital, Carlson Capital, Clinton Group, Sandell Asset Management and Marcato Capital.

14 To our understanding, Cevian Capital operates exclusively in Europe, save for one U.S. activism campaign it carried out in 2018. Oasis Management (Hong Kong) operates solely in Asia, and Crystal Amber Advisers operates solely in the U.K. (and has not initiated an activist campaign in any market since 2019). Karpus, Bulldog Investors and City of London Investment engage in activism solely with respect to closed-end funds, and Basswood Capital, PL Capital, Stillwell Value and Clover Partners engage in activism solely with respect to regional banks.

While we fundamentally disagree that activism as practiced by Elliott and other peer activists constitutes a category of investment activity that harms the U.S. capital markets and warrants a regulatory response, using such obviously flawed data to attempt to support this premise is particularly concerning. To the extent that the data relied upon by the Commission to support its flawed proposition that activism creates harms is not accurate, the conclusions drawn from that data are at best unreliable, if not flatly incorrect.[15] As but one potential example, to the extent that an investor that is incorrectly identified by DERA or the Commission as a Prominent Activist engages in a transaction that only benefits that investor, but not other shareholders in the relevant company, then that transaction is not activism. If and to the extent that that transaction gives rise to regulatory concern, those concerns would not apply to activism, as the nature of the underlying transaction would be factually distinct.

We understand that there are other sources of data on this point that appear to be more accurate than the FactSet Sharkwatch resource. We would be happy to share our thoughts on this with the Commission or DERA.

B. Categorization of Schedule 13D Filings

DERA's analysis relies upon a review of over 15,000 initial Schedule 13D filings over an 11-year period (2011 through 2021). These filings are divided into two categories for purposes of the DERA 13(d) Memorandum:

- "Corporate Action Filings" (defined as filings relating to beneficial ownership acquired in events such as "mergers and acquisitions, IPOs, other restructurings, private placements or compensation awards");[16] and
- "Non-corporate Action Filings" (defined as filings "typically associated with the accumulation of shares in open-market trading through a sequence of multiple transactions and are more likely to discuss potential plans and proposals that are commonly viewed as characteristic of activist campaigns").[17]

We are puzzled that the only explicit reference to M&A transactions in this analysis is in a category that is not viewed as indicative of "the accumulation of shares in open-market trading through a sequence of multiple transactions" – a fundamental strategy of hostile bidders in M&A transactions, and in fact the behavior that Congress was most concerned about when it enacted the Williams Act.[18] We do not understand why the distinction drawn by DERA is relevant to any aspect of the 13(d) Rulemaking Proposal.

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15 *See, e.g.*, *United States v. Castleman*, 572 U.S. 157, 182 (2014) (Scalia, J., concurring) (rejecting agency definitions based on the principle that "*falsus in uno, falsus in omnibus*").

16 DERA 13(d) Memorandum, p. 3 at text accompanying n. 8.

17 DERA 13(d) Memorandum, p. 3 at text accompanying n. 10.

18 Perhaps DERA is seeking to capture in the "Corporate Action Filing" category the conversion of shares in a target company to shares of the acquiring firm following consummation of an M&A transaction. But this is of course *not* the part of an M&A transaction that the disclosure mandate of Section 13(d) is designed to address. Instead, Section 13(d)'s primary function is to ensure that the market (investors as well as public companies) is aware of the assembly of a position by a potential acquiror (or by an a potential activist) at the appropriate time. This activity would appear to constitute a "Non-corporate Action Filing" under DERA's nomenclature. This means that Schedule 13D filings with respect to a single M&A transaction would likely end up in both categories, resulting in potential double counting. This would appear to call into question the accuracy of any data as assembled on the basis of these definitions.

We note further that the “Non-corporate Action Filings” category, which is central to DERA’s analysis, is a category that is, by DERA’s own admission, likely overstated “and subject to some possible error.”[19] This is no doubt true because DERA apparently includes in its data even those investors who may have proposed no activist plans or might not be viewed as an activist investor. The magnitude of this overstatement is unclear, but it is a significant data point to not have quantified, and it is not clear why DERA chose not to. Further, in DERA’s examples of what constitutes activist plans,[20] DERA provides a list that omits activist proposals that seemingly align with important policies of the Commission, such as improved governance structures for shareholders to express their views, increasing diversity among directors, and environmental and other ESG issues the company should pursue. Including these in the list might present a more objective spectrum of activist proposals that would be negatively affected by DERA’s analysis, and by the 13(d) Rulemaking Proposal.

4. DERA’s Economic and Substantive Analysis Is Flawed in Multiple Respects

The DERA 13(d) Memorandum’s attempt to develop a cost-benefit analysis for the proposal to shorten the Schedule 13D filing deadline from 10 to five days is, in some instances, refreshingly candid – demonstrating that the benefits of activism vastly exceed the unquantified, and unestablished, harms that the Commission has ascribed to activism, as we describe below.[21] In other instances, DERA’s analysis is deeply flawed.

A. Two Fundamental, Yet Unjustified, Assumptions

The analysis contained in the DERA 13(d) Memorandum is predicated upon two fundamental and interrelated assumptions, neither of which is evaluated by DERA (either in the DERA 13(d) Memorandum or in the cost-benefit analysis contained in the 13(d) Rulemaking Proposal). We also note that these points are assumed, but not established, by the Commission in the 13(d) Rulemaking Proposal. They are thus nothing more than unsubstantiated assertions made by the Commission in the 13(d) Rulemaking Proposal and repeated, but not justified, by DERA.

1. Unsupported Assertion That Activism Warrants Specific Regulatory Attention

The DERA 13(d) Memorandum describes the DERA Staff’s efforts to categorize Section 13D filings by Prominent Activists, as distinct from “Other Institutions” and “Other Individuals.”[22] This categorization proceeds with no discussion or analysis of why activists (prominent or otherwise) warrant separate regulatory scrutiny. Putting aside our concerns with the facially incorrect data upon which DERA relies (as discussed above), the Administrative Procedure Act requires that when a federal agency issues a rule, the agency must “articulate a

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We note that Schedule 13D filings relating to activism efforts likely would not be subject to potential double counting, as, unlike an M&A transaction, an activist does not seek to acquire control of a public company – only to influence that company to change its operations and practices so as to improve performance for the benefit of the company’s shareholders. Given the focus on activists in the DERA 13(d) Memorandum (as well as in the 13(d) Rulemaking Proposal), this dichotomy calls into question conclusions that the Commission seeks to draw as to activists (as compared to acquirors of companies) on the basis of this data.

[19] DERA 13(d) Memorandum at n. 11.

[20] *Id.* at n. 10.

[21] *See* Section 4.B. below.

[22] *See, e.g.*, Table 1 of the DERA 13(d) Memorandum and accompanying text.

satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"[23] The cost-benefit analysis of any such proposal must therefore evaluate whether the costs of the proposal are more than offset by its anticipated benefits. As discussed in Section 4.B. below, DERA's data demonstrates that the benefits of activism far exceed any estimated costs. Not only has the Commission failed to discuss *why* activism warrants a significant departure from longstanding practices, DERA has validated the point that activism benefits the market. This lack of any empirical or analytical support for the proposition that activism creates harms that require a regulatory response demonstrates just how misguided the 13(d) Rulemaking Proposal is.

2. *False Notion That Sales by a Stockholder of a Company that Subsequently Becomes the Subject of an Activist Campaign Constitute a Harm Due to an "Information Asymmetry" Warranting Regulatory Intervention*

The DERA 13(d) Memorandum simply assumes that other investors suffer harm when they sell their shares in a company shortly before an activist investor discloses a campaign relating to that company.[24] DERA does not evaluate whether the fact that an activist happens to be concurrently developing a thesis as to that public company is in fact an "information asymmetry" that warrants regulatory intervention, nor does it evaluate the costs of seeking to protect stockholders who decide to sell shares of a public company that subsequently becomes the subject of an activist campaign. This "harm" assumption is flawed for several reasons.

This scenario is by no means unique to activists. If a hostile bidder is considering launching a tender offer for a public company, there will be a period during which neither the target nor the market will be aware of the bidder's intent or of the information that led the bidder to form that intent. There is no suggestion that this situation constitutes an "information asymmetry" warranting regulatory intervention. Yet, without analysis, the fact that an *activist* may be considering action regarding a public company is assumed by DERA to meet this threshold. A short-seller may take a short position, even a large one, and be prepared to release a report once she fills her position, which may move the stock price massively, and this will generally happen without any prior interaction with the company (unlike most activist situations) and yet short-sellers are not required to disclose their positions because of a supposed "information asymmetry."[25] Indeed, any investor (talented or otherwise) that develops a view as to the prospective fortunes of a given public company may decide to acquire, or sell, stock in that company. By definition, any shareholder who sells or buys and ends up facing this investor is not aware of that investor's analysis (the investor's view is by definition private). The federal securities laws do not view this as a harm, or seek to expand beneficial ownership reporting to capture any such "informational asymmetry" that may exist in this

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23 *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962)); *see also Advocates for Hwy. & Auto Safety v. Fed. Motor Carrier Safety Admin*, 429 F.3d 1136, 1145 (D.C. Cir. 2005) (agency acted arbitrarily and capriciously by "adopt[ing] a rule with little apparent connection to the inadequacies it purports to address").

24 DERA 13(d) Memorandum at p. 20; *see also id.* at pp. 24, 25 and 26.

25 As we noted in our Original 13(d) Comment Letter, the Commission believes that while the confidentiality of short sellers should be protected, activists are not entitled to similar protection despite the similarity in the value of their proprietary trading strategies and the damage to that value that public disclosure would cause. Original 13(d) Comment Letter, n. 121.

situation.[26] Why? Because forced premature disclosure frustrates and chills private research, which is an engine for the market at all levels.[27] Informational differences are an essential part of a well-functioning securities market, as discussed further in the Lewis Report.

The Supreme Court has also expressly rejected this theory. In *Rondeau v. Mosinee Paper Corp.*,[28] an investor assembled a beneficial ownership position in a public company that exceeded 5% without filing a Schedule 13D. The investor acknowledged that he was not aware of his obligation to make such a filing, and he ceased acquiring shares and filed a Schedule 13D upon learning of this obligation. The company sued, seeking equitable relief for the violation of Section 13(d). In seeking to justify such relief, the company claimed that "an injunction is necessary to protect the interests of shareholders who either sold their stock to petitioner at pre-disclosure prices or would not have invested had they known that a takeover bid was imminent."[29] In denying that equitable relief was warranted, the Court held:

> [T]he principal object of the Williams Act is to solve the dilemma of shareholders desiring to respond to a cash tender offer, and it is not at all clear that the type of "harm" identified by respondent is redressable under its provisions.[30]

The Court then noted that "those persons who allegedly sold at an unfairly depressed price have an adequate remedy by way of an action for damages."[31] This demonstrates that one may not simply presume that all shareholders who purchased or sold without knowledge of a bidder's intent are "harmed" for purposes of the federal securities law. Instead, each shareholder (or the shareholder class, if so certified) would need to demonstrate and quantify such harm. Of course, the *Rondeau* decision evaluates the presence of this alleged "harm" in the context of a situation in which a Schedule 13D filing was clearly required. The Commission's (and DERA's) assumption that such a "harm" also occurs when no such filing is required does not withstand scrutiny. If this position were nonetheless to result in promulgation of any aspect of the 13(d)

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26 For a cogent discussion of this point, see Matt Levine's March 24, 2022 Bloomberg column entitled "*The SEC Wants to Stop Activism*," under the sub-caption "*Activism*," which column was extracted and submitted as a comment letter on the 13(d) Rulemaking Proposal by Simon Lorne, who formerly served as General Counsel of the Commission. See www.sec.gov/comments/s7-06-22/s70622-273347.htm.

27 *See, e.g.*, *Dirks v. SEC*, 463 U.S. 646, 657-58 (1983) ("We reaffirm today that '[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market.'").

This position is also reflected in the Commission's well-established "mosaic theory," which acknowledges that investors who, by virtue of their own expertise and efforts, develop analyses of public companies perform a service to the market. In the adopting release for Regulation FD, which prohibits selective disclosure by public companies, the Commission stated:

> Analysts can provide a valuable service in sifting through and extracting information that would not be significant to the ordinary investor to reach material conclusions. We do not intend, by Regulation FD, to discourage this sort of activity. The focus of Regulation FD is on whether the issuer discloses material nonpublic information, not on whether an analyst, through some combination of persistence, knowledge, and insight, regards as material information whose significance is not apparent to the reasonable investor.

Selective Disclosure and Insider Trading, 65 FED. REG. 51716, 51722 (Aug. 24, 2000). The mosaic theory applies to all investors; the focus on analysts in the Regulation FD adopting release was an example relevant to the context of that rulemaking.

28 422 U.S. 49 (1975).

29 *Id.* at pp. 59-60.

30 *Id.* at p. 60.

31 *Id.*, citing *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 595 (1952) (Frankfurter, J., concurring).

Rulemaking Proposal on the basis of this ill-advised theory of "harm," the Commission will have in effect disregarded contrary and longstanding Supreme Court authority without acknowledging it is doing so or providing any justification for departing from controlling precedent.

Neither DERA (nor the Commission more generally) attempts to explain *why* market participation by activists prior to announcement of their campaign warrants different treatment than market participation by hostile bidders, short-sellers or other investors with a view as to the prospects of a public company. Yet, the DERA 13(d) Memorandum appears to attempt to justify the shortening of the Schedule 13D filing deadline solely by focusing on the activities of activists, although the resulting change (if this proposal is adopted by the Commission) will affect *all* market participants.[32] Because the DERA 13(d) Memorandum "treats similarly situated p[arties] differently" without "provid[ing] an adequate explanation" for doing so, its analysis is by definition arbitrary and capricious.[33]

The flaw in DERA's approach cannot be repaired through further economic analysis, as the facts underlying the purported basis for regulatory intervention simply reflect the normal functioning of an efficient market. The view of the prospects of a stock of a given public company will, by definition, be different for a buyer as opposed to a seller, and a well-functioning market efficiently moves the investment to the party who has a greater desire to own the exposure. Differing views of an issuer's prospects is not an "information asymmetry" warranting any form of regulatory intervention, particularly where those differing views are the product of painstaking research and original analysis performed by one of the parties to the transaction. To borrow the Commission's terminology, if an information asymmetry exists as between an activist and a shareholder who, unaware of the activist's impending plans, sells, the activist has caused that asymmetry to exist as a result of the activist's expensive, time-consuming and proprietary analysis of the underlying company, an analysis that the selling shareholder has not performed or for other reasons does not care about. Taken to its logical extreme, the only way to address this "information asymmetry" would be to compel every investor to make public all of its research regarding a given company prior to trading. This is not required by existing law, nor could it be – it is an absurd outcome that would be functionally impossible to implement. To require a market participant to share that information with the market would remove the very incentive that the market provides to perform such an analysis –

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32 We observed the testimony of Haoxiang Zhu, Director of the Division of Trading and Markets, to the House Financial Services Committee's Subcommittee on Capital Markets on June 22, 2023, during which he was asked a similar question by a member of that subcommittee in the context of the 10B-1 Rulemaking Proposal. Mr. Zhu's justification of the differential treatment proposed by the Commission was that the short sale provision and Rule 10B-1 arise under different statutory provisions, and Rule 10B-1 is intended to provide transparency of large concentrated positions, whereas the short sale rulemaking apparently was motivated by a different concern. The fact that these rules would exist under different statutory provisions (which is also true with respect to the 13(d) Rulemaking Proposal) has nothing to do with why one category of investor is entitled to confidentiality while another is not. And, as we note in our 10B-1 Comment Letter, the Commission has not provided any justification for the assumption that the goals of Section 10A of the Exchange Act require public disclosure, rather than confidential disclosure to the Commission for its analysis and review, and Director Zhu's response at the hearing did not provide any insight on this question.

33 *Etelson v. Off. of Pers. Mgmt.*, 684 F.2d 918, 926 (D.C. Cir. 1982); *Burlington N. and Santa Fe Ry. Co. v. Surface Transp. Bd.*, 403 F.3d 771, 776 (D.C. Cir. 2005).

to reap the economic benefits of that differentiated analysis. This will impair activism, depriving the market of a powerful remedy for poor corporate governance.[34]

The Commission's attempt to characterize the efforts of activists as creating harms to other shareholders is also misguided as it introduces a normative judgment into some, but not all, trading behavior – in effect introducing a wealth redistribution scheme under the guise of investor protection. In the zero-sum world of investing, the transfer of wealth to one investor necessitates the extraction of wealth from another. The Commission does not acknowledge, much less analyze, the key question of why one investor should be preferred over the other in this situation. Therefore, the attempt by DERA to evaluate the costs and benefits of the 13(d) Rulemaking Proposal must fail, because the flawed underlying premise of the rulemaking proposal cannot support a rational cost-benefit analysis.[35]

By way of contrast, trading on the basis of material non-public information is quite correctly prohibited under federal securities law. That prohibition is predicated upon the investor that is in possession of such information having a duty to disclose that information prior to trading on it or otherwise refrain from trading. This duty applies, as a general matter, to those who have access to a company's proprietary, non-public information – such as senior executives, board members, and outside advisers. This duty does not apply to an investor with a view as to the company that is based upon publicly available information. The development of such a view is permitted, in fact encouraged, by the mosaic theory, which is recognized by the Commission and under federal securities law. The Commission's attempt to frame an activist's view as to a given company, a view that the activist developed on her own and without access to the company's material non-public information, as somehow creating an information asymmetry warranting a regulatory response is misguided. And nothing in the DERA 13(d) Memorandum cures the flaws inherent in the Commission's misguided analysis.

DERA estimates that annual gains from activism exceed the losses estimated by DERA to have been caused by activism by a factor of *148 times*.[36] This is data that DERA puts forth, but then ignores, throughout its cost-benefit analysis, although there is extensive academic literature demonstrating that activism generates sustainable benefits for the market.[37]

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34 Brav, Jiang & Li, *Governance by Persuasion: Hedge Fund Activism and Market-Based Shareholder Influence*, OXFORD RSCH. ENCYCLOPEDIA OF ECON. AND FIN. (2022) ("Brav") at p. 1 ("shareholder engagement by activist hedge funds has evolved to become both an investment strategy and a remedy for poor corporate governance.").

35 DERA's analysis also fails to acknowledge that the legislative history of the Williams Act makes clear that Congress elected a ten-day filing period (after considering, and initially adopting, a five-day filing period) to afford market participants sufficient time to assemble positions confidentially while protecting the market's overall need to know of the buyer's actions. Or, to again borrow the Commission's terminology, an "information asymmetry" was explicitly built into the Williams Act. As we discuss in our Original 13(d) Comment Letter, while the Commission seeks to justify shortening the Schedule 13D filing deadline by reference to the fact that technology now affords more speed to market participants, that truism does not address whether Congress's intentionally created "information asymmetry" should be shortened. Congress was not focused on the time needed to type, or transmit to the Commission for filing, a Schedule 13D in arriving at the duration of the Schedule 13D filing period.

36 *See* DERA 13(d) Memorandum at Tables 4-5 (estimating annual gains from activism at $13.8 billion, as compared with estimated annual losses due to activism of $93 million). We discuss this data in greater detail in the following sub-section of this letter.

37 *See, e.g.*, Brav at p. 66 (summarizing the analysis contained in Section 4 of that article that activism generates sustainable gains for shareholders); authorities cited in n. 3 of our 10B-1 Comment Letter (same conclusion).

While DERA's data, on its face, demonstrates the failure of the Commission's efforts to justify the 13(d) Rulemaking Proposal as a necessary regulatory response to activism, even this data understates the net value of activism to the markets. The Commission's analysis in the 13(d) Rulemaking Proposal (which DERA parrots in the DERA 13(d) Memorandum) is that it need only consider the supposed (and speculative) foregone gains of selling shareholders. The countervailing actual *gains* of investors who do not choose to sell their shares and then, at no cost to themselves, benefit from the results of the activist's efforts are not acknowledged by the Commission, but are buried in DERA's data alongside (and undifferentiated from) gains realized by shareholders who were never considering selling their shares. And, of course, some sellers may very well have sold for their own reasons having nothing to do with lack of knowledge of the activist's views, in which case any foregone gains would not constitute a loss to such a seller. DERA's simplistic analysis, while generating data that proves our point as to the benefits of activism, in fact likely understates the amount of that benefit by overstating the amount of harm alleged to be caused by activism. Of course, whether the net annual gain generated by activism is as DERA estimates or (as we expect) far greater, either outcome proves that the Commission's attempt to justify the 13(d) Rulemaking Proposal as a response necessitated by activism is irreparably flawed.[38]

We also note that in the 13(d) Rulemaking Proposal, the Commission refers to "potentially informed trading" occurring in the marketplace around activist campaigns. We acknowledge that ill-advised market participants in possession of material non-public information may convey that information to others. This "tipping" behavior is already prohibited by the federal securities laws, as noted above. And neither the Commission nor DERA provide any evidence of actual trading of this nature actually occurring.[39] Given the existence of a meaningful remedy, we would expect that any proposal to create new regulatory provisions to address already-proscribed behavior would evaluate and quantify the need for this new tool, including a discussion of why the existing remedy fails to curb the improper behavior. However, the Commission never demonstrates that such trading does in fact occur at a volume warranting significant changes in longstanding regulations. In fact, it is our understanding that the Commission has not brought a significant number of insider trading enforcement actions that arose out of trading in the context of an activist's campaign (and the Commission cites no such cases in the 13(d) Rulemaking Release). To that end, descriptions by the Commission and DERA of this phenomenon consistently use the modifier "may" (and cite to authorities using that modifier or making blanket assertions without any evidentiary support).[40] This suggests that there is not a market failure here warranting this significant regulatory response. DERA points to increases in trading volumes as potential evidence of "potentially informed trading." Of course, trading volumes could spike in the time preceding the filing of a Schedule 13D for any number of reasons (including other market participants correctly anticipating the identity of a soon-to-be subject of activism based on their own analysis, the soon-to-be subject of activism

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[38] *See, e.g.*, *State Farm*, 463 U.S. at 43 (agency action arbitrary and capricious where agency "fail[s] to consider an important aspect of the problem").

[39] We note (as does Professor Lewis in the Lewis Report) that the Commission has access to confidential data showing with precision who was on each side of every trade in the equities markets, via the Consolidated Audit Trail. If such "potentially informed trading" was in fact occurring with frequency sufficient to justify the 13(d) Rulemaking Proposal, the Commission (including DERA) has access to the data that would so demonstrate.

[40] 13(d) Rulemaking Proposal, pp. 51-52 and n. 88; DERA 13(d) Memorandum, pp. 20-21.

encountering its own adverse developments that increase focus on the stock, or trading activity triggered by quant or high-speed traders).

DERA's reliance upon vague allegations that "potentially informed trading" *may* occur, without consideration of remedies already available to the Commission to restrict such activity, does not provide an adequate basis upon which to construct a cost-benefit analysis justifying any shortening of the Schedule 13D filing deadline. These flawed underlying assumptions compromise the validity of any cost-benefit analysis of this proposal.

B. As DERA's Data Shows, The Benefits of Activism Far Outweigh Any Alleged Costs

In the cost-benefit analysis contained in the 13(d) Rulemaking Proposal, the Commission stated that it was unable to provide a reasonable estimate of the effects of the proposed amendments, as it did not have all the inputs needed for the many variables it identified as relevant to such a quantification.[41] We presume that the DERA 13(d) Memorandum is intended to rectify this inadequacy, at least in part. We welcome the Commission's attempt to improve upon the clearly inadequate economic analysis contained in the 13(d) Rulemaking Proposal.

However, we have significant concerns about many aspects of the updated cost-benefit analysis in the DERA 13(d) Memorandum. As described in this comment letter and the Lewis Report, even if one were to assume, *arguendo*, that DERA's various unsubstantiated assumptions are correct and thus assume that activism creates "information asymmetries" that constitute harms warranting regulatory intervention by the Commission, the DERA 13(d) Memorandum clearly shows that the economic benefits of activism vastly outweigh any such assumed harms.

As noted above, DERA's evaluation of historical Schedule 13D filings from 2011-21 shows that the aggregate increase in shareholder value from activism was $13.8 *billion* per annum, with campaigns initiated by Prominent Activists (as such term is defined by DERA) comprising between 24.6% (for full-stake campaigns) and 37.5% (for less than full-stake campaigns) of these totals.[42] In comparison, DERA's data from the same dataset shows that the "harms" assumed to occur to shareholders who sell prior to public announcement of an activist's campaign aggregate only $93 *million* per annum.[43]

Notwithstanding our significant concerns with a number of the definitional and analytical predicates underlying this data, assuming *arguendo* that this data is accurate, the annual gains to shareholders generated by activism from 2011-2021 are *148 times greater* than the annual losses to shareholders who sold shares in companies that subsequently became the subject of an activist's campaign during that period.[44] We disagree that there are any harms to shareholders in this context for the reasons described above. This data nonetheless provides exponentially strong support for the point that we made in our Original 13(d) Comment Letter, and that has been made repeatedly over the years by any number of activists, academics, reporters and market participants (as well as by other commenters on the 13(d) Rulemaking

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41 13(d) Rulemaking Proposal, Section III.A.

42 DERA 13(d) Memorandum, Table 4.

43 *Id.* at Table 5. We cannot ascertain from this data whether these alleged harms arise in activist campaigns initiated by Prominent Activists or all activists, nor can we ascertain whether the distinction between full-stake campaigns and other campaigns noted by DERA in Table 4 applies to the data in Table 5.

44 Even if activism were to be impaired, rather than eliminated, by the 13(d) Rulemaking Proposal, the costs of any such impairment will far outweigh any potential benefits that the rulemaking might otherwise generate.

Proposal) – activism creates sustainable value for shareholders, and thereby strengthens the U.S. capital markets.[45] Given that disparity, the 13(d) Rulemaking Proposal cannot be "necessary or appropriate in the public interest or for the protection of investors,"[46] and thus it would be arbitrary and capricious for the Commission to adopt the 13(d) Rulemaking Proposal.[47]

Despite the clarity of this data, it is not otherwise mentioned in the DERA 13(d) Memorandum – there is no evaluation by DERA of the relevance of this information to the 13(d) Rulemaking Proposal. We are left to our own devices to ascertain the import of this data, which is actually the elephant in the room. We feel compelled to highlight this information so as to ensure that it receives the attention it warrants as the Commission considers the DERA 13(d) Memorandum.[48]

C. The Presence of Harmful Conduct is Assumed, Not Demonstrated

We note some particularly troublesome drafting in the same section of the DERA 13(d) Memorandum that contains the data confirming our contention that activism creates positive value for market participants. The section in which this data is presented (Section 3) is captioned "Potential Effects Associated with Certain Selling Shareholders." One would expect, from this caption, a discussion of the range of *effects* (both positive and negative) that DERA believes occur. Instead, every other reference in this section uses the word *harm* rather than *effect* (including in the very first sentence of Section 3). There is no discussion anywhere in this section of any "effects" other than harms. As noted above, this presumption of harm is wholly unsupported, and it appears that DERA seeks to mask this shortcoming by the use of the more benign term "effect" in the caption.

Of even greater concern is the first sentence of the first paragraph of Section 3 of the DERA 13(d) Memorandum. That sentence reads as follows:

> A number of commentators suggested that the economic analysis in the Proposing Release could have been enhanced by a quantitative analysis of the potential harms to selling shareholders under the current Schedule 13D filing deadline.

In support of this proposition, DERA provides the following footnote:

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45 In addition to the various sources to which we cited for this proposition in our Original 13(d) Comment Letter, for a more recent source, see *Investor Activism – Seize the day (and the board)* in the Leaders section of THE ECONOMIST, May 27, 2023 at p. 14.

46 *See* Sections 13(d) and 23(a)(1) of the Exchange Act, which are among the statutory provisions that the Commission cites for the authority to adopt the 13(d) Rulemaking Proposal. Both of these provisions require that any rulemaking adopted by the Commission pursuant to such statutory authority must be necessary or appropriate or in the public interest or for the protection of investors.

47 *See, e.g.*, *Michigan v. EPA*, 576 U.S. 743, 752–53 (2014) (in the context of a proposed rulemaking authorized by a statute mandating that any rulemaking must be necessary or appropriate, agencies must "pa[y] attention to the advantages and the disadvantages of [their] decisions" and may not act unreasonably by adopting rules the benefits of which are far outweighed by the costs thereof; "[n]o regulation is 'appropriate' if it does significantly more harm than good.").

48 *See, e.g.*, *State Farm*, 463 U.S. at 43 (agencies may not "fai[l] to consider an important aspect of the problem").

> *See, e.g.*, Lewis Study (exhibit to letter from Elliott) (stating that the Commission "could have estimated the *benefits* to selling shareholders" and presenting one potential approach for such an analysis).[49]

This is of course a reference to the Original Lewis 13(d) Report, which supports our position. Note that DERA's footnote, which refers to a suggestion by Professor Lewis that the Commission could have estimated the *benefits* to selling shareholders of activism, is cited to support the proposition that "a number of commentators" suggested that an analysis of potential *harms* could have enhanced the original cost-benefit analysis prepared by DERA. The Original Lewis 13(d) Report is the *only* authority cited by DERA in the entire DERA 13(d) Memorandum for the proposition that there are harms to shareholders from activism, when in fact the cited authority supports precisely the opposite proposition. This is, with all due respect to DERA and the Commission, a blatantly misleading citation and, once it is eliminated as incorrect, leaves DERA with no support for the theory of "harm" to selling shareholders.[50]

We note, in the same paragraph in which this ill-advised citation occurs, DERA's suggestion that a potential harm is caused by "potentially informed, opportunistic traders" that *may* (yes, that word, again) become aware of a potential campaign prior to disclosure by the activist.[51] We have already discussed the problem with attempting to perform a quantitative analysis of events that may, or may not, occur in the absence of any empirical data as to likelihood of occurrence. Anything *may* happen; the question is what has *actually* happened.

We would also note that activists[52] have significant incentives to maintain the confidentiality of their strategies until they are ready to make public disclosure. Premature disclosure brings forward the market reaction that DERA has acknowledged – prices rise, because activists generally create value for all shareholders, so other investors exhibit herd behavior and emulate the activist's trades. That dynamic, in turn, makes it more expensive for the activist to acquire the exposure to the company's stock it desires, impairing the value of the activist's campaign. We of course cannot say that leaks never happen, and we acknowledge the

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49 DERA 13(d) Memorandum at n. 55 (emphasis added). The language from the Original Lewis 13(d) Report that DERA summarizes in its footnote 55 can be found at page 3 of the Original Lewis 13(d) Report. That language reads in its entirety as follows:

> The Commission could have estimated the benefits to selling shareholders and the costs associated with reductions in the aggregate [of] investor activism. Once again, the Commission chose not to perform this analysis. I offer one possible path toward quantification.

This language comprised one of three bullet points in the Original Lewis 13(d) Report provided in support of the proposition that "the Commission's cost-benefit conclusions are unsupported by any quantitative analysis." Original Lewis 13(d) Report at p. 3.

50 Unfortunately, this is not the only example of misleading citation to authority in the DERA 13(d) Memorandum or in the 13(d) Rulemaking Proposal. *See* footnotes 71, 72 and 80 and respective accompanying text; *see also* our Original 13(d) Comment Letter at note 102 and accompanying text (describing the Commission's citation in the 13(d) Rulemaking Proposal to a law review article for the proposition that cash-settled equity derivatives have been used with the aim of accumulating a significant position of control in public companies, but omitting the subsequent conclusion in the same article that disclosure of economic interests created by cash-settled equity derivatives should not be required). It appears difficult to justify these errors as mere inadvertence.

51 *Id.* at n. 57 and accompanying text. *See also id.* at n. 60 and accompanying text ("further evidence led them to suggest . . .", "institutions unusually accessing EDGAR filings for issuers prior to Schedule 13D filings each appeared to engage in this activity . . .".)

52 As noted above, we only speak for our own firm in this letter and not on behalf of other investment managers that participate in activism. However, our characterizations of how activists engage with the markets reflect our extensive experience in this space generally, and are not solely descriptions of how Elliott acts.

source cited by DERA for the proposition that certain brokers may leak information regarding the trading activity of one client to other preferred clients.[53] Of course, if any such leak occurs, the activist has nothing to do with that behavior. The broker that leaked its client's trading information has violated its obligations under provisions of the federal securities law other than Section 13(d) (as well as the broker's obligation to its client), and has subjected itself to enforcement action by the Commission. Justifying the imposition of new regulatory impediments on activism by pointing to improper behavior by unaffiliated brokers or other unaffiliated market participants is a *non sequitur*, as well as a patently improper basis upon which to attempt to justify a consequential rulemaking that will upend decades-long regulations. This errant regulatory focus on the activist, rather than on the offending opportunistic parties, raises the question we have raised before – whether the Commission is for some mysterious reason carrying water for the corporations and their advisors who want to insulate underperforming executives and Boards from activism.[54]

D. <u>DERA Acknowledges a Significant Potential Cost of the 13(d) Rulemaking Proposal But Fails to Analyze It</u>

DERA estimates that approximately one-third of Schedule 13D filers would be adversely affected by shortening the Schedule 13D filing deadline.[55] This is a consequential acknowledgement, but DERA struggles to evaluate its potential impact on the market. In fact, DERA states that they are "unable to predict how, if at all, a particular filer may change its behavior in response to a shortened filing deadline."[56] DERA does note, however, that if some subset of Schedule 13D filers were to abandon campaigns, approximately $810 million in increased shareholder value would be foregone,[57] and that "academic studies have found that lower levels of activist ownership are associated with smaller increases in shareholder value."[58] It is noteworthy that DERA does not identify any quantifiable countervailing benefits from shortening the Schedule 13D filing deadline against which to compare these acknowledged costs.

It is also important to note DERA's acknowledgement that market participants could adjust behavior so as to avoid the effect of a shortened Schedule 13D filing deadline, but DERA is unable to say how they might do so.[59] We are very confident that the regulatory uncertainty

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53 DERA 13(d) Memorandum at n. 61 and accompanying text.

54 As we noted in our Original 13(d) Comment Letter (at p. 2), we remain mystified as to why the Commission, charged with the protection of all investors, continues to advocate for a rule that would impair the ability of activists to spark healthy debate and create value for shareholders of companies with which an activist engages. We are hopeful that the provision by DERA in the DERA 13(d) Memorandum of data supporting the sustainable value creation point will assist the Commission in concluding that the costs of the 13(d) Rulemaking Proposal far outweigh any potential benefits.

55 DERA 13(d) Memorandum at Figure 3 and accompanying text at p. 15.

56 *Id.* at p. 19.

57 *Id.* at text accompanying n. 53. We do not see how this estimate in forfeited shareholder value was determined, given the far larger amount of value that DERA acknowledges is created by activism earlier in the DERA 13(d) Memorandum. *Id.* at Table 5.

58 *Id.* at text accompanying n. 54.

59 *Id.* at pp. 11, 19. DERA does suggest that activists could adapt to a shortened filing deadline by taking certain actions in lieu of abandoning campaigns, such as "reducing their total economic stake, adding to their stake after the filing date, or accumulating shares more quickly during the proposed new filing window." *Id.* at p. 19. As postulated by DERA, these are suggested as costless options, which is patently absurd. Each of these "options" would fundamentally alter how an activist assembles its exposure to a given company in ways that would impair the ability of an activist to pursue a particular campaign. We would be happy to share our thoughts as to why these options are neither cost-free nor viable with the Commission or its Staff.

that the 13(d) Rulemaking Proposal (and/or the 10B-1 Rulemaking Proposal) will impose will increase the cost of activism and will result in a reduction of the frequency with which activists will engage in campaigns, and we and others have conveyed this view to the Commission frequently.[60] This is, of course, a cost to the market, for the reason stated in this section of the DERA 13(d) Memorandum: "academic studies have found that lower levels of activist ownership are associated with smaller increases in shareholder value."[61] Thus, DERA confirms that the 13(d) Rulemaking Proposal will impose costs on the market, which it is unable to quantify with precision. That does not excuse the Commission from considering those costs in deciding whether the 13(d) Rulemaking Proposal is either "necessary" or "appropriate." Instead, in considering the 13(d) Rulemaking Proposal, the Commission must seek to evaluate those costs, taking into consideration the views expressed in comment letters regarding the likely impact of this and related rulemaking proposals on activism.[62] This uncertainty demonstrates that the Commission lacks a basis upon which to conclude that the benefits of the 13(d) Rulemaking Proposal outweigh the costs. When coupled with DERA's acknowledgment of an unquantified cost to a meaningful subset of market participants from a shortening of the Schedule 13D filing deadline, the bottom line is that the Commission lacks a cost-benefit analysis sufficient to establish that the 13(d) Rulemaking Proposal will in fact be beneficial to the U.S. capital markets (and, as noted above, the Commission has also failed to demonstrate the existence of any harm under the current structure). As such, any such conclusion will not meet the requirements of the Administrative Procedure Act.[63]

E. DERA Misapprehends How Activists Operate

The "Market Trends" section of the DERA 13(d) Memorandum suggests that activists operate solely by accumulating minority equity stakes rather than full control.[64] This appears to be based upon the Brav article, which is cited by DERA.[65] Professor Brav measures the size of activists' stakes in target firms based solely upon purchases as reported on Schedule 13D filings.[66] However, in the same article, Professor Brav and his co-authors state that an activist also "must rely upon support from fellow shareholders,"[67] and then devotes an entire section of the article to the analysis of the role of other investors in activist campaigns.[68] This is consistent with our descriptions of how activists operate.[69]

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60 In addition to various comment letters submitted to the Commission, this view was expressed at the Investor Advisory Committee (the "IAC") held on September 21, 2022, not only by me but by other speakers on the panels that were held that day.

61 *Id.* at p. 19, citing authority in fn. 53. As noted above, we are also very confident that the cost to the market will be far greater than the $810 million annual cost noted in the DERA 13(d) Memorandum at n. 54; instead it would be the a meaningful component of the $13.8 billion annual increase in shareholder value attributable to activism as set forth in Table 4 of the DERA 13(d) Memorandum.

62 *See* nn. 46-47, *supra,* and accompanying text for a discussion of the cost-benefit analysis that is mandated by any regulation supported by a statutory grant of authority setting a standard of "necessary or appropriate."

63 *See id.*

64 *Id.* at p 10 (referring to "strict minority stakes" held by activists).

65 Brav, *supra*, as cited in the DERA 13(d) Memorandum at n. 35.

66 Brav, p. 28 and Table 2.

67 *Id.*, at p. 11. *See also id.* at p. 6 ("Activists . . . do not seek full control but operate by 'influencing control'").

68 *Id.* at pp. 69-79.

69 *See, e.g.,* our 10B-1 Comment Letter at p. 8.

DERA's reference to the ownership metric in Professor Brav's article is thus correct in isolation, but DERA omits the very important further point that an activist's efforts consist of more than acquiring the strict minority stake in the company's stock that an activist typically holds. Such a minority stake, by itself, rarely will enable an activist to influence a given company. Activists assemble exposure to a company in a number of ways, only one of which is by purchasing long positions in the equity of the company, and they can only influence a given company through the force of their reasoning and the ability to convince other shareholders of the merits of their position. All of this entails effort and costs extending beyond the activist's equity and economic exposures to the company.

It is not clear to us the point that DERA seeks to make in this citation to Professor Brav's article, but to the extent DERA seeks to base any aspect of its economic analysis on the presumption that an activist engages solely by means of a "strict minority stake" in the company's stock, that analysis is based on a fundamentally flawed assumption (and one that is not supported by the authority cited by DERA for the proposition).

F. DERA's Extensive Discussion of Abnormal Returns Does Not Demonstrate Anything Improper

DERA provides an extensive discussion of "abnormal returns" in the DERA 13(d) Memorandum. This analysis appears to have been provided, at least in part, in response to a suggestion by Professor Lewis in the Original Lewis 13(d) Report. Professor Lewis noted that such an analysis could facilitate a proper assessment of potential gains to market efficiency, but noted that the Commission chose not to perform this analysis in the 13(d) Proposing Release.[70]

The data provided in the DERA 13(d) Memorandum regarding abnormal returns does not suggest any meaningful correlation between activism and realization of such returns, only that some degree of abnormal returns do occur during the period between a Schedule 13D trigger date and current filing deadline. We note that Figure 2 to the DERA 13(d) Memorandum shows that returns continue to increase after the current Schedule 13D filing deadline for a given event, in an amount that far exceeds the increase in returns between the fifth day preceding the filing deadline and the current filing deadline. There is no discussion of what may cause those gains, or, importantly, whether, if the filing period is shortened, the gains that the Commission labels as "abnormal" in the five-day window prior to filing will simply shift to the period after the new filing deadline.

We also note that there is no attempt to exclude from this analysis any returns that accrued because the Schedule 13D filer publicly disclosed its intent after the trigger date but before filing the Schedule 13D – which is not an uncommon occurrence. In this context, given DERA's quantification of the significant extent by which gains from activism exceed any perceived harms therefrom, any "abnormal returns" may be nothing more than the market's positive reaction to an activist's public declaration of intent. In short, despite the extensive discussion of abnormal returns, and the somewhat pejorative juxtaposition of that concept alongside a discussion in which activism is incorrectly presumed to inflict harms on the U.S.

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[70] *Id.* at n. 79, citing to the Original Lewis 13(d) Report at p. 3. The Original Lewis 13(d) Report cites to two academic studies as examples of the analysis of abnormal returns suggested by Professor Lewis. DERA cites to one such report in the DERA 13(d) Memorandum (Bebchuk, et al., *Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy,* 39 J. CORP. L. 1 (2013)), but for a proposition unrelated to the quantification of abnormal returns (DERA 13(d) Memorandum at n. 33).

markets, there is no data supporting the proposition that activism is the cause of returns that are other than the results of an efficient market.

G. *DERA Makes an Unwarranted Suggestion that Activism Constitutes Unfair Trading that Saps Public Trust in the Securities Markets*

DERA takes the case of "potentially informed, opportunistic traders" to a particularly troublesome extreme at the end of the DERA 13(d) Memorandum. Although neither DERA nor the Commission have established that activists are in any way complicit in any information leakage that may occur in the context of activist campaigns, DERA couples an unsubstantiated allegation that such trading occurs with the truism that "lessening an informational advantage that some market participants may perceive to be unfair could enhance trust in the securities markets."[71] What is, of course, completely lacking in this pairing of concepts is anything other than the unestablished assumption that activism somehow begets trading that diminishes trust in the capital markets. This allegation is in effect an *ad hominem* attack on activism generally, implying that activists aid and abet insider trading. DERA does not suggest that this is a claim with any basis in demonstrated facts, but it is troubling that such an unjustified suggestion could find itself in a document prepared by a regulatory authority as part of an active notice and comment exercise. It seems like the sloppy coda to biased analysis. If, and to the extent, such opportunistic trading occurs, it is not the activists that are so trading. Suggesting that regulatory steps need to be taken to restrict activism to protect the markets against behavior that is carried on by unaffiliated parties and is already proscribed by the federal securities laws does not withstand even the slightest scrutiny.

H. *DERA Makes an Unwarranted Characterization of the Scope of the Commission's Investor Protection Mandate under Section 13(d)*

In its struggle to demonstrate that activism harms the U.S. capital markets, DERA advances the completely novel theory that the investor protection goal that underlies Section 13(d) includes the impact of "activist campaigns on investors other than shareholders of the targeted issuers."[72] The Williams Act was adopted to protect investors in companies that were targets of contests for corporate control or other efforts to influence the ownership or management policies of public companies. Congress was also focused on protecting the market for corporate control. Hostile takeovers (the primary focus of Congress at the time of the enactment of the Williams Act) and activism make public companies stronger by providing a means for shareholders to directly influence underperforming boards and management of public companies.

DERA does not cite any authority supporting this expansion of the SEC's authority under Section 13(d) to include the protection of investors other than investors in the voting securities

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[71] *Id.* at p. 27. We also note that the authorities cited in support of the anodyne proposition that trust in the markets is a good thing are similarly anodyne, and (in all but one instance) wholly unrelated to activism. The 2008 Guiso article (cited in n. 76 of the DERA 13(d) Memorandum) surveyed Dutch households and Italian banking customers to ascertain the effect of trust on stock market participation. The three articles cited in n. 77 analyzed the impact of trust on markets from several different perspectives, with the only article that focused on activism (the 2018 Back et al. article) concluding that "the association between liquidity and asymmetric information of the activist may be indeterminate . . ." None of these sources supports the bald allegation in the DERA 13(d) Memorandum that activism is in fact contributing to an erosion of trust in the markets.

[72] *Id.* at p. 13. *See also Id.* at p. 19 at text following n. 53 for a similarly stark and unsupported suggestion that costs or benefits that may accrue to shareholders of non-targeted companies and debtholders warrant quantification.

of companies that are the subject of Schedule 13D (or Schedule 13G) filings. This is because no such authority exists. There is no reference in any provision of the Williams Act, or in any regulation adopted by the Commission thereunder, or, perhaps most importantly, in the extensive legislative history of the Williams Act, that provides (or even suggests) that Congress's concern in adopting the Williams Act included stakeholders in issuers other than targets or holders of debt securities of targets. The Supreme Court has stated:

> The purpose of the Williams Act is to insure that public shareholders who are confronted by a cash tender offer for *their* stock will not be required to respond without adequate information regarding the qualifications and intentions of the offering party.[73]

Perhaps most obviously, Section 13(d) does not impose any obligation on a filer of a Schedule 13D (or 13G) to provide any disclosure regarding the potential impact of the investment on any company other than the one in which the filer has acquired stock.[74] And, as pointed out in the Lewis Report, DERA's suggestion that adverse effects of activism on third party suppliers or other counterparties to companies that are the subject of an activist effort is flatly inconsistent with internal Staff guidance on the performance of cost-benefit analyses, which view enhanced competition and efficiency as gains, not costs, for cost-benefit analysis purposes.

DERA's cavalier floating of this unwarranted concept as an issue warranting consideration by the Commission is arbitrary and capricious. There is no basis in law for the suggestion, as it flatly contradicts longstanding Supreme Court precedent as well as a well-established Commission position. It was not raised in any manner in the 13(d) Rulemaking Proposal,[75] yet there it is, in the DERA 13(d) Memorandum, cited as a fact in need of no empirical support, inviting the Commission to rely upon it in a final rule. Any attempt to justify regulatory action by this blatantly incorrect securities law analysis will invite challenge under

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73 *Rondeau*, *supra*, 422 U.S. at 58 (emphasis added). Immediately following this passage, the *Rondeau* court cites a discussion contained in the Senate Report on the Williams Act that describes "the dilemma facing such a shareholder". That discussion focuses solely on a shareholder in a company that is the subject of a tender offer. *Id.* at fn. 8, *citing* S. Rep. No. 550, 90th Cong., 1st Sess., 2 (1967). *See also* 5 Louis Loss, Joel Seligman & Troy Paredes, *Securities Regulation* (6th ed. 2021) at p. 52 ("The legislative history thus shows that the sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer.").

74 We of course acknowledge that investor protection is at the heart of the Commission's mission, and we share the Commission's focus on protecting all investors. However, there is no basis for importing into the broad concept of "investor protection" the idea that all investors are entitled to protection in all cases under all aspects of the federal securities laws and the Commission's regulations, and, as noted above, the authority cited by the Commission for the 13(d) Rulemaking Proposal that refer to "investor protection" are subject to an appropriateness standard that mandates a particularly reasoned form of cost-benefit analysis. *See* nn. 46-47 and 62 and accompanying text, *supra*.

75 See footnote 144 to the 13(d) Rulemaking Proposal, which defines "market participant" (as that term is used in the 13(d) Rulemaking Proposal) as follows:

> [A]ny investor in or trader of a covered class, as determined in [the 13(d) Rulemaking Proposal]. The term has been used to account for the foreseeable possibility that a large blockholder may need to consult with persons who are not investors or traders, such as outside counsel, broker dealers, filing agents and others in connection with having to make its initial Schedule 13D filing.

The reference to "investors" embedded in this definition is limited to investors in voting common stock of a company that is the subject of a Schedule 13D filing. The DERA 13(d) Memorandum's suggestion that other investors (whether investors in debt securities of such an entity, or investors in debt or equity securities of unrelated issuers) is a proper concern of the Commission under Section 13(d) is not only fanciful, it is inconsistent with the Commission's own position as enumerated in the 13(d) Rulemaking Proposal.

the Administrative Procedure Act, and also will be susceptible to challenge under the Supreme Court's decision in *FCC v. Fox Television Stations* and related decisions.[76]

I. Concerns Regarding the Reliability of the Data Generally

Note 3 to the DERA 13(d) Memorandum concedes that the number of Schedule 13D filings received by the Commission in 2020 was overstated in the 13(d) Rulemaking Proposal by a factor of two – 5,288 filings actually received as compared to 10,542 filings as reported in the 13(d) Rulemaking Proposal. DERA asserts that this error was due to the inclusion of "duplicate records" in the initial calculation.

What DERA does not say is whether the data for the *other* years analyzed in the Memorandum (2011-21) is reliable, or if similar double counting (or other) issues affected that data. At a minimum, a mistake of this magnitude supports the claims that we and others have been making that the Commission is not allowing sufficient time for complex rulemakings such as this to be properly evaluated, presented for comment, and commented upon.[77] The Commission's error also suggests that similar double counting or other issues may be present in the other years of the review period – it does not appear that DERA has had the opportunity to scrub that data.

As we note above, we also believe that infirmities in the definitions used by DERA to organize its review of historical Schedule 13D/G filing data may introduce additional imprecision into the data.[78] While we have submitted a FOIA request to the Commission seeking, among other things, the data assembled by DERA for evaluation in the DERA 13(d) Memorandum, we have not yet received a substantive response to that request, so we are unable to ascertain how the issues described above may have affected the conclusions drawn by DERA.[79]

5. DERA Correctly Concludes That Regulatory Structures in Other Jurisdictions Are Not Relevant Here.

In our Second Supplemental 13(d) Comment Letter, we described why, contrary to the suggestion by Wachtell, Lipton, Rosen & Katz in a supplemental comment letter filed by that law firm with the Commission, corporate control concepts contained in the law of other jurisdictions are not germane to the 13(d) Rulemaking Proposal. We are gratified by DERA's concurrence in that view.[80]

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76 *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (agencies are free to change their existing policies if they meet a three-part test requiring a reasoned explanation for the change, none of which are met in this instance: (i) the agency must "display awareness that it is changing position"; (ii) the "agency may not depart from a prior policy *sub silentio* or simply disregard rules that are still on the books, and (iii) the agency must show that there are good reasons for the new policy;); see also *Ramaprakash v. FAA, 346 F.3d 1121, 1124 (D.C. Cir. 2003)* (agency "must provide a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored").

77 See n. 10, *supra*.

78 See n. 18, *supra*.

79 Freedom of Information Act Request submitted by Thomas R. Brugato of our counsel Covington & Burling LLP on June 1, 2023, and acknowledged by the Commission's Office of FOIA Services on that date (FOIA Tracking Number 23-02407-FOIA).

80 DERA 13(d) Memorandum, n. 45. We note that, in reaching this conclusion, DERA claims that "several commentators" suggested that deadlines for reporting the acquisition of meaningful ownership stakes in other countries are relevant to the 13(d) Rulemaking Proposal, but does not identify any other commentators that have

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The strength of the U.S. capital markets is due in no small part to the nuanced and balanced regulatory structure created by the Williams Act and implemented by the Commission's regulations and other actions in the 55 years since that Act's enactment. Congress's thoughtful analysis, and the Commission's adherence to Congress's intent, has provided public companies and their shareholders with knowledge of tender offers and activist campaigns while preserving the salutary effects of these events on underperforming companies and Boards. As discussed in our 13(d) Comment Letters, the 13(d) Rulemaking Proposal threatens to compromise fundamental attributes of the U.S. securities regulatory system without justification.

The DERA 13(d) Memorandum helpfully demonstrates the value that activism creates for the market and all investors, yet accepts without question or analysis the Commission's flawed proposition that activism harms the U.S. capital market, warranting regulatory response. We continue to urge the Commission to abandon or significantly amend the 13(d) Rulemaking Proposal.[81]

Sincerely,

Richard B. Zabel

General Counsel & Chief Legal Officer
Elliott Investment Management L.P.
360 S Rosemary Ave, 18th Floor
West Palm Beach, FL 33401

cc: The Hon. Gary Gensler, SEC Chair
The Hon. Caroline A. Crenshaw, SEC Commissioner
The Hon. Jaime Lizárraga, SEC Commissioner
The Hon. Hester M. Peirce, SEC Commissioner
The Hon. Mark T. Uyeda, SEC Commissioner

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advocated for this proposition. We are not aware of any comment letter (other than the Wachtell comment letter and our Second Supplemental 13(d) Comment Letter), that has advocated for (or otherwise analyzed) this position (and of course our Second Supplemental 13(d) Comment Letter did not support it).

81 We note that the IAC provided its recommendations to the Commission as to both the 13(d) Rulemaking Proposal and the 10B-1 Rulemaking Proposal on June 22, 2023. While we are disappointed that the IAC's recommendations as to the 13(d) Rulemaking Proposal do not reflect, or even acknowledge, the testimony provided at the September 2022 IAC meeting that opposed the changes proposed by the Commission, we are particularly surprised that the Commission saw fit to request that the IAC finalize its recommendations prior to the Commission's receipt of comments on the DERA 13(d) Memorandum, and only two days after the issuance of the DERA 10B-1 Memorandum. This suggests that the Commission views the subsequent economic analyses performed by DERA for these rulemaking proposals, and the public comments thereon, are not relevant to the IAC's consideration of these rulemaking proposals. That is a troubling conclusion, which undercuts the validity of the IAC's recommendations.

<u>Exhibit A</u>

Lewis Report on the DERA 13(d) Memorandum

Review of the Supplemental Data and Analysis on Certain Economic Effects of Proposed Amendments Regarding the Reporting of Beneficial Ownership

Craig Lewis[1]

June 27, 2023

[1] I am the Madison S. Wigginton Professor of Finance at Vanderbilt University's Owen Graduate School of Management and a Professor of Law at Vanderbilt Law School. From 2011 to 2014, I was the chief economist of the Securities and Exchange Commission (the "Commission"), where I also served as director of the Division of Economic and Risk Analysis. At the Commission, I focused on economic analysis in the financial regulatory process, and oversaw activities related to agency policy, rulemaking, and risk analysis. This comment letter was commissioned by Elliott Investment Management L.P. I was supported by staff of Global Economics Group, who worked under my direction.

Overarching Comments:

- After reviewing market trends and analyzing baseline data, the Division of Economic and Risk Analysis's ("DERA") supplemental memorandum on the economic analysis of beneficial ownership reporting ("DERA 13(d) Memorandum") does not make a supportable case for shortening the beneficial ownership filing deadline or for any other aspect of the original 13(d) rulemaking proposal ("Proposed Rule").[2] Rather, the DERA 13(d) Memorandum presents an analysis of the baseline and potential benefits that supports the existing reporting regime and highlights the risks of the proposed changes.

- Activist investors benefit shareholders of public companies through improved corporate governance initiatives that result in increases in shareholder value. The DERA 13(d) Memorandum estimates the increase in shareholder value of companies involved with activist campaigns disclosed (in part) through Schedule 13D filings to be $13.8 billion annually (2011- 2021).[3]

- In aggregate, non-activist investors benefit far more from activist campaigns than from the low risk of being a selling shareholder between the proposed Schedule 13D filing deadline and the actual filing date. The benefits are so much greater than the costs that the loss in shareholder value from one fewer activist campaign annually ($128 million on average) due to the Proposed Rule would be larger than the aggregate "harm" to selling shareholders across all campaigns in a year ($93 million).[4]

- Despite commentor objections, DERA continues to refer to selling shareholders as "harmed" investors – though DERA does so without economic justification.[5] When viewed from the standpoint of ex-ante economic efficiency, investors would prefer activist involvement and the associated gains, even if it means that they might miss the gains from a particular activist campaign if they sold between the proposed deadline and actual filing date (the so-called "harm").

- The DERA 13(d) Memorandum reports that over the recent decades, there has been no meaningful change in the average level of beneficial ownership reported in Schedule 13D

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[2] Memorandum of the Staff of the Division of Economic and Risk Analysis, Supplemental data and analysis on certain economic effects of proposed amendments regarding the reporting of beneficial ownership (Apr. 28, 2023), available at https://www.sec.gov/comments/s7-06-22/s70622-20165251-334474.pdf ("DERA 13(d) Memorandum"); Modernization of Beneficial Ownership Reporting, Release No. 34-94211 (Feb. 10, 2022), 87 FR 13846 (Mar. 10, 2022) ("Proposed Rule").
[3] DERA 13(d) Memorandum at p. 18.
[4] DERA 13(d) Memorandum at pp. 18; 25.
[5] Craig Lewis, Review of the Economic Analysis for Proposed Rule Amendments to Modernize Beneficial Ownership Reporting, Exhibit B to letter from Elliott Investment Management (Apr. 11, 2022), available at https://www.sec.gov/comments/s7-06-22/s70622-279518.pdf; Letter from Jeffrey N. Gordon, Columbia Law School (Jun. 20, 2022), available at https://www.sec.gov/comments/s7-06-22/s70622-20132543-303070.pdf.

filings.[6] This contradicts the Securities and Exchange Commission's ("Commission") position that a need for updating beneficial ownership disclosures is attributable to technological advances that facilitate the rapid accumulation of large beneficial ownership positions, leading to investor protection concerns.[7]

- DERA's attempt to characterize declines in shareholder value to the suppliers and close competitors of activist targeted issuers as a *cost* in their economic analysis is anti-competitive and a reversal of the Commission's public guidance on economic analysis that treats enhanced competition (which can lead to lower prices and higher quality) as a benefit of a rule.[8]

[6] DERA 13(d) Memorandum at p. 10.
[7] Proposed Rule at p. 13852.
[8] DERA 13(d) Memorandum at p. 13; Current Guidance on Economic Analysis in Commission Rulemakings, March 16, 2012, at p. 11, available at: https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

Table of Contents

I. Background

I was commissioned by Elliott Investment Management L.P. ("Elliott") to assess the economic analysis in the DERA 13(d) Memorandum. This follows my review of the original economic analysis included in the Proposed Rule.[9] My assessment of the original economic analysis was attached as Exhibit B to Elliott's comment letter dated April 11, 2022 (the "Lewis Study").[10]

As I noted in the Lewis Study, the Commission's position that overall investors and market participants would benefit from a reduction in information asymmetry was left unsupported in the Proposed Rule.[11] In response to suggestions made in the Lewis Study and other comment letters, the Commission has provided a supplemental analysis of one aspect of the Proposed Rule –the potential economic effects of shortening the Schedule 13D filing deadline from ten days to five days.[12]

DERA conducts extensive additional analysis, but often presents the results without explanation, leaving the public to infer the economic implications of their work. Unstated, but discernible from the DERA 13(d) Memorandum, is the fact that non-activist investors gain significantly more from activist campaigns than from the minimal risk of being a selling shareholder during the time between the proposed Schedule 13D filing deadline and the actual filing date. The Commission's initial assumption – that shortening the filing deadline would benefit market participants by reducing information asymmetry – is not defensible. Any decrease in activism due to the Proposed Rule would result in costs to market participants that cannot be offset by selling shareholders. This is not surprising, considering the limited number of selling shareholders (those who sell between the proposed and actual Schedule 13D filing deadline) compared to the overall group of shareholders in a targeted firm, who typically gain from activist campaigns.

Beyond the shortening of the filing deadline, the DERA 13(d) Memorandum notes that other effects of the Proposed Rule may not be readily quantified, which includes changes to group definitions and deems holders of certain cash-settled derivative securities as subject to beneficial ownership reporting.

> *However, we note that this analysis reflects one aspect of the overall potential impact of the proposed amendments, and that other effects of the proposed amendments may not be readily quantified.*[13]

This is an important admission, as the Commission does not have economic support for the remainder of its modernization proposal. Similar to the economics of the shortened filing window, market participants should not expect benefits from the remainder of the proposal. Any reduction of

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[9] Proposed Rule at p. 13876-91.
[10] Craig Lewis, Review of the Economic Analysis for Proposed Rule Amendments to Modernize Beneficial Ownership Reporting, Exhibit B to letter from Elliott Investment Management (Apr. 11, 2022), available at https://www.sec.gov/comments/s7-06-22/s70622-279518.pdf (the "Lewis Study").
[11] Proposed Rule at p. 13877; Lewis Study at. pp. 8-9.
[12] DERA 13(d) Memorandum at pp. 11; 20.
[13] DERA 13(d) Memorandum at p. 11.

shareholder activism caused by the proposed changes would have large implications as it impacts all the investors of an activist engaged company, whereas any "benefits" from alternative group definitions and derivative disclosure would accrue to a small set of investors that choose to sell shares in the short windows of time that immediately precede public disclosure of activism. Ex-ante, market participants would favor activist involvement and the associated gains over the incremental changes in market behavior from a small subset of investors.

II. Potential Effects of Activist Campaigns and Potential Effects Associated with Selling Shareholders

A. Selling Shareholders and Shareholder Activism

Information asymmetry is an essential feature of securities markets.[14] The possibility of informational differences motivates investors to engage in research with the expectation that they may be rewarded if they identify profitable trading opportunities. If this research leads to improved price discovery, some investors will have access to more or better information than others. This can create a competitive advantage for those with superior information and can potentially affect the pricing and trading of securities.

Activist investors rely on their ability to generate informational asymmetries through their research and understanding of the fundamental value of a firm. Activists work to uncover opportunities for firm improvement that are not reflected in the target's current share price. Activists then use this information to push for changes in the target firm's operations, board, or strategies, with the goal of increasing the firm's value. In essence, activists leverage information asymmetries for the benefit of all shareholders by seeking to improve the firm's performance and thus its share price.

The current beneficial ownership reporting rules require investors owning more than 5% of a firm's securities to publicly disclose their holdings, which can reveal the presence of an activist investor and possibly their intentions. By proposing to shorten the filing window from ten days to five days, the Commission is attempting to reduce information asymmetry without demonstrating that there is a need to do so.[15] By forcing activist shareholders to reveal their positions earlier, the Proposed Rule primarily benefits short-term or selling investors, who could leverage this publicly available information without having to perform the same level of research as an activist investor.

This could lead to selling shareholders gaining an 'economic windfall' as they can use the information disclosed by activist investors for their own short-term gains, whereas the activists are more focused on sustainable forms of value creation. The proposal to shorten the filing window suggests that the Commission believes that to make markets function more efficiently, selling shareholders – who may hold less optimistic views on the economic value of target firms – should

[14] Grossman, Sanford J., & Joseph E. Stiglitz, On the Impossibility of Informationally Efficient Markets, The American Economic Review. 70.3 (1980): 393-408.
[15] Proposed Rule at pp. 13847; 852.

receive additional opportunities to benefit from the fundamental research done by other market participants, rather than conducting their own active research. However, the Commission seems to have misunderstood the problem. The transmission of economically valuable information from investors carrying out fundamental research to selling shareholders is an unanticipated bonus, not a "harm" as it is currently labeled. The Proposed Rule disincentivizes activist investors from performing in-depth research and engaging in activism, which would in turn have broader implications for corporate performance, securities markets, and potentially deleterious effects on competition and capital formation.

B. The Risks Associated with a Reduction of Activist Activity Far Outweigh the Economic "Harm" Experienced by Selling Shareholders

The DERA 13(d) Memorandum calculates the economic effect of shareholder activism (see Table 4 of the DERA 13(d) Memorandum) and the "potential harms to selling shareholders under the current Schedule 13D filing deadline" (see Table 5 of the DERA 13(d) Memorandum).[16] DERA estimates that the benefits to shareholders of companies involved with activist campaigns disclosed (in part) through Schedule 13D filings to be $13.8 ***billion*** annually (2011- 2021).[17] By comparison, the aggregate "harm" to selling shareholders across all campaigns is $93 ***million*** annually.[18]

Before discussing the implications of DERA's analysis, it is important to note DERA continues to describe certain activity related to selling shareholders as "harmed" without providing support for that characterization. As I discussed in the Lewis Study, the Proposed Rule's prescribed transfer of economically valuable information from activist investors to selling investors would result in an economic windfall (and not a "harm") that *benefits* sellers rather than the investors concerned with creating additional economic value. I noted in the Lewis Study that the Commission could have provided estimates of the windfall *benefits* the Proposed Rule would transfer to selling shareholders; yet, in the DERA 13(d) Memorandum to justify DERA's analysis they mischaracterize my study as a call for a quantification of *harms*.

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[16] DERA 13(d) Memorandum at pp. 18; 25.
[17] DERA 13(d) Memorandum at p. 18.
[18] DERA 13(d) Memorandum at pp. 25. DERA provides a description of how it identified its set of activist campaigns, the process suffers from both Type I and Type II errors that impact that size of its measurements. A Schedule 13D is classified as an activist investment by DERA if it includes a tabular trading history as determined by text analysis (the text analysis is left undescribed and therefore we are unable to immediately evaluate DERA's process), which the DERA notes some portion of the activities with no tabular table reflect actual transactions and potential activist activities no classified as such. Additionally, as DERA notes, their process leads to some prominent activist activities being misidentified as "corporate action filings." Approximately 253 of the Schedule 13Ds classified as corporate action filings are made by prominent activists (12,657 x 2.0%) (see footnote 9 of the DERA 13(d) Memorandum), this represents 7.6% of DERA's sample of non-corporate action [253/(253+3067)]. DERA could have alternatively analyzed a set of Schedule 13D filed by prominent activists to avoid assignment errors.

A number of commenters suggested that the economic analysis in the Proposing Release could have been enhanced by a quantitative analysis of the potential harms to selling shareholders under the current Schedule 13D filing deadline.[19]

Despite the reference to a number of commenters, the Lewis Study is the only comment letter cited at this part of the DERA 13(d) Memorandum. Setting aside the mischaracterization of my original analysis, the DERA 13(d) Memorandum analysis of the effects on market participants does not support the Commission's position that overall investors will benefit from the Proposed Rule.[20] Consider DERA's estimates of activism benefits and "harms" in a scenario where a shortened reporting window discourages an activist from initiating a *single* campaign in a year. As per Table 4 of the DERA 13(d) Memorandum, the average rise in shareholder value for a campaign that requires more than five days to develop a position is $128 million.[21] This suggests that the lost benefits from a single deterred activist campaign would surpass DERA's estimated total "harm" for selling shareholders per year ($93 million) across an of average 123 campaigns per year from 2011-2022.[22] Since the elimination of just one activist campaign is likely a very conservative estimate, the DERA 13(d) Memorandum does not provide economic justification for reducing the reporting window.

To understand this better, consider DERA's approach to estimating the overall "harm" to selling shareholders – a methodology that is similar to a calculation of ill-gotten gains the Commission might make during an enforcement process when information is improperly withheld from shareholders. This analogy to ill-gotten gains is implicitly how the Commission perceives the profits activists make after the proposed five-day reporting window. The DERA 13(d) Memorandum calculates the total "harm" as the product of abnormal trading volume (excluding the filer's trades) and the change in share price on the days following the proposed five-day reporting window. Abnormal trading volume is determined as the trading volume that exceeds the average daily trading volume in the 60-day period that started 120 days before the filing trigger date.[23] As per the calculations in Table 5, the trades on any given day are assumed to have been executed at the average of that day's closing price and the closing price of the preceding day. The "harm" per share traded is considered as the difference between that price and the closing price one day after the filing date.[24]

DERA uses abnormal trading volume as an indicator of the level of informed, opportunistic trading. They believe the expected volume likely represents trading between uninformed investors, causing no harm.[25] The abnormal volume (excluding filer trading) is then seen as the level of informed trading. This interpretation assumes that the activist has informed select investors about the upcoming campaign before its public announcement and every share exchanged with the opportunistic investor(s) is "harmed." These assumptions are problematic for four reasons: 1)

[19] DERA 13(d) Memorandum at p. 20.
[20] Proposed Rule at p. 13877.
[21] DERA 13(d) Memorandum at p. 18.
[22] DERA 13(d) Memorandum at pp. 25.
[23] DERA 13(d) Memorandum at pp. 22.
[24] DERA 13(d) Memorandum at pp. 25.
[25] DERA 13(d) Memorandum at pp. 21.

activists may announce upcoming campaigns before filing a Schedule 13D; 2) market participants might be able to deduce a significant position is being built by analyzing trading volume;[26] 3) they overlook market makers and day traders (trading participants who open and close their position between the proposed deadline and the filing date); 4) unaffiliated parties like brokers may be trading ahead of an activist campaign, not because it was "leaked" to them but because they learned about the campaign and are breaching their fiduciary duties. In regard to 3), traders that buy and sell during the reporting window would likely represent a material portion of the abnormal volume and would not be impacted. DERA could have used consolidated audit trail ("CAT") data that contains information on which traders were participating in the market to estimate a precise measure of the impact but did not do so. Given DERA's willingness to use CAT data in the recently proposed Order Competition rule, the analysis of "informed" trading is an obvious setting to utilize CAT data.[27]

Finally, DERA's estimate of price change (average of current and previous day's closing prices minus the previous close) inaccurately measures the harm to selling shareholders, as it includes price changes due to general market fluctuations.[28] A more accurate harm estimate would account for abnormal price changes by adjusting for overall stock market variations.

Generally, the large disparity between the benefits to shareholders from activist campaigns and DERA's estimates of "harm" to selling shareholders is not surprising. The announcement of an activism campaign is associated with a positive stock price reaction that benefits *all shareholders* of a target firm while only *a small subset of shareholders* comprise the marginal increase in trading volume between the proposed filing date and the actual filing date, which DERA estimates to be 1.2% of all shares outstanding.[29] Providing selling shareholders with a windfall of value generated through other investors' fundamental research cannot be justified if it risks eliminating benefits to many shareholders from activist involvement.

III. Technology and Other Advancements are not a Basis for Amending Beneficial Reporting

The Proposed Rule pointed to technology and other advancements as a basis for updating beneficial ownership reporting – including the speed at which positions are built and the size of positions needed by activists to engage in campaigns.

> *…in light of the technological advances and the rapid pace with which trading activities and large accumulations of beneficial ownership can occur in the financial markets today as compared to when the deadline was enacted in 1968, we*

[26] Nickolay Gantchev & Chotibhak Jotikasthira, Institutional Trading and Hedge Fund Activism, 64 MGMT. SCI. 2930 (2018).
[27] Order Competition Rule, Release No. 34-96495 (Dec. 14, 2022), 88 FR 128 (Jan. 3, 2023).
[28] DERA 13(d) Memorandum at pp. 25.
[29] DERA 13(d) Memorandum at pp. 25.

are concerned that the current delay in reporting market-moving information on Schedule 13D raises investor protection concerns.[30]

However, the DERA 13(d) Memorandum reports that there has been no meaningful change in the average level of beneficial ownership reported in Schedule 13D filings and does not support the Commission's initiating concern related to investor protection. According to the DERA 13(d) Memorandum,

> *…[in] at least one study, there has been no material change in the average level of beneficial ownership reported in Schedule 13D filings between 1994, the advent of electronic filing, and 2007. Our own analysis of how the statistics reported in this study compare to beneficial ownership reported in more recent initial Schedule 13D filings, from 2011 to 2021, supports the observation that the average level of beneficial ownership reported in Schedule 13D filings has not meaningfully changed in recent decades.* [31]

DERA did not make data available on the size of beneficial ownership positions over the time covered in its analysis or about the speed of accumulation of beneficial ownership positions though they have the data available to present. Regarding whether lower ownership stakes have become more consequential, DERA noted that from their perspective it is uncertain if that is the case.[32] The combination of these admissions indicate there is no support for the justifications provided by the Commission in the Proposed Rule.

IV. DERA is Misplaced in Its Assignment of a Cost to Activist Targets' Competitors and Suppliers

DERA perceives the potential for increased competition and efficiency improvements stemming from activist involvement with issuers as a downside, or 'cost', of implementing the Proposed Rule. This viewpoint is inconsistent with its declared goals of economic analysis. The following statement from the DERA 13(d) Memorandum articulates their perspective:

> *[R]esearch has found that issuers that are the suppliers and close competitors of the targeted issuers, in certain circumstances, experience decreases in shareholder value around an activist campaign, which researchers have associated with cost-cutting and increased efficiency at the target issuer…Thus, any reduction in activism may be accompanied by additional positive or negative effects on other investors.*[33]

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[30] Proposed Rule at p. 13852.
[31] DERA 13(d) Memorandum at p. 10.
[32] DERA 13(d) Memorandum at p. 10.
[33] DERA 13(d) Memorandum at p. 13.

The Commission's March 2012 public guidance on economic analysis in rulemakings (the "Guidance") makes it clear that efficiency gains and competition should be viewed as benefits within the cost-benefit analysis of proposed rules not as costs:

> *Typically, the economic benefits of a rule include likely gains in economic efficiency such as… enhanced competition, which can lead to reduced prices or higher quality…*[34]

The literature referenced by DERA to support its point about *negative effects* of activism makes it clear that associated impacts to competitor and supplier firms are actually in line with the same efficiency and product *benefits* the Commission has stated it is looking for in its economic analysis.

> *The effects on rivals' product market performance is commensurate with post-activism improvements in target's productivity, cost and capital allocation efficiency, and product differentiation.*[35]
>
> *Suppliers can avoid squeezing effects also by building up a new customer base and by creating new markets. More specifically, they can develop products at higher quality in order to gain a cost advantage or differentiate their products away from other suppliers to increase their customer base.*[36]

V. Conclusion

Despite a statutory obligation to determine as best it can the economic implications of a proposed rule,[37] key economic elements presented in the DERA 13(d) Memorandum are left without interpretation, leaving it up to the public to infer the economic implications of their work. The unstated but discernable conclusion is that there is insufficient support for shortening the beneficial ownership filing deadline or, for that matter, for adopting any of the other changes proposed by the Commission in the Proposed Rule. Instead, the DERA 13(d) Memorandum reinforces the validity of the existing reporting regime and emphasizes the risks associated with proposed changes.

DERA's analysis acknowledges the significant benefits that activist investors bring to shareholders through improved corporate governance initiatives, resulting in increased shareholder value. As demonstrated by DERA's own analysis, non-activist investors benefit more from activist campaigns than from the low risk of being a selling shareholder between the proposed filing deadline and the actual filing date. The potential loss in shareholder value from reducing the number of

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[34] Guidance at pp. 10-11.
[35] Hadiye Aslan & Praveen Kumar, The Product Market Effects of Hedge Fund Activism, 119 J. FIN. ECON. 226 (2016), at. p 1 (cited by DERA in n. 42 of the DERA 13(d) Memorandum).
[36] Hadiye Aslan, Shareholders Versus Stakeholders in Investor Activism: Value for Whom?, 60 J. CORP. FIN. 101548 (2020), at p. 31 (cited by DERA in n. 42 of the DERA 13(d) Memorandum).
[37] Guidance at p. 3.

activist campaigns annually due to the Proposed Rule would exceed the aggregate "harm" to selling shareholders.

The DERA 13(d) Memorandum documents that contrary to the Commission's claims of technological advances necessitating updates to beneficial ownership disclosures that there has been no meaningful change in the average level of beneficial ownership reported in Schedule 13D filings over recent decades. This challenges the notion that investor protection concerns arise from the rapid accumulation of large beneficial ownership positions.

Lastly, DERA's inclusion of declines in shareholder value for suppliers and close competitors of activist targeted issuers as a cost in their economic analysis is anti-competitive and contradicts their previous guidance on economic analysis, which treated enhanced competition as a benefit of a proposed rule.

The DERA 13(d) Memorandum does not provide a persuasive case for shortening the beneficial ownership filing deadline (or for making any other changes to Section 13(d)). Rather, it supports the existing reporting regime, highlights the benefits of activist involvement, undermines the justifications for updated disclosures, and raises concerns about DERA's economic analysis approach.