COUNCIL FOR INVESTOR RIGHTS AND CORPORATE ACCOUNTABILITY

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

December 20, 2022

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

Re: Comments of Release No. 34-93784 (File No. S7-32-10) and Release No. 34-94211 (File No. S7-06-22)

Dear Ms. Countryman:

We are a consortium of investors, known as the Council for Investor Rights and Corporate Accountability ("**CIRCA**"), who are committed to ensuring there is a strong system of corporate governance in place in the U.S. for the betterment of the U.S. capital markets, investors in those markets and the U.S. economy generally.

We are writing to reiterate our opposition to the Securities and Exchange Commission (the "**SEC**") proposal to: (i) adopt public, next-day reporting of security based swaps; (ii) remove clear definitional lines around the "group" definition under Section 13(d) of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), and (iii) treat activist derivatives counterparties as beneficial owners of the referenced securities (together, the "**Proposals**").[1] The SEC should **not** adopt these Proposals.

We are also writing to express our strong disagreement with the arguments made by Wachtell, Lipton, Rosen and Katz in a comment letter, dated October 4, 2022 ("**Wachtell Letter**") in support of the Proposals.[2] The Wachtell Letter concludes that the Proposals would make shareholder reporting "more consistent with the original intent of Section 13(d) of the Exchange Act, and with the early-warning systems in the most advanced market economies with which our nation competes."[3] The Letter notes that the more aggressive disclosure requirements under the Proposals

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1 *See* CIRCA Letter, by Rob Collins, to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, regarding Release No. 34-93784 (File No. S7-32-10) (March 21, 2022); CIRCA Letter, by Rob Collins, to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, regarding Release Nos. 33-11030 34-94211 (File No. S7-06-22) (April 11, 2022); and CIRCA Letter, by Jose Ceballos, regarding Release No. 34-93782 (File No.S7-32-10) and Release No. 33-11030, 34-93782 (File No. S7-06-22) (Sept. 8, 2022).

2 Letter from Wachtell, Lipton, Rosen & Katz, to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, regarding Release Nos. 33-11030, 34-94211 (File No. S7-06-22 (Oct. 4, 2022).

3 *Id.* at 2.

and related rules are necessary to provide "essential information to the markets … so that all market participants have access to the same information."[4] Wachtell argues that the Proposal's change to the "group" definition is a "measured amendment" that does not put "mainstream institutional investors at risk of being deemed part of a group."

We do not agree with Wachtell that foreign corporate governance and shareholder reporting systems provide a better balance than the current U.S. system does between market information and shareholder activism. Wachtell has made these arguments before, and their arguments were found to be lacking.

Some years ago, Wachtell warned that U.S. businesses would fall behind their foreign counterparts unless the U.S. adopted management-friendly, governance regimes, such as those in Germany and Japan.[5] Wachtell argued that the U.S. shareholder-friendly environment held back the ability of U.S. companies to compete because shareholder pressure required U.S. directors and management to focus on short-term expansion rather than long-term planning. U.S. states did not generally adopt more insulating governance structures in response to the warning and, contrary to Wachtell's predictions, U.S. companies did not fall behind their foreign counterparts.[6]

Wachtell's argument regarding foreign corporate governance approaches fails to mention that some of the foreign jurisdictions cited offer benefits to shareholders that the U.S. does not. As a result, these foreign systems as not "apples to apples" with the governance system in place in the U.S. For example, shareholder-friendly benefits available under some foreign regimes cited by Wachtell include: (i) the ability for shareholders to call special meetings to remove all the directors, (ii) prohibitions on adoption of poison pills by issuers; and (iii) maintenance of regulatory takeover panels that provide orderly oversight over change of control offers. These benefits help to offset the hurdles faced by shareholders in foreign jurisdictions as a result of the more aggressive reporting requirements.

The Wachtell Letter argues that a shorter Schedule 13D filing timeline and public derivatives reporting are necessary to provide "essential information to the markets, so that all market participants have access to the same information" and shareholders can see "the extent to which [activists'] interest are consistent with the sustainable profitability of the company…"[7] These arguments are not borne out by empirical evidence.[8] Studies show that "activist interventions

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[4] *Id.*

[5] L. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, Columbia Law Review, Vol. 113:1637 (2013) ("**Columbia Law Review Article**") at 1650.

