MEMORANDUM

October 31, 2022

TO: File Nos. S7-32-10 and S7-06-22

FROM: Robert Fisher
Office of Commissioner Mark T. Uyeda

RE: Email Communication from Henry T. C. Hu

On October 28, 2022, Commissioner Mark T. Uyeda received an email from Henry T. C. Hu indicating a recently published article touching on issues in connection with the following proposed rulemaking: (1) 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 and (2) Modernization of Beneficial Ownership Reporting. Please see attachment for a copy of the email.

From: [redacted]
Sent: Friday, October 28, 2022 3:19 PM
To: [redacted]
Subject: new article: "Governance and the Decoupling of Debt and Equity: The SEC Moves"

Dear [redacted]

I hope you've been well. In case you might find it of interest, I wanted to mention that I have a new "decoupling" article with the above title that will soon appear in the "Capital Markets Law Journal" (published by the Oxford University Press). A draft is downloadable (for free and without registration) at http://ssrn.com/abstract=4241269 This is the first article to:

> (1) analyze the various decoupling-related SEC proposals (e.g., the December "Swaps Release" and the February "Beneficial Ownership" Release) as a whole, propose significant changes, and offer ideas for enhancing the proffered cost-benefit analysis; and
>
> (2) situate the prospective SEC role with the roles that substantive law authorities (such as Delaware courts and legislature), private ordering, and foreign regulators are already playing.

The article relies in part on the analytical framework for decoupling and associated terminology introduced in a 2006 article I lead co-authored – the one that you had me come discuss in person with you and Commissioners Atkins and Casey.

A brief summary is set out below. If you have any comments or questions, I'd be honored if you cared to share them (my cell is [redacted] if you need to reach me by phone). The article itself is about 30,000 words.

> "Decoupling"—the unbundling of the rights and obligations of equity and debt through derivatives and other means—has posed unique challenges for corporate and debt governance. Corporate governance mechanisms, including those related to shareholder voting and blockholder disclosure in control contests, have faced "empty voting with negative economic ownership" and "hidden (morphable) ownership" issues. Classic contract-based interactions of debtors and creditors have faced "empty crediting with negative economic interest," "hidden interest," and "hidden non-interest" issues. In 2006, the initial version of an analytical framework for decoupling was introduced. In that decade, foreign regulators, Delaware and other substantive law authorities, and private ordering started responding.
>
> In 2021 and 2022, the Securities and Exchange Commission (SEC) voted out proposals directed at decoupling, as well as other proposals that may affect decoupling. Using the analytical framework, this Article is the first to: (1) analyze the SEC proposals as a whole; and (2) consider how the possible SEC role relates to the roles already played by substantive law authorities and private ordering.

As for (1), the Article proposes a variety of fundamental changes to the proposals and shows how such changes as well as judicial findings and actions of foreign jurisdictions can enhance the robustness of the SEC's cost-benefit analysis to potential court challenges.

One set of changes the Article proposes is regarding two SEC proposals relating to the hidden (morphable) ownership strategy for avoiding blockholder disclosure rules under Section 13(d) of the Securities Exchange Act of 1934. Because of Dodd-Frank Act Section 766 "security-based swap" constraints, the SEC proposed a bifurcated disclosure architecture, one for holdings of cash-settled equity swaps (aka total return equity swaps) (per a new Schedule 10B) and one for holdings of other cash-settled synthetic equity (per a revised Schedule 13D). The proposed architecture has two core weaknesses. First, the "situs" of cash-settled equity swaps within the architecture and the architecture's "silo" mindset would upset the vital balance between enhancing market transparency and efficiency and incentivizing shareholder activism important to corporate governance. Second, startling, unjustified asymmetries in regulatory treatment would arise across categories of synthetic equity and between synthetic equity and direct equity. The Article offers a solution that, despite Dodd-Frank Section 766, would better incentivize activism and reduce the asymmetries.

Another set of changes the Article proposes is regarding an SEC proposal directed at empty creditors with negative economic interest. The Article shows, for example, that the proposed disclosure requirements could be triggered when empty crediting is impossible even in theory. This is because merely holding credit default swaps in the requisite amount could require disclosure even absent any holdings of the debt or equity that carry with them the control rights essential to undermining the company's viability. The Article proposes changes.

The SEC's proposals are susceptible to litigation on cost-benefit grounds. For example, broadly speaking, some market participants question the existence of the hidden (morphable) ownership phenomenon. The Article shows how judicial findings in related litigation involving U.S. persons or U.S. courts can help address this claim. Similarly, it shows that all foreign jurisdictions examined (Australia, Canada, France, Germany, Hong Kong, Ireland, Italy, Netherlands, Switzerland, and the United Kingdom) have adopted measures to address hidden (morphable) ownership.

As for (2), the Article begins by showing that Delaware and other state substantive law authorities have used the analytical framework and exhibited aversion to empty voting. It also shows how private ordering is addressing both debt decoupling (via, e.g., "net short" provisions in debt agreements) and equity decoupling (via, e.g., "morphable ownership" provisions in poison pills). Certain SEC proposals are potentially helpful to such Delaware and private ordering efforts.

Thanks again!

Best Regards,

Henry

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