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Challenges For Investors in Dealing with Section 13(d) Filing Requirements

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A significant challenge for institutional investors, such as private equity firms, investing in public companies is managing the disclosure hurdles of Section 13(d) of the Securities Exchange Act of 1934. That section was added as part of the Williams Act to provide companies and the public with notice of significant accumulations of stock positions in public companies and changes in those positions. Thus, Section 13(d) and the SEC's implementing rules require any person who acquires beneficial ownership of an outstanding class of equity securities of a company registered with the SEC to file with the SEC a report on Schedule 13D about its ownership within ten days of becoming such beneficial owner and to promptly (generally understood to be within a day) file an amendment to report any material change in beneficial ownership (usually an increase or decrease of 1% or more) or in the information required to be disclosed. There are exceptions from the Schedule 13D filing requirements for "passive investors," which are those institutional investors without an intention to control or change control of the company so long as they do not beneficially own 20% or more of the class. Instead, a passive investor may file a short form Schedule 13G report annually to report its ownership.

An historic challenge for investors has been how to pursue a potential transaction involving the company without triggering premature public disclosure due to the need to file an amended Schedule 13D to disclose a new "plan or proposal" or because of loss of Schedule 13G "passive investor" status by virtue of a change in intent or purpose. As an example, consider a private equity investor in a public company that is a Schedule 13D filer, perhaps because it has board representation, who believes an additional investment in the company would be advantageous or who believes it would be strategically beneficial to pursue a going private transaction through a leveraged buyout involving management. A critical question is what steps may the investor take and how far may it go in contemplating, planning for and pursuing such a transaction before having to file a Schedule 13D amendment. Weaving a path through this difficult maze can create a dilemma for the investor – on the one hand, an omelet cannot be made without at least buying (not to mention breaking) the eggs but on the other hand, the more that is done, the more likely disclosure will be triggered, which can interfere with the transaction, cause disruption, and harm the company and other investors. If anything, SEC and court pronouncements on this question have pushed toward earlier public disclosure. Thus, awareness of the problem and careful planning is required to navigate through this maze.

A second issue has recently drawn attention because of the U.S. Department of Justice charges that ValueAct Capital, as an investor in two companies that announced plans to merge, violated the Hart-Scott-Rodino Act ("HSR") by acquiring its interests allegedly with an intent to influence the merger without making the requisite HSR filing. The charges were settled, with ValueAct Capital paying a record HSR fine, but they left the question how far may an investor go and still rely on the "investment-only" exemption for HSR filings and how does that answer translate to how active an investor may be without losing Schedule 13G "passive investor" status.

On July 14, 2016, the staff of the SEC Division of Corporation Finance addressed the second part of this question in new Compliance & Disclosure Interpretation ("CDI") 103.11 by advising that disqualification from the ability to rely on the HSR investment-only exemption due to efforts to influence management on a particular matter would not alone preclude an investor's ability to file as a passive investor on Schedule 13G. Rather, eligibility to use Schedule 13G would be a facts and

circumstance determination dependent, among other things, on whether the investor acquired or is holding equity securities with the purpose or effect of changing or influencing control of the company. The CDI gives as examples of permissible activities engaging with management on executive compensation and social, environmental and other public interest issues or engaging on corporate governance topics, such as removal of staggered boards, majority voting for directors and elimination of shareholder rights plans, as long as the purpose of the engagement is part of a broad effort to improve corporate governance generally for the investor's portfolio companies, rather than to facilitate a specific change in control in a particular company. By contrast, the CDI indicates that Schedule 13G would be unavailable if the engagement was on matters that specifically call for the sale of the company, the sale of a significant amount of the company's assets, the restructuring of the company or a contested election of directors.

The SEC guidance is helpful (i) in distinguishing the analysis for purposes of HSR filing and Schedule 13G eligibility, and (ii) without establishing bright lines for Schedule 13G eligibility, in identifying some activities that investors can undertake with a company and its management in exercising their shareholder franchise without losing passive investor status and indicating other activities that would cross the line.

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