[6] *Columbia Law Review Article* at 1650.

[7] *Wachtell Letter* at 2.

[8] Not only do studies undermine the argument, but countries have also found that more aggressive shareholder reporting regimes are not beneficial to shareholders generally. For example, Canada, which considered adopting a derivatives reporting regime to address alleged gaps in essential information ended up determining not to adopt such a regime given the adverse impact such regimes would have on shareholder activism and the risk that such a regime would end up entrenching management. *See* Notice and Request for Comments, Canadian Securities Administrators, with respect to proposed amendments to Multilateral Instrument 62-104

benefit targeted companies and their shareholders both in the short term and in the long term"[9] and produce company returns that remain higher for years after the activist event.[10] This evidence suggests that shareholders are not disadvantaged by not "getting in" on an investment targeted by an activist early on because the shareholders share in the long-term benefits of the activism for years after the activist event.

We are not aware of any evidence – and Wachtell did not provide any evidence – showing that shareholders are harmed by the timing of when they "get out" of an investment under the current reporting timeline. To the extent that shareholders unwittingly "miss out" on obtaining higher prices or returns generated by activist activity by selling prior to the filing of an activist's Schedule 13D, in our experience, those sellers tend to be large, sophisticated financial institutions and not retail investors. These selling institutions generally sell on the tail of activist purchases based on the enhanced market liquidity available in the market. Contrary to the SEC's assumptions, it is not clear that these institutions would elect not to sell if they knew the content of the activists' Schedule 13D filings on an earlier date. Instead, depending on the particular investment strategy followed by the institution for its clients, institutions often sell even after a Schedule 13D filing indicating activist activity in a stock because the stock no longer satisfies the issuer's investment guidelines. Regardless, these institutions are well positioned to evaluate the timing of their sale transaction and the possible reasons for the increase in market liquidity in a particular name. As a result, there is not any need to adopt more stringent reporting requirements to better protect them.

Contrary to additional claims made in the Wachtell letter, reporting of derivatives positions and earlier reporting of share positions do not benefit the broader shareholder community. Instead, public reporting primarily benefits management and directors seeking to prevent shareholders from having a role in corporate actions. For public shareholders, the end result of derivatives reporting is that activism will be materially diminished and shareholders, as a result, will not realize the long-term benefits that follow activist activity and oversight of management and the board.

Takeover Bids and Issuer Bids and National Policy 62-103 *Early Warning System and Related Take-over bid Insider Reporting Issues.* Among other changes, the proposals would treated securities underlying derivatives as reportable under large beneficial ownership reports, similar to Schedule 13D.

[9] *Columbia Law Review Article* at 1668. *See also Id.* at 1669 ("…the two studies by Alon Brav and his coauthors examined changes in operating performance during the two years following the filing of a 13D. These studies used three standard metrics that financial economists employ for measuring operating performance: return on assets (ROA), operating profit margin, and Tobin's Q (which measures the effectiveness with which a company turns a given book value into shareholder value). The studies found that targets of activist interventions experienced significant improvement in these metrics during the two years following the announcement of the interventions, as compared to similar firms not targeted. Furthermore, the studies found that the target companies were underperforming before the interventions and that their performances recovered during the subsequent two-year period.").

[10] *Id.* at 1674 ("…the leading study on hedge fund activism by Alon Brav and his coauthors …. examined the returns of activist targets in the two years following an activist event. The study found no evidence of the stock price reversal feared by insulation advocates in either the first or second year following the activist event.") and 1675 ("…the study finds no evidence of the asserted reversal of fortune during the five-year period following the 13D announcement window. To the contrary, the targets of activism did not exhibit abnormal negative returns during any part of the period.").

Wachtell's conclusion that adoption of the Proposals would "make the [shareholder reporting and "group" definition] rules more consistent with the original intent of Section 13(d) of the Exchange Act…." and … benefit shareholders", is incorrect.[11] The original intent of the Williams Act was to prevent coercive, squeeze out mergers. In adopting Schedule 13D reporting, Congress expressly sought to "avoid tipping the scales either in favor of management or in favor of the person making the takeover bids."[12] Congress did not seek to adopt a law that would discourage shareholders from having discussions among themselves or sharing views regarding proposals to hold management and directors accountable.

Wachtell asserts that the Proposal implementing the section 13(d)(3) "group" definition "cannot be reasonably read as extending" to cover activities of "mainstream" investors, including meetings with activists.[13] We do not agree. The Proposal's elimination of the established legal standard, linking "group" status to the presence of an agreement, is a material change not only in substance but also in approach. Moving from the current bright-line, "agreement" test to a "facts and circumstances" standard will be difficult to apply and likely to have a chilling effect on the willingness of institutional shareholders to interact with activist shareholders.

We do not believe that the right approach to address ambiguities in the Proposal's suggested "group" definition would be to adopt a safe harbor, along the lines of what Wachtell proposed. Wachtell suggests, in order to avoid any "misunderstanding" regarding the proposed "facts and circumstances" definition of "group," that the SEC clarify that "mainstream passive institutional investors" would not trigger Schedule 13D "group" status if they meet with activists so long as they "qualify and act" as Schedule 13G filers.[14] The Wachtell test is, by definition, circular; it effectively provides that an investor will not trigger the "group" definition if it is "passive" (which itself is based on facts and circumstances). This safe harbor does not provide any clarity or "safety" to shareholders. Instead, the proposal will serve merely to diminish management accountability.

When evaluating Wachtell's argument, SEC should bear in mind that Wachtell is personally invested in the SEC's adoption of public shareholder reporting and beneficial ownership rules for derivatives as well as a broader definition of "group" in order to allow its clients to better defend themselves against shareholder actions. Wachtell represents the management and directors of a number of public companies in the U.S., and will be better positioned to kill shareholder efforts to bring about corporate change as a result of the tools that the Proposals provide. The proposed public reporting requirements will give management and directors more information to use to entrench themselves, and the broadening of the group definition is likely to dissuade institutional shareholders from interacting with activist shareholders or participating in activist initiatives.

We continue to advocate for preservation of a strong corporate governance environment in the U.S. as being in the best interest of all shareholders and of our capital markets generally. In order

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[11] *Wachtell Letter* at 17.

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

[13] *Id.* at 16.

[14] *Id.* at 17.

to meet that standard, it is essential to ensure the necessary safeguards to permit shareholder oversight through activism be preserved. These include not requiring public reporting of cash settled swaps, defining a "group" for purposes of section 13(d)(3) as persons who have entered into a written or oral agreement to vote together or to change control of a company (as the law currently provides) and retaining the existing beneficial ownership definition that recognizes that cash-settled derivatives do not give rise to a reporting obligation. We also oppose the SEC's efforts to shorten the time period for Schedule 13D reporting and note that the SEC has not provided any convincing argument on why a condensed time period is needed or that the costs involved in shortening the time period outweigh the benefits to retaining the current, longer reporting time line.

In order to most effectively protect shareholders and maintain a fair balance between the interests of management and directors and the interests of shareholders and of the capital markets generally, the SEC should **not** adopt the Proposals – in any form – and should not reduce the Schedule 13D reporting time line to less than 10 days.

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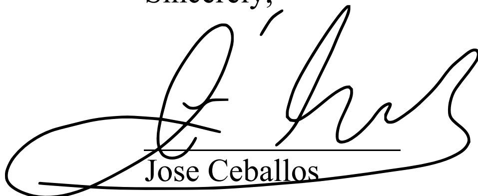
We appreciate the opportunity to comment on the Proposals and the Wachtell Letter. Should you have any questions on our comments or would like to schedule a call, please feel free to reach out to our Counsel, Willkie Farr & Gallagher LLP, Georgia Bullitt, at [redacted], Russell Leaf, at [redacted], or Tariq Mundiya, at [redacted].

Sincerely,



Jose Ceballos