# SEC CHANGES WOULD LET YOU KNOW MORE ABOUT YOUR SHAREHOLDERS

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It has been more than 50 years since the Securities and Exchange Commission ("SEC") adopted its beneficial ownership reporting rules, which require investors who buy more than a 5% stake in a company to disclose their holding and their intentions. There have long been concerns that the rules needed to be updated to keep pace with current market practices and real-time information flows.

In February 2022, the commission announced several proposed amendments that attempt to address those perceived shortcomings. The time frames for disclosures would be reduced, so that an investor who passes the 5% threshold would be required to disclose that fact within five calendar days instead of the current 10. Subsequent changes to the holding would have to be disclosed within one business day.

In addition, some cash-settled derivatives that allow the holder to vote shares would now be encompassed by the rule and count toward the threshold—securities not covered by the current rules.

Finally, amendments would alter the definition of when investors are acting together for the purposes of influencing or changing control, dropping the current rule's requirement that there be "an agreement." The change could force some activists, for instance, to aggregate their holdings for purposes of the disclosure thresholds, thus requiring them to reveal their holdings and intentions.

Do the proposed amendments go far enough to address information asymmetries in today's market environment? How will market participants react to the proposed amendments? Brian Breheny, head of Skadden's SEC Reporting and Compliance practice and former chief of the SEC's Office of Mergers and Acquisitions, recently discussed these questions with Skadden M&A partner Ann Beth Stebbins for "The Informed Board," transcribed below:

***Ann Beth Stebbins****: The SEC recently proposed several amendments to its beneficial ownership reporting rules. We call these 13D and 13G, but trying to avoid the alphabet soup, we'll stick to "beneficial ownership reporting rules." The rules were originally designed to address information asymmetries, but we've seen a lot of changes in the market since those rules were first adopted. What do the beneficial reporting rules currently do? How do they work?*

***Brian Breheny***: After the financial crisis, there was a real movement to try to change these rules, which, ultimately, didn't happen for varied reasons.

The beneficial ownership rules were adopted in 1968, as part of the Williams Act. It was a response to, what was then, one of the biggest merger phases in U.S. history. And there was a view that there was lacking, under the federal securities laws, disclosure and protection for companies and investors. And so


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the beneficial ownership rules were adopted to require that an individual who owned more than 5% of a company's securities to make public disclosures. The rules required disclosures if triggered—if you went above 5%—within 10 days on a form filed on the SEC's website or filed with the SEC. In those days, there wasn't a website; now there is, of course.

For a long time, people were saying, "Is it time to modernize those rules? Ten days is a long time. Do we still need that amount of time?" So, that is something the SEC did, as well as a bunch of other things: modernizing the rules and how they apply, and what securities are covered. I mentioned the financial crisis: there were a lot of derivatives that impacted the market, and the view was, by a number of market participants, that there just wasn't the level of information available for people to understand the types of securities that could impact the market and companies. And so, that's why I mentioned, when I was at the SEC, after the financial crisis, there was a real hope and expectation that the SEC was going to amend these rules. And for different reasons, they didn't.

The whole idea is to give companies and investors an early warning system. Because if you trigger this requirement after the 10 days to file—after the document itself gets filed—it has a lot of information in it, including what plans or proposals this large investor has with regards to the company, including potentially take-over or activist plans.

***Stebbins**: Let's talk a little bit about the definition of "group," and how the new rules will treat market participants and, in particular, market participants who coordinate their behavior.*

**Breheny**: This is a really crucial part of this rulemaking. When I was running the M&A office at the SEC, I would hear from time to time from people who would say, "When are you folks at the SEC going to go after such-and-such hedge fund that's coordinating with each other to take over companies? They all work as groups." And honestly I would say, "tell me the information you have," and why wouldn't I investigate that, if it was actually true?

For the longest time, the view was that you needed an agreement among one or more shareholders to act together, basically. And in the release, what the SEC says, is that they're proposing to remove the word "agreement." They've changed it now to just say, "two or more persons are acting together," which leaves open what ultimately will be needed to try to prove that they're acting together. The SEC also stated in the release it issued for these proposed rules that, based on the statute, an agreement was never required to find shareholders acting as a group.

I think the hope was, or the hope is, is that they're going to try to find ways to capture concerted actions among shareholders in a way that, perhaps, they didn't in the past. Honestly, as somebody who advises on these rules, just like you, for a long time, I think most people believed that you really needed to have an agreement in order to be a "group." And absent that agreement, it wouldn't be a "group."

I think what the SEC's trying get at is to give themselves some flexibility, which I think could be very good for companies, right? Because there are activist investors who are taking concerted actions, but they're not aggregating. Remember, if you form a "group," you have to aggregate your share ownership. So, if a shareholder is at 3%, and another shareholder is at 3% individually they're below 5%. Collectively, they're *above* 5%, and if they're viewed as a "group". . . they would have to disclose their ownership.

***Stebbins**: And their intentions.*

***Breheny*:** Absolutely. And that's the key. I really do think it's going to be in the details because if the rule gets adopted, the SEC still has to get out and make those arguments that say they're acting together. So, the agreement requirement has been eliminated, or will be eliminated. They still have to prove that shareholders are acting together. I think it's going to be difficult for the SEC to prove that.

I think that, at the end of the day, it's probably a good step because of a little bit more flexibility, to try to go after folks they may view as skirting the rules.

***Stebbins***: *One thing I saw when I read the proposed rules is that there are some limitations on the acting-in-concert concept, as to what the purpose is. So, it has to be with the purpose or effect of changing influence of control. And I think that's important because the SEC does not want to stifle or chill shareholder communications. Shareholders can still talk to each other, right? So, how do you think about that if you are an activist, or let's say you're a corporate director and there is an activist in your stock, and your activist stockholder is talking to other activists about something that's not necessarily changing or influencing control. They're talking about ESG. They're talking about climate. They're trying to influence the climate policies of an Exxon. That is not forbidden at all or restricted in the rules as proposed. Am I reading that right?*

***Breheny:*** I think the SEC is in a difficult spot. They want the rules to not restrict the ability for investors to communicate with the company. And so, what they've tried to do—

***Stebbins***: *And with each other.*

***Breheny:*** And with each other, that's right. And so, what they've tried to do is at least give some guidance as to what they would view as "change of control" as opposed to something that wouldn't change control. This has also been an issue in the shareholder's proposal context. You'd say, "If I'm an investor who believes I don't have a change of control intent," or at least "I'm holding my shares without a control intent," and if somebody approaches me, somebody who wants to take over the company, somebody who would like to speak to management about executive compensation, somebody who would like to speak to management about, as you mentioned, ESG. If I start a conversation with the company or that other investor, have I now just changed my intent? Which has an impact—an impact on how they report under these beneficial ownership rules.

So what I think they're trying to do here is give a little guidance because, honestly, I think the SEC wants to be able to allow investors to talk to each other and the company, as long as it's not intended to try to take over control. So if you want to speak to management about compensation or voice your concern that you think management's getting paid too much money, or you have a particular issue about some sort of compensatory arrangement at the company, should that be viewed as a control tactic? I think most people will think the answer is no.

It becomes a different situation if the company is in play and you're calling the company to try to advance another structure of a transaction or alternative transaction. It's a little bit of a slippery slope because now: Are you trying to influence control of the company? The SEC and the staff have given guidance related to these matters a few times. Some of it was staff guidance, not commission guidance, and some of it is commission guidance where they're trying to say, "Here's how we would think about this so that people have a little bit more flexibility." Honestly, it's still going to be facts and

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circumstances because you'll have to think about the context in which these communications are happening, but I think it's good that the Commission is on the record with some of this guidance. It will be helpful as companies and investors, and lawyers who advise them, think about these facts. It's good to see kind of how the SEC is thinking about this—and again, the Commission as opposed to the staff.

***Stebbins****: Where could the SEC have gone farther, compared to European regimes or where proponents of rule changes in this area have been pushing?*

***Breheny:*** So today you have 10 days to report if you trigger the 5% threshold. It's been proposed to shorten that to five days. In other jurisdictions, within a day you have to get the information out. In the UK, I think that the timeframe is a day.

In addition, in many jurisdictions once you've triggered the threshold, you cannot buy any more shares until the report is on file. The way that the SEC rules work is if you trigger the 5%, you have 10 days to file the report. During that 10 days you don't have a standstill, so you could continue to buy.

I've been involved in situations where we've had clients who called and said, I've just got a call from an activist investor, and they told me they own 19% of the stock—that's illegal, correct? And I'm like, "No, unfortunately." Under the rules, if you trigger 5%, you can buy all you want at that point, and then you have to file within 10 days. So it's not uncommon to see somebody file 13D and say "Okay, I triggered the 5% 10 days ago, and now I own 19% because I've been buying during that 10-day period."

The SEC didn't go there: they asked some questions about it, but they haven't done that. That's something I thought, "Boy, that would not go down well in the activist community," I realized, "but they didn't propose it." They could adopt it when they adopt the rules. They could change it, but the rules won't be exactly the same. We'll see what happens in the "public comment process."

***Stebbins****: How much attention will this get in the "public comment process," and who do you expect to be commenting?*

***Breheny****:* It's going to be interesting to see. Corporate America has been asking for this for a long time, and so I suspect most of those folks—the Society for Corporate Governance, the Council of Institutional Investors—I think a lot of people will weigh in here.

***Stebbins****: What about our friends the activists?*

***Breheny***: Yes, I don't know, I guess it's possible.

***Stebbins****: They want more time, so they can instill discipline on corporate boards.*

***Breheny***: I think you're probably right. I think the Managed Funds Association, which represents the hedge fund industry, might weigh in with a comment. They certainly were very vocal when I was at the SEC and thinking about these rules. I also think it's quite possible by the way, that if these rules get adopted they will get challenged. Many of the SEC rules, as you know, have been challenged over the years. The SEC got the authority to shorten the 10-day timeframe in the Dodd-Frank Act, and so I don't think there's an argument that the SEC doesn't have the authority to do this. Many of the recent challenges to SEC rules have been challenges under the Administrative Procedure Act. The SEC, like all federal agencies, is required to consider the cost/benefits on the economic analysis, and a lot of times the challenge is based on that. They'll say "SEC, you shortened it to five days and you weighed the cost/benefits, but you didn't do it accurately."