Working Draft, May 2013

PRE-DISCLOSURE ACCUMULATIONS BY ACTIVIST INVESTORS: EVIDENCE AND POLICY

Forthcoming, *Journal of Corporation Law*, Volume 39, Fall 2013

Lucian A. Bebchuk, Alon Brav, Robert J. Jackson, Jr., and Wei Jiang*

---

* William J. Friedman and Alicia Townshend Friedman Professor of Law, Economics and Finance and Director of the Program on Corporate Governance, Harvard Law School; Professor of Finance, Fuqua School of Business, Duke University; Associate Professor of Law and Milton Handler Fellow, Columbia Law School; Professor, Finance and Economics Division, Columbia Business School. We wish to thank Ronald Gilson, Jeffrey Gordon, and June Rhee, along with participants at the Conference on Markets and Owners hosted by the Columbia Project on Investment, Ownership, and Control in the Modern Firm, for valuable comments. We are also grateful to the Harvard Law School and the Columbia Law School for financial support.

Electronic copy available at: http://ssrn.com/abstract=2258083

Abstract

The SEC is currently considering a rulemaking petition requesting that the Commission shorten the ten-day window, established by Section 13(d) of the Williams Act, within which investors must publicly disclose purchases of a 5% or greater stake in public companies. In this Article, we provide the first systematic empirical evidence on these disclosures and find that several of the petition's factual premises are not consistent with the evidence.

Our analysis is based on about 2,000 filings by activist hedge funds during the period of 1994-2007. We find that the data are inconsistent with the petition's key claim that changes in market practices and technologies have operated over time to increase the magnitude of pre-disclosure accumulations, making existing rules "obsolete" and therefore requiring the petition's proposed "modernization." The median stake that these investors disclose in their 13(d) filings has remained stable throughout the 17-year period that we study, and regression analysis does not identify a trend over time of changes in the stake disclosed by investors. We also find that:

* A substantial majority of 13(d) filings are actually made by investors other than activist hedge funds, and these investors often use a substantial amount of the 10-day window before disclosing their stake.

* A significant proportion of poison pills have low thresholds of 15% or less, so that management can use 13(d) disclosures to adopt low-trigger pills to prevent any further stock accumulations by activists—a fact that any tightening of the SEC's rules in this area should take into account.

* Even when activists wait the full ten days to disclose their stakes, their purchases seem to be disproportionately concentrated on the day they cross the threshold and the following day; thus, the practical difference in pre-disclosure accumulations between the existing regime and the rules in jurisdictions with shorter disclosure windows is likely much smaller than the petition assumes.

* About 10% of 13(d) filings seem to be made after the 10-day window has expired; the SEC may therefore want to consider tightening the enforcement of existing rules before examining the proposed acceleration of the deadline.

Our analysis provides new empirical evidence that should inform the SEC's consideration of this subject—and a foundation on which subsequent empirical and policy analysis can build.

JEL Classification: D21, G32, G34, G35, G38, K22

Electronic copy available at: http://ssrn.com/abstract=2258083

I. INTRODUCTION

The Securities and Exchange Commission is currently considering revising the rules governing blockholder disclosure. A rulemaking petition recently submitted to the Commission by the senior partners of a prominent law firm urges the Commission to accelerate the timing of the disclosure of 5% stock accumulations in public companies.[1] While the Commission's rules have long required public-company investors to disclose their ownership within ten days of crossing the 5% threshold, the Petition proposes to shorten this period to one day.

The Commission subsequently announced a rulemaking project in this area, and members of the Commission's staff have signaled that the staff is examining the subject. Former SEC Chairman Mary Schapiro, acknowledging the "controversy" surrounding these important rules, has indicated that the Commission is actively considering whether to adopt the changes proposed in the Petition,[2] and the SEC staff have recently signaled that responding to the Petition is part of the Commission's regulatory agenda.[3]

Notably, the Petition offers no systematic evidence on stock accumulations. Instead, the Petition repeatedly refers to several anecdotes concerning recent cases in which activist hedge funds purchased large amounts of stock (or securities convertible to stock) prior to disclosure. The Petition argues that these anecdotes underscore a new, more general phenomenon of secret stock accumulations made possible by changes in trading technologies that demand immediate changes in the disclosure rules. Recent developments in market

---

[1] Letter from Wachtell, Lipton, Rosