

April 15, 2015

The Honorable Richard Shelby
Chairman
The Honorable Sherrod Brown
Ranking Member
U.S. Senate Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Jeb Hensarling
Chairman
The Honorable Maxine Waters
Ranking Member
U.S. House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairmen Sessions and Hensarling and Ranking Members Brown and Waters:

Loopholes in federal securities laws are allowing activist investors to secretly buy large stakes in companies before initiating hostile take overs, depriving the market of material information and significantly disadvantaging ordinary investors. Over the past several years, lawyers and scholars have petitioned the Securities Exchange Commission (SEC) to address the situation to no avail. As a result, we urge Congress to step in with a legislative solution.

The Ten-Day Reporting Window

Current SEC rules provide a ten-day period before stock purchasers are required to report having acquired at least a five percent ownership threshold in publicly traded companies.¹ The *Wall Street Journal* has documented that during this ten-day window, activist hedge funds are tipping each other off regarding their plans, while ordinary investors and targeted companies are left in the dark.²

Most recently, William Ackman and his hedge fund, Pershing Square Capital Management, partnered with Valeant Pharmaceuticals to engineer an approach designed to do an end-run around securities laws intended specifically to prevent secret accumulations of stock.³ They used the ten-day window between the acquisition and required disclosure of a five percent stake in a company to go from owning just under five percent to nearly ten percent of their

¹ 17 C.F.R. § 240.13d-1.

² Susan Pulliam, Juliet Chung, David Benoit and Rob Barry, Activist Investors Often Leak Their Plans to a Favored Few, *Wall Street Journal*, March 26, 2014 (available at <http://www.wsj.com/articles/SB10001424052702304888404579381250791474792>).

³ David Katz and Laura McIntosh, Corporate Governance Update: Heightened Activist Attacks on Boards of Directors, *New York Law Journal*, July 24, 2014 (available at <http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.23471.14.pdf>).

target, Allergan.⁴ Only after that period did Valeant disclose its intention to make an offer for the company. Once Pershing Square's ownership interest became public, Allergan's share price increased. Eventually, Mr. Ackman profited by \$2.6 billion.⁵

As the law stands, it has become common for aggressive investors such as Mr. Ackman "to intentionally structure their acquisition strategies to exploit the gaps in the current reporting regime to their own short-term benefit and to the overall detriment of market transparency and investor confidence."⁶ Indeed, Mr. Ackman reportedly consulted with Robert S. Khuzami, the former director of enforcement at the SEC, in crafting his strategy.⁷

The five percent ownership rule was intended to promote transparency in the market so investors could make decisions on more equal information. But as things stand, activists like Mr. Ackman and those they tip off benefit from outsized returns, injuring investors not privy to the same information.

Moreover, the ten-day rule is out of step with rules governing the markets in other countries. Australia requires disclosure of acquisitions greater than five percent within two business days, the United Kingdom imposes a two-trading-day deadline for disclosure of acquisitions in excess of three percent, Hong Kong's deadline is three days, and in Germany it is "immediately," but in no event later than four days.⁸

Legislative Solution

As UCLA law professor Stephen Bainbridge said, "In an era of high frequency trading, the 10-day reporting window adopted by the Williams Act in 1968 simply makes no sense."

Leo E. Strine, Jr., former chief judge of the Delaware Chancery Court explained, "the voting electorate should have up-to-date, complete information about the economic interests of a hedge fund holding a large bloc of a corporation's shares and proposing that the corporation make business strategy changes it is suggesting."⁹

We agree with Professor Bainbridge and others that the reporting window should be reduced from ten days to one; a "cooling-off period" of two business days following the public filing on an initial Schedule 13D should be adopted, during which acquirers would be prohibited

⁴ *Id.*

⁵ David Gelles, No Allergan Deal, But a \$2.6 Billion Profit for Ackman, *New York Times*, November 17, 2014 (available at <http://dealbook.nytimes.com/2014/11/17/no-allergan-deal-but-a-2-6-billion-profit-for-ackman/>).

⁶ Wachtell, Lipton, Rosen & Katz, Petition for Rulemaking Under Section 13 of the Securities and Exchange Act of 1934, March 7, 2011 (available at <https://www.sec.gov/rules/petitions/2011/petn4-624.pdf>).

⁷ Peter J. Henning, Is it Time to Broaden the Definition of Insider Trading?, *New York Times*, April 28, 2014 (available at <http://dealbook.nytimes.com/2014/04/28/could-it-be-time-to-broaden-the-definition-of-illegal-insider-trading/>).

⁸ Wachtell, Lipton, Rosen & Katz, Petition, Mar. 7, 2011.

⁹ Leo E. Strine, Jr., Can We Do Better By Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law, 114 Col L.Rev. 495 (2014) (available at <http://columbialawreview.org/wp-content/uploads/2014/03/Strine-L.pdf>).

from acquiring additional beneficial ownership; and the definition of “beneficial ownership” should be modernized to prevent activists from acquiring control using stealth techniques and derivative instruments to evade the reporting requirements.¹⁰ As the SEC has demonstrated no inclination to act, Congress should hold hearings on this issue and draft legislation codifying these changes into the law.

Conclusion

Transparency and disclosure are required for investor confidence in our financial markets. When activist hedge fund managers manipulate the laws and exploit gaps (with the well-paid assistance of former top regulators, no less) to hide their acquisitions, allowing them to reap outsized profits while ordinary investors are left in the cold, Americans legitimately believe the game is rigged. We urge you to take up legislation that would help level the playing field.

Sincerely,

Citizens for Responsibility and Ethics in Washington
Government Accountability Project
New Rules for Global Finance

¹⁰ Stephen Bainbridge, [The Long Overdue Closure of the 10-day Reporting Window Under Section 13\(d\) Remains Overdue](http://www.professorbainbridge.com/professorbainbridge.com/2014/03/the-long-overdue-closure-of-the-10-day-reporting-window-under-section-13d.html), *ProfessorBainbridge.com*, March 31, 2014 (available at <http://www.professorbainbridge.com/professorbainbridge.com/2014/03/the-long-overdue-closure-of-the-10-day-reporting-window-under-section-13d.html>).