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April 28, 2022

Submitted via email to: rule-comments@sec.gov
Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: File No. S7-06-22
Release Nos. 33-11030; 34-94211
Comments on Modernization of Beneficial Ownership Reporting

Dear Ms. Countryman:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities (the "**Committee**" or "**we**") of the Section of Business Law of the American Bar Association (the "**ABA**") in response to the request for additional public comments by the U.S. Securities and Exchange Commission (the "**Commission**") on the proposed rules entitled "Modernization of Beneficial Ownership Reporting" (the "**Proposed Rules**") as set forth in a release published in the Federal Register on March 10, 2022 (Release Nos. 33-11030; 34-94211; File No. S7-06-22) (the "**Proposing Release**").

The comments expressed in this letter (this "**Comment Letter**") represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and, therefore, do not represent the official position of the ABA. In addition, this Comment Letter does not represent the official position of the Section of Business Law of the ABA or the views of the organizations to which members of the drafting committee may be affiliated with.

I. Overview

Nearly 50 years ago, in 1974, the Commission, acting at least in part in response to "apparently varying judicial interpretations of the Williams Act,"[1] commenced a fact-finding investigation to "re-examine the entire area"[2] of

[1] Adoption of Beneficial Ownership Disclosure Requirements, Exchange Act Release No. 13291 (Feb. 24, 1977).
[2] *Id.*

administrative regulation under the Williams Act.[3] On the basis of the findings of that investigation, between 1975 and 1978 the Commission proposed and adopted, but then delayed, amended, re-designated, and then again adopted, certain rules relating to disclosure required pursuant to Section 13(d) of the Securities Exchange Act of 1934, as amended (the "Act").[4] The postponement in implementing those rules was prompted by the Commission staff's receipt of "numerous inquiries and requests for interpretation advice concerning their application"[5] after the rules were initially adopted, notwithstanding that those rules had been drafted with the benefit of the findings produced by a targeted public fact-finding investigation.

We understand the purpose of the Proposing Release is to address perceived abuses of the beneficial ownership rules in contests for corporate control, as well as reduce information asymmetries in connection with potential control positions. As set forth in the Proposing Release, the Proposed Rules include, among other things, (i) shortening the filing deadlines for initial and amended beneficial ownership reports filed on Schedules 13D and 13G, (ii) defining "deemed" beneficial ownership to include reference securities underlying cash-settled derivative securities that are held for the purpose or effect of changing or influencing the control of the issuer of the reference securities, or in connection with or as a participant in any transaction having such purpose or effect, clarifying disclosure requirements of Schedule 13D with respect to derivative securities, and (iii) clarifying the circumstances under which two or more persons have formed a "group" under the Act and new exemptions to permit such persons to communicate and consult with each other, jointly engage issuers and execute certain transactions without being subject to regulation as a group.

We support the Commission's proposal to accelerate the initial Schedule 13D filing deadline given technological advancements and in recognition of the desire to reduce perceived information asymmetries between activities and their targets to promote greater market transparency. However, we believe the Proposing Release, in its effort to target perceived abuses and reduce information asymmetries between investors in connection with control positions, will increase the complexity of the beneficial ownership rules for, and

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[3] *See* Notice of Public Fact-Finding Investigation In the Matter of Beneficial Ownership, Takeovers And Acquisitions by Foreign and Domestic Persons, Exchange Act Release No. 11003 (Sept. 9, 1974); Public Fact-Finding Investigation In the Matter of Beneficial Ownership, Takeovers And Acquisitions by Foreign and Domestic Persons, Exchange Act Release No. 11008 (Nov. 5, 1974).

[4] *See*, *e.g.*, Various Proposals Relating to Disclosure of Beneficial Owners And Holders of Record of Voting Securities, Exchange Act Release No. 11616 (Aug. 25, 1975); Adoption of Beneficial Ownership Disclosure Requirements, Exchange Act Release No. 13291 (Feb. 24, 1977); Deferral of Effective Date of Beneficial Ownership Disclosure Requirements, Exchange Act Release No. 13844 (Aug. 10, 1977); Filing and Disclosure Requirements Relating to Beneficial Ownership, Exchange Act Release No. 14692 (Apr. 21, 1978).

[5] Exchange Act Release No. 13844.

compound the frequency of disclosure from, institutional investors listed in Rule 13d-1(b)(ii), such as registered broker-dealers, banks, registered investment advisers, registered investment companies and insurance companies ("**QIIs**"), and other market participants that certify that they do not hold the equity securities with the purpose or effect of changing or influencing control of the issuer.

The Commission has historically sought to reduce the reporting demands on market participants acting in the ordinary course of their business or without the purpose or effect of changing or influencing the control of an issuer, even when their beneficial ownership percentage has exceeded the five percent threshold, in part because the Williams Act focuses on rapid accumulations of issuer stock with an intent or effect of controlling the issuer.[6] In particular, the Proposed Rules raise many of the concerns previously acknowledged by the Commission when it amended the beneficial ownership rules to reduce the reporting obligations of Passive Investors[7] by allowing Passive Investors to use Schedule 13G because, at the time, the beneficial ownership reporting regime had imposed "unnecessary disclosure obligations on persons whose acquisitions do not affect the control of issuers."[8] In adopting the amended rules, the Commission also observed that QIIs are permitted "greater flexibility in filing amendments in recognition of the fact that [QIIs] routinely buy and sell securities in the ordinary course of business and are less likely to abuse the process."[9] We believe the Proposed Rules will impose significant burdens, including collateral costs, on QIIs, such as pension funds, that will ultimately be passed along to shareholders, employees and the market in general.

We recommend the Commission reassess whether it should exercise its rulemaking authority to expand the definition of "beneficial ownership" to include cash-settled derivatives. In the alternative, we recommend the Commission further tailor the Proposed Rules to directly target the perceived abuses in the use of derivatives in connection with control activities, while sparing undue reporting burdens and legitimate trading activity. If cash-settled derivatives are to be covered in any adopted rules, we believe the market will be better served if the Commission provides a more refined approach relating to control activities in order to avoid interfering with the unrelated use of derivatives for trading and risk mitigation purposes.

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[6] H.R. Rep. No. 90-1711 (1968); *See also* Filing and Disclosure Requirements Relating to Beneficial Ownership, Exchange Act Release No. 17353 (Dec. 4, 1980).
[7] The term "Passive Investor" as used in Comment Letter refers to beneficial owners eligible to report beneficial ownership on Schedule 13G in reliance upon Rule 13d-1(c), consistent with the Proposing Release.
[8] Amendments to Beneficial Ownership Reporting Requirements, Exchange Act Release No. 39538 (Jan. 12, 1998).
[9] *Id*.

Moreover, we believe the proposed changes to conform proposed Rule 13d-5(b)(1)(i) to the statutory text of Section 13(d)(3) and (g)(3) of the Act will create significant uncertainty and will make compliance with the beneficial ownership rules and reporting thereunder more difficult. We recommend the Commission address the significant compliance uncertainties that result directly from replacing the "agreement" standard in favor of one based solely on action in determining "group" status. In the alternative, we encourage the Commission to reconsider articulating specific attributes of actions that would evidence a group in the absence of an agreement to act.

Below we express our views regarding certain aspects of the Proposed Rules, including examining the aforementioned matters more closely, and we address some of the points on which the Commission sought comment on the Proposed Rules and we suggest some clarifications that we believe would enhance the utility of the Proposed Rules and further the Congressional intent of Sections 13(d) and 13(g) of the Act and the Commission's goals as expressed in the Proposing Release.

We appreciate the opportunity afforded by a public comment period, but we are mindful that the antecedent experience of the 1970s suggests both that the development and application of beneficial ownership rules is particularly complex and that a rushed process is likely to prove ultimately unworkable. Accordingly, we hope that the Commission will not only give close attention to public comments submitted in respect of the Proposing Release, but that it will also consider making iterative, revised proposals in light of those comments—and seeking further comments—before adopting any rules.

II. Filing Deadlines for Schedule 13D and Schedule 13G

a. Proposed Amendment to Rule 13d-1(a) Filing Deadline for Initial Schedule 13D

The proposed amendment will revise the Rule 13d-1(a) filing deadline for the initial Schedule 13D to five days after the date on which a person acquires more than five percent of a class of equity securities registered under Section 12 of the Act instead of the current ten day deadline. We support the proposed amendment to accelerate the Schedule 13D filing deadline from ten to five days.[10] We believe the proposed amendment represents the reform necessary for today's market. For many years now, there has been much debate and discussion regarding the modernization of filing deadlines for Schedule 13D. The proposed changes to Rule 13d-1(a) would be the most noteworthy

[10] The Committee is not unanimous in this view. There is support among some members of the Committee to further shorten the initial filing deadline to one or two calendar days and there are other members of the Committee that suggest a five business day deadline is more appropriate.

modifications since the rules were first adopted in 1968, and the proposed amendment will be essential to providing timely and quality information to all market participants in today's market.

Our support for the change to Rule 13d-1(a) is driven by technological advancement, the reduction of information asymmetries between activists and their targets, and the overall goal of promoting greater market transparency. The shortening from ten to five days is meaningful and beneficial, but is not so short that it would be unduly burdensome to investors who seek accumulating positions to promote shareholder activism.

One of the purposes of Schedule 13D disclosures is to provide timely information and to alert investors in securities markets of potential changes in corporate control and to provide them with an opportunity to evaluate the effect of these potential changes. The current and outdated rules do not reflect the technological advancements and modernization of the market, and so market participants and investors are not receiving key information in a timely manner, thus resulting in market asymmetries.

Ultimately, we believe the proposed amendment to Rule 13d-1(a) is a much needed update to the outdated current rule. We believe accelerating the Schedule 13D filing deadline from ten to five days will immediately provide greater transparency and reduce market asymmetries while balancing interests and continuing to permit activists the ability to conduct shareholder activism. We believe the proposed amendment will serve the market well, and provide the much needed change investors need in today's market.

b. Proposed Amendment to Rule 13d-2(a) to Require Amendments to Reflect Material Changes Be Filed Within One Business Day

Currently, Rule 13d-2(a) requires filers to amend a Schedule 13D "promptly" to reflect any material change to the facts set forth in the filing. The Commission has proposed amending Rule 13d-2(a) to require amendments to be filed within one business day. We understand the Commission's desire to remove uncertainty as to the date on which an amendment is due, and we acknowledge that there have been technological advances that in some cases can expedite the amendment process since the current version of the rule was adopted. However, we believe that the proposed amendment goes too far and would provide too short of a turnaround time for Schedule 13D filers to make certain amendments, and would unnecessarily sacrifice the flexibility that the current version of the rule provides.

The Commission has considered the meaning of "promptness" in the past, and recognized the benefits of having flexibility to amend a Schedule 13D to update for material changes. In 1985, the Commission noted:

> No bright line test has been adopted in order to determine when an amendment to a Schedule 13D is "prompt." This determination, for example, cannot be made by reference to the ten-day time period provided in Section 13(d)(1) of the Exchange Act and Rule 13d-1 for filing an initial Schedule 13D. Strong policy considerations indicate that the "prompt" amendment requirement should be construed flexibly in order to comport with the circumstances of the particular case. Thus, the question of whether an amendment is prompt will be determined based on all of the facts and circumstances surrounding both prior disclosures by the filing person and the material changes which trigger the obligation to amend.
>
> Whether an amendment to a Schedule 13D is "prompt" must be judged, at least in part, by the market's sensitivity to the particular change of fact triggering the obligation to amend, and the effect on the market of the filing person's previous disclosures. Although the promptness of an amendment to a Schedule 13D must be judged in light of all the facts and circumstances of a particular situation, "[a]ny delay beyond the time the amendment reasonably could have been filed may not be deemed to be [prompt]."[11]

As the Commission recognized, in order to serve the policies of the Williams Act, the timing for public filings should vary based on the circumstances. In the course of a proxy contest, for example, amendments to reflect certain material changes within one business day may be appropriate, whereas a routine amendment to a Schedule 13D to reflect a change in a filing person's beneficial ownership may not require a similar urgency. We believe this is still true, and certain information should be publicly disclosed and reported to the market more quickly than other information, depending on the circumstances. Further, completing a filing is not just a question of technology, but often a question of marshalling complex and evolving facts and making difficult disclosure judgments, depending on many factors, including the complexity of the information, the pace of developments of the information, and the number of persons or parties who have an interest in the disclosure and need to review the information, contribute to its drafting, and, if they are signing the Schedule 13D, are subject to liability for the accuracy of the information. In some cases, going through this process can be done within one business day. However, in others, more time is necessary to collect the information and ensure its accuracy, notwithstanding the technological advances noted by the Commission. Accordingly, we believe shortening the amendment deadline to one business

[11] *In the Matter of Cooper Laboratories, Inc.*, Exchange Act Release No. 22171 (June 26, 1985).

day for all amendments to Schedule 13D will unnecessarily lead to Schedule 13D filers unintentionally disclosing inaccurate or misleading information in their amendments and a large increase in the number of late filings.

Drafting good narrative disclosure that is useful for the marketplace takes time and is typically subject to multiple rounds of review and revision. Accelerating the deadline for all Schedule 13D amendments to one business day is not likely to result in additional clarity or more information reaching the market sooner. The accelerated deadline could have the unintended consequence of forcing practitioners to provide less fulsome disclosure solely because of the reduced amount of time available to draft and review the required disclosure.

We also note that, under the Proposed Rules, beneficial ownership reports on Schedules 13D and 13G would be required to be filed using a structured, machine-readable data language. From a practical perspective, the conversion of narrative disclosure to a machine-readable data language, which requires tagging of the relevant information, is a time consuming affair that can often take a full business day under the most efficient scenarios. Despite the advances in technology, at the end of the day, someone must draft the disclosure, others will review the disclosure, and only when it has finally been approved can it then be sent for conversion to a machine-readable data language, where the appropriate facts and figures can be tagged. To expect this to happen within one business day of each and every material event simply ignores the reality of the work that is involved in any such effort.

For these reasons, we believe Rule 13d-2(a) should maintain the obligation to amend Schedule 13D "promptly." However, in accordance with Question 28 in the Proposing Release, we believe that amending Rule 13d-2(a) to provide that an amendment must be filed promptly, but no later than some period of time (*e.g.*, between two and four business days) from the date of the material change, would accomplish the Commission's goal of removing the uncertainty of the amendment deadline. To the extent that a Schedule 13D filer is able to file earlier, the filer would still be obligated to do so because the rule would still require prompt filings, and as the Commission noted in *In the Matter of Cooper Laboratories*, delays beyond the time an amendment could have been filed may not be prompt. An added advantage of a four business day deadline would be to align the Form 8-K deadline after the occurrence of a reportable event applicable to issuers with the Schedule 13D amendment obligations of shareholders, allowing them the time to coordinate and ensure that the information released to the market is consistent, accurate and timely. Alternatively, the Commission could require certain categories of amendments (*e.g.*, dispositions/acquisitions in beneficial ownership of one percent or more) that must be filed within the shorter one or two business day window.

c. Proposed Rule Amendments Relating to QIIs

i. *Proposed Amendments to Rule 13d-1(b)*

Under the proposed amendments to Rule 13d-1(b), a QII would be required to file its initial Schedule 13G within five business days after the first month-end for which its beneficial ownership exceeded five percent as of the end of such month, instead of within 45 days after the end of the calendar year.[12] We do not agree with these proposed changes. While we support the Commission's desire to accelerate the disclosure of beneficial ownership reports, we believe that the proposed changes to Rule 13d-1(b) would cause QIIs to incur substantial costs that would outweigh any benefits to the market, and the proposed changes do not reflect the intent of Section 13(d) of the Act. The Commission believes that with today's technological advancements, QIIs are capable of incorporating daily monitoring systems that should permit them to more easily file initial Schedules 13G based on five percent beneficial ownership as of any month-end. In particular, the Commission stated in the Proposing Release that the "proposed acceleration of these deadlines is expected to result in more timely disclosures while minimizing any additional burdens."[13] We strongly disagree. Despite recent technological advancements, the proposed filing requirements would impose significant compliance burdens on QIIs by requiring such investors to monitor their positions daily, especially if monthly amendments may also be required and with the proposed changes to Rule 13d-2(c) (each as discussed further below).

Many QIIs are large institutions with various departments and numerous trading strategies. Despite technological advancements, it is often difficult for QIIs to gather aggregate information quickly, confirm such information for accuracy, draft disclosure documents and receive approval for filing purposes. Additionally, many QIIs beneficially own positions in a large number of issuers, and these positions change frequently. The proposed accelerated deadlines would cause these institutions to have a dramatic increase in initial Schedule 13G filings and amendments—beyond the number that the SEC may expect—and we believe that it will be difficult for some QIIs to be consistently timely with their filings. Further, given the increased difficulty in making such filings in a timely manner, we believe the Proposed Rules would increase the number of unintentionally inaccurate filings.

In addition, we believe that the reasons the Commission offers for proposing the accelerated filing deadlines for QIIs do not justify the costs and heavy burdens that would be imposed on such institutions. Section 13(d) of the

[12] If such QII's beneficial ownership exceeds ten percent at the end of any month, then such initial Schedule 13G filing is due within ten days after the end of such month. *See* Rule 13d-1(b).

[13] Proposing Release at 36-37.

Act was adopted with the intent to alert the market of rapid accumulations of issuer equity securities, which might represent a change in corporate control.[14] In 1978, the Commission amended Rule 13d-1 to permit certain QIIs to file on Schedule 13G if such QIIs acquired the securities in the ordinary course of business and had no control intent.[15] Part of the Commission's rationale was that QIIs are heavily regulated entities, and the Commission realized the heavy burdens that would otherwise have been imposed on QIIs. Not much has changed. Today, QIIs are regulated entities that can only file on Schedule 13G if they do not have a control purpose under Rule 13d-1(b). Additionally, many QIIs are required to file, quarterly, a Form 13F, which reports the number of securities in public companies over which such QIIs have investment discretion, and which the market often relies on for similar information. QIIs are also already required to file Schedules 13G if their beneficial ownership exceeds ten percent as of any month-end, so any large positions are already reported based on a month-end basis.

If the Commission does not agree with our view, we suggest that the initial Schedule 13G filing for a QII be due within ten days after the end of the month for which its beneficial ownership exceeds five percent as of month-end. If the proposed amendments to Rule 13d-1(b) are adopted and require initial Schedules 13G for QII to be based off of month-end beneficial ownership, most QII Schedules 13G will be filed months, and possibly even a year, earlier than what the current rules require.[16] Permitting ten days to file the initial Schedule 13G would strike a balance between accelerating the filing deadline while still giving QIIs adequate time to prepare and file what could be numerous additional Schedule 13G filings each month.

ii. *Proposed Amendments to Rule 13d-2(c)*

Under the proposed amendments to Rule 13d-2(c), a QII would be required to file a Schedule 13G amendment within five days after acquiring more than ten percent beneficial ownership, and thereafter, for additional five percent changes in beneficial ownership. We do not agree with these proposed changes. As discussed above, we believe that the proposed amendments to Rule 13d-2(b) may require QIIs to file a significant number of additional Schedules 13G each month. Therefore, we believe that there should be no changes to Rule 13d-2(c), and that such amendments should remain due within ten days after the end of any month in which a QII's month-end beneficial ownership exceeds ten

[14] S. Rep. No. 550, 90th Cong., 1st Sess. 7 (1967).
[15] Exchange Act Release No. 14692.
[16] For example, under the current rules, if a QII beneficially owned more than five percent (but less than ten percent) as of January 31, 2022, and remained a five percent beneficial owner as of December 31, 2022 (but less than ten percent), such QII's Schedule 13G would be due by February 14, 2023. Under the Proposed Rules, this Schedule 13G would be due in February 2022.

percent, and thereafter, for additional five percent changes. This would align the filing deadline with the initial Schedule 13G timeline described above and would provide QIIs with the ability to manage initial Schedule 13G filings and amendments more efficiently for crossing such ten percent and five percent thresholds, as applicable. As stated above, QIIs do not have any control intent, and thus we believe the timing of their beneficial ownership reporting is not a source of meaningful concern. With the additional compliance burdens the proposed amendments would place upon such entities, we believe it would be more manageable for them to track month-end beneficial ownership. The proposed amendments to Rule 13d-2(c) would only provide a few additional days or perhaps a couple of weeks of advanced disclosure to the market but would create significant compliance costs that we believe outweigh any possible benefit to the market. We believe creating month-end thresholds with uniform ten-day reporting deadlines is a reasonable compromise for QIIs.

d. Proposed Rule Amendments Relating to Passive Investors

i. *Proposed Amendments to Rule 13d-1(c)*

The proposed amendments to Rule 13d-1(c) would require Passive Investors to file an initial Schedule 13G within five calendar days after acquiring more than five percent beneficial ownership. Given that Passive Investors do not seek to acquire or influence control of the issuer in which they are invested, such a requirement would have limited benefit to the market. Further, the Commission created the "passive investor" concept in recognition of the need to limit filing obligations on such investors, noting that the then-existing reporting scheme imposed burdensome "obligations on persons whose acquisitions do not affect the control of issuers."[17] Given these concerns, we believe requiring Passive Investors to file an initial Schedule 13G within [five business] days is reasonable and would also further the Commission's objective of accelerating public disclosure of material information to the market.[18]

ii. *Proposed Amendments to Rule 13d-2(d)*

Under the proposed amendments to Rule 13d-2(d), a Passive Investor would be required to file a Schedule 13G amendment within one business day after acquiring more than ten percent beneficial ownership, and thereafter, for additional five percent changes in beneficial ownership. While we are supportive of providing more clarity to when amendments required by Rule 13d-2(d) should be filed, we disagree with the one business day proposal. We believe a standard that would require an amendment to be filed promptly, but in no event later than two to four business days, is reasonable. As discussed above

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[17] Exchange Act Release No. 39538
[18] *Id*.

regarding QIIs, Passive Investors do not have a control intent. We believe the compliance burdens for requiring amendments within one business day for Passive Investors would outweigh the potential benefit to the market and the proposed amendments do not appear to solve any known issue in the current rule.

e. Proposed Rule Amendments Relating to Exempt Investors

i. Proposed Amendments to Rule 13d-1(d)

Under the proposed amendments to Rule 13d-1(a), an Exempt Investor[19] would be required to file its initial Schedule 13G within five business days after the first month in which its beneficial ownership exceeded five percent as of the end of such month, instead of within 45 days after the end of the calendar year. We do not agree with these changes. Accelerating the filing deadline for Exempt Investors will provide no additional information to the market given that the vast majority of Exempt Investors become Exempt Investors following the effectiveness of a registration statement under the Act. Any such registration statement contains all of the information, if not more, that would be included in a Schedule 13G. Thus, this additional burden of an accelerated filing deadline for investors will yield no additional information being released to the market in the case of shareholders who become Exempt Investors as a result of a class of securities becoming registered under Section 12 of the Act.

In rare cases, an investor may become an Exempt Investor as a result of an involuntary change in circumstance, such as when issuer share repurchases cause the shareholder to exceed the five percent threshold. In these limited circumstances, we are supportive of the Commission's desire to require more prompt Schedule 13G disclosure. However, we suggest revising the filing deadline to ten days after the end of the month in which such Exempt Investor crossed the five percent beneficial ownership threshold and acknowledge that an Exempt Investor may rely on the most recent outstanding share amount as reported in the issuer's most recent periodic report unless the Exempt Investor knows or has reason to believe that such information is not complete or accurate. Similar to the discussion above for QIIs, the proposed amendment will likely cause some Exempt Investors to file a Schedule 13G months or even a year earlier than what would be required under the current rule. We believe an initial filing deadline consistent with our suggestion for QIIs would provide a reasonable amount of time in light of the potential benefits to the market of accelerated disclosure and the additional costs that would be incurred by Exempt Investors.

[19] The term "Exempt Investor" as used in Comment Letter refers to persons holding beneficial ownership of more than five percent of a covered class at the end of the calendar year, but who have not made an acquisition of beneficial ownership subject to Section 13(d) of the Act, consistent with the Proposing Release.

f. Monthly Schedule 13G Amendments

i. *We believe Clarifications are Necessary Regarding What is Material for Monthly Schedule 13G Amendments*

Under the proposed amendments to Rule 13d-2(b), the Commission would eliminate the annual Schedule 13G amendment requirement for all filers, and would instead impose monthly amendments for material changes, if any, which would be due within five business days after the end of any such month. While we do not object to the concept of monthly amendments for material changes, we believe that the Commission should provide more clarity on what changes qualify as material for these purposes. For example, Rules 13d-2(c) and (d) require that QIIs and Passive Investors amend their Schedules 13G if such investors exceed the ten percent beneficial ownership threshold, and thereafter, for five percent changes. It is unclear what would be viewed as a material change requiring a month-end amendment. For Exempt Investors, it is unclear, for example, whether a five percent change, a ten percent change or some other percentage would constitute a material change. Smaller percentages would not seem material, otherwise Rules 13d-2(c) and (d) would no longer be relevant and would be rendered duplicative.

Without additional guidance, filers may be compelled to amend Schedules 13G monthly for any changes, and with the new filing requirements for initial Schedule 13G filings, this may cause investors to incur substantial costs to comply with the proposed amendments.

ii. *Proposed Amendments to Rule 13d-2(b)*

As discussed above, the proposed amendments to Rule 13d-2(b) would require monthly Schedule 13G amendments for material changes, if any, which would be due within five business days after the end of any such month. We believe that for many of the reasons described above and for consistency with our suggestions on the deadlines for other month-end filings, that such amendment should be due within 10 days after the end of a month, if applicable.

III. Cash-Settled Derivatives

Cash-settled derivatives do not convey any of the traditional indicia of controlling interests. These instruments, as recognized in the Proposing Release,[20] do not entitle the counterparties to acquire the reference securities,

[20] *See* Proposing Release at 58 ("We recognize that cash-settled derivative securities differ from the rights covered under Rule 13d-3(d)(1) in that they ordinarily do not entitle their holders to acquire the reference securities.").

and they also do not convey any voting rights. In a typical transaction, an investor purchasing a cash-settled derivative will have no control over when or how (or even if) the counterparty hedges its exposure. Even in an instance in which a counterparty has hedged by purchasing reference securities in the market, whether or how the securities are voted is independently determined. While the Proposing Release assumes that hedge shares will not be voted, the financial institutions that engage in these transactions, in addition to maintaining policies that do not permit any discussion of how reference shares may be voted, will also generally not disclose their policies regarding the voting of hedge shares. Such policies may, as the Proposing Release speculates, be to not vote any hedge shares, but the policies could also provide for other arrangements, such as voting for a default election or to ratably split votes among the relevant alternatives.

Given that these transactions provide only economic exposure without any of the traditional indicia of control and that the investors engaging in these transactions typically do not seek to take direct control of a company (*i.e.*, the behavior targeted by the Williams Act), it is difficult to justify a determination that cash-settled derivatives give rise to beneficial ownership or that such determination is a natural continuation of the goals of the Williams Act.

It also is not clear how the Commission derives authority from the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to redefine "beneficial ownership" when Rule 13d-3(a) and all relevant authority relating to an understanding of beneficial ownership has historically required a showing of control over the voting or the disposition of securities.[21] Accordingly, we believe it is critical that the Commission take a tactical approach specifically addressing control concerns without unintentionally capturing derivative securities held by entities without the intention to seek to change or influence control.

It is not clear under the Proposed Rules when a cash-settled derivative holding will be considered a beneficial ownership interest. The Proposed Rules provide that cash-settled derivatives will be considered beneficial ownership interests if "held with the purpose or effect of changing or influencing the

[21] *See* Brief for the Securities Exchange Commission at 2, *CSX Corporation v. Children's Inv. Fund Mgmt. (UK) LLP*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008) ("As a general matter, economic or business incentives, in contrast with some contract, arrangement, understanding or relationship concerning voting power or investment power between the parties to an equity swap, are not sufficient to create beneficial ownership under Rule 13d-3."); Brief for the International Swaps and Derivatives Association, Inc. and the Securities Industry and Financial Markets Association at 3, *CSX Corporation v. Children's Inv. Fund Mgmt. (UK) LLP*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008) ("No legal authority has ever held, or, under these circumstances, could properly hold, that the long party to such contracts – without some other extrinsic understanding or agreement that creates the necessary voting or investment power – is a 'beneficial owner' under Rule 13d-3…").

control of the issuer."[22] In addition to the inherent subjectivity of determining whether an investor had the intent to influence the control of the issuer, it will also be necessary to determine *when* an investor developed that intent. The Commission has, in the past, stated that "in many instances these determinations will be difficult and fact intensive" and has confirmed that some, but not all, shareholder activism would be permissible without creating a presumption that an investor's intent was to influence the control of the issuer.[23] The uncertainty regarding which activities will lead to a determination that an investor has control intent creates inevitable uncertainty for investors regarding whether they will become subject to the applicable reporting requirements and will inevitably lead to ex post facto determinations based on hindsight. Intentions also change over time, and it is not always clear when the "magic moment" of transition occurs in practice as market participants may be developing and adapting plans in real time.[24] Further guidance would be appropriate to know precisely what activities or planned actions will be deemed to lead to control intent and at what stage such plans will be sufficiently definite to cause such determination.

Even if intent is established, determining the size of a derivative position under the Proposed Rules (and, therefore, whether reporting is required) will be burdensome. Proposed paragraph (e)(2)(i) of Rule 13d-3 provides that the number of equity securities that a holder of a cash-settled derivative will be deemed to beneficially own pursuant to paragraph (e)(1) will be the larger of two calculations, as set forth in proposed paragraphs (e)(2)(i)(A) and (B).[25] Flaws exist with respect to both proposed calculations. As the Commission recognizes, not all contracts will provide a way to calculate the number of reference securities on which the amount payable pursuant to that security is based,[26] however, it is also not always the case that there will be an obvious notional amount and that term is not defined in the Proposing Release. Furthermore, the proposed methodology relies on a daily delta calculation. These delta calculations will not only be model-dependent, but they are also likely to oscillate rapidly under certain market conditions. Rapid changes in the size of position for purposes of the Proposed Rules will make it difficult for market participants to comply with filing obligations as the amount of beneficial ownership may change significantly despite no additional investment. Significant resources will also need to be devoted to performing complex calculations daily under the proposed methodology.

Clarification is also needed regarding the language of the proposed Rule 13d-3(e)(1)(i)(B) regarding the meaning of "to be settled exclusively in cash."

[22] Proposing Release at 177.
[23] Exchange Act Release No. 39538.
[24] *See In the Matter of Tracinda Corp.*, Exchange Act Release No. 34-58451 (Sept. 3, 2008).
[25] Proposing Release at 177.
[26] Proposing Release at 60.

While physically-settled derivatives and derivatives that may be physically- or cash-settled at the option of the investor would otherwise lead to a determination of beneficial ownership, it is not clear under the Proposed Rules whether a derivative security that may be settled in either cash or securities at the election of the counterparty would be deemed to constitute a beneficial ownership interest in the reference securities.

The question of whether cash-settled derivatives should be deemed beneficial ownership interests for purposes of Section 16 of the Act has also been raised in the Proposing Release. Including cash-settled derivatives will result in an increased number of persons being subject to the filing requirements and short-swing profit rules of Section 16 of the Act. Compared to investors that hold large blocks of a company's securities (or the right to receive large blocks of shares in the near future), an investor with solely economic exposure is less likely to have material information of the kind that is presumed under Section 16 of the Act. The lack of a netting provision (*i.e.*, that only long positions are counted as beneficial ownership interests and such positions are included regardless of any off-setting short positions) in the Proposed Rules will magnify this effect, and market participants with many positions, even if those positions largely off-set each other, will be captured. Combined with the strict liability under Section 16(b) of the Act, including these investors is likely to be over-inclusive, and potentially reduce market activity and create unintentional windfalls for the Section 16(b) plaintiffs' bar.

Finally, the Proposed Rules as related to cash-settled derivatives should be reconsidered and evaluated by the Commission and by market participants and commenters together with the Commission's proposed Rule 10B-1[27] relating to regulatory disclosures and dissemination of information regarding cash-settled security-based swaps given the broader impacts, especially when taken together, of these potential changes on the derivatives market.

IV. Group Formation

As practitioners, we owe a responsibility to our clients to competently advise them regarding their obligations regarding beneficial ownership disclosure. Within the Proposed Rules, we are concerned that by re-designating Rule 13d-5(b)(1) as Rule 13d-5(b)(1)(i) and conforming the latter to the statutory text of Sections 13(d)(3) and (g)(3) of the Act, the Commission will return practitioners to the era of unpredictability and opacity that it sought to alleviate in adopting Rule 13d-5(b)(1) in the first place. Indeed, the sole judicial opinion specifically cited by the Commission in its adoption of Rule

[27] 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, Exchange Act Release No. 93784 (Dec. 15, 2021).

13d-5(b) called Section 13(d) of the Act "anything but a model of clarity…."[28] We cannot help but think that abandoning a relatively focused rule in favor of one that merely relies on an opaque statute is a step in the wrong direction, regardless of the small set of actions that would be excluded by proposed safe harbors (which themselves raise considerable questions). Instead, we urge the Commission to identify more precisely the "group" behavior that it hopes to curb and seek a more focused response that would not create so much collateral uncertainty.

Moreover, we question the Proposing Release's dismissal of the role of an "agreement" in finding a group even under the statute, as it is clear from the legislative history that the moment of "agreement" was expressly understood to form the group and commence its disclosure obligations under Section 13(d) of the Act.[29] The very claim in the Proposing Release that "there is no indication that Congress intended for the analysis of whether or not a group had formed to be dependent upon the existence of an express or implied agreement among two or more persons"[30] is contradicted by the sources cited for support of that statement, which plainly declare that "[t]he group would be deemed to have become the beneficial owner, directly or indirectly, of more than 10 percent of a class of securities *at the time they agreed to act in concert*. Consequently, the group would be required to file the information called for in section 13(d)(1) within 10 days after *they agree to act together*…."[31] (emphasis added). While it is certainly true that an "agreement" need not be "written" or "formal," any concern that the former term has been misconstrued in the context of Rule 13d-5(b) as implicitly including those limiting adjectives could be remedied by a narrowly tailored modification of the rule such as referring to an "agreement, arrangement or understanding" rather than solely to an agreement.

If this aspect of the proposed rule must stand, it is fundamentally important that the Commission provide more clarity in distinguishing actions that take place in parallel, on the one hand, from "act[ing] as … a group," on the other hand. This is a critical issue not only because practitioners and investors require clarity to make good-faith efforts to comply with Sections 13(d) and 13(g) of the Act, but because of the opportunity for abusive litigation pursuant to Section 16(b) of the Act that arises under a vague facts-and-circumstances standard. When a Section 13(d) group beneficially owns more than ten percent of the outstanding shares of a class of equity securities registered under Section 12 of the Act, every member of that group becomes subject to Section 16 of the

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[28] Exchange Act Release No. 14692, fn. 15, citing *GAF Corp. v. Milstein*, 453 F.2d 709 (2nd Cir. 1971).

[29] *See* S.Rep. No.550, 90th Cong., 1st Sess. 8 (1967); H.R.Rep.No.1711, 90th Cong., 2d Sess. 8-9 (1968). This legislative history was also discussed in *GAF Corp.*, as cited by the Commission in adopting Rule 13d-5(b)(1) in 1978.

[30] Proposing Release, fn. 128.

[31] S.Rep. No.550, 90th Cong., 1st Sess. 8; H.R.Rep.No.1711, 90th Cong., 2d Sess. 8-9.

Act. Under an open-ended facts-and-circumstances standard, allegations that a person is subject to Section 16 of the Act as a member of a group will create substantial procedural leverage for plaintiffs' attorneys because of the potential justification for extensive factual investigation to address even the preliminary question of whether Section 16 of the Act applies. Even where such claims are ultimately meritless, the cost and distraction of complex Section 16 litigation may be used as a cudgel to induce settlements. Increasing the leverage of that behavior will only distort transaction efficiencies.

Looking to the plain meaning of the term "group" is of little assistance. A popular dictionary defines a "group," among other ways, as "two or more figures forming a complete unit in a composition" (offering the illustration "went there as a group") and "a number of individuals assembled together or having some unifying relationship."[32] A group may have a greater or lesser degree of cohesion or commonality, and certainly some interpretations that give effect to the plain meaning of the term would produce results that we generally anticipate to be outside the Commission's intent. Absent any textual guidance regarding the boundaries, though, practitioners have little to turn to. For example, while there seems to be little point in worrying that the universe of buyers of a given security on a particular day constitute a Section 13(d) group on merely that basis, the "act" they committed was itself a "unifying relationship," so it is difficult to see how the plain meaning of the words eliminates the possibility that they are a group. Perhaps it is less clear whether the subset of those buyers who happened to participate in an internet discussion promoting a short-squeeze strategy concerning the stock can be equally confident that they did not form a group. And if they *did*, what about persons who merely read, but did not actively participate in, the same discussion?

If any such subset of buyers is *not* a Section 13(d) group, is the outcome different when an identical discussion instead takes place among hedge-fund managers? If so, what is the basis for the distinction? What if those hedge-fund managers discussed only an industry, rather than a specific company, but some of them later happen to buy securities of a single issuer within otherwise divergent portfolios? Similarly, what about persons who purchase a security after reading a publicly available research report promoting such purchase or after watching an interview with a media personality (or prominent hedge fund manager) who recommends such purchase? Does the public nature of that communication insulate those buyers from the claim of group status? If so, why? How would internet discussion forums be treated? These situations are obviously not exhaustive, but all take place with regularity and illustrate the difficulty of finding a principled distinction among them without more clarity regarding the standard.

[32] https://www.merriam-webster.com/dictionary/group.

As another example, can persons who act opposite each other (*e.g.*, a buyer and a seller) be said to act "as a group"? In a fundamental economic sense and the apparent plain meaning of the term, they appear to have competing objectives rather than the "common objective" that courts long ago determined to be fundamental to the existence of a group,[33] but proposed Rule 13d-6(d) suggests that outside of the safe harbor, the counterparties to an "agreement setting forth the terms of a derivative security" may indeed form a group with respect to the securities referenced by that derivative security. If that is indeed the implication (and leaving aside the question of whether it is consistent with existing judicial interpretations of the statute), how can parties to an ordinary securities purchase and sale agreement be confident that they are not a "group" during the time between signing the agreement and closing the transaction?

Even with respect to proposed safe harbors that at first seem more straightforward, we fear that neither their basis nor their reliability ultimately holds up to scrutiny. Proposed Rule 13d-6(b), for example, would disqualify a QII from the safe harbor in the case of a typical financing, like a PIPE, in any case in which another participant is not a QII. Why the issuer's choice of participants in a financing should dictate whether those persons form a Section 13(d) group is unclear in any case, but the standard by which participants must judge themselves is unaddressed. Can they rely on the safe harbor unless they have actual knowledge of co-investors who are not QIIs? Can they rely on representations from the issuer? Will customary agreements between an issuer and its financing sources be found to reflect "act[ing] as a … group" if the terms are consistent across multiple financing sources? Will it be significant that the issuer's agreements with multiple investors may be reflected in a single document (regardless of the various investors having no obligations to each other)? For example, would customary registration rights agreements—which may see investors act in parallel pursuant to their agreements with the issuer, typically made in a single document—disqualify PIPE investors from the safe harbor proposed to be established by Rule 13d-6(b)? For these reasons, we encourage the Commission to consider exempting QIIs from any new "group formation" provisions as long as such QIIs act consistently with the requirements of Rule 13d-1(b), *i.e.*, in the ordinary course of their businesses and without intent or effect of influencing the management of the issuer. Simply put, designing a comprehensive set of safe harbors that would adequately exempt QIIs from unintended group formation is unrealistic and unnecessary where such QIIs are not acting with the intent or effect of influencing management of the issuer.

Further, it is essential that the Commission recognize and address the significant compliance uncertainties that result directly from replacing the

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[33] *See*, *e.g.*, *Wellman v. Dickinson*, 682 F.2d 355 (2nd Cir. 1982).

"agreement" standard in favor of one based solely on action. For example, will such groups exist only during the moment of the action that creates the group, as seems to be the literal meaning of proposed Rule 13d-5(b)(1)(i)? If not, what will mark the termination of a group? Once members have acted as a group at some point, would continuing parallel activity serve as evidence of a group even in the absence of coordination? In the absence of an agreement, it is considerably more likely that multiple parties may take different views of whether they have created a group, making compliance by even a self-identified member of a group practically impossible (perhaps even meaning that a group member may not know if the total ownership by the group has given rise to obligations under Sections 13(d), 13(g), or 16 of the Act).

As suggested earlier, we are confident that current Rule 13d-5(b)(1) can be modified to address any concerns the Commission has regarding overly-narrow readings of the word "agreement," and that doing so would both provide practitioners the essential clarity necessary for us to advise our clients and give effect to the Congressional intent. In the alternative, we encourage the Commission to reconsider articulating specific attributes of actions that would evidence a group in the absence of an agreement to act. For example, as an alternative to proposed Rule 13d-5(b)(1)(i), we request that the Commission and its staff please consider the following: "When two or more persons agree to act together, or when two or more persons act together while aware of their mutual activity and in the belief that their mutual activity will advance an objective they share in common, in either case for the purpose of acquiring, holding, voting, or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership, for purposes of Sections 13(d) and 13(g) of the Act, as of the date of such agreement or such action, as the case may be, of all equity securities of that issuer beneficially owned by any such persons." Further, we recommend the Commission, in adopting any rules, make clear in the release that the amended rule is neither intended nor designed to cover side-by-side investing absent an agreement or coordinated act, arrangement or understanding for the purpose of acquiring, holding, voting, or disposing of equity securities of an issuer.

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We appreciate the opportunity to continue to participate in this process and respectfully request that the Commission consider our recommendations and suggestions. We are available to meet and discuss these comments or any questions the Commission and its staff may have, which may be directed to the individuals listed below.

Very truly yours,

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Jay H. Knight
Chair of the Federal Regulation of
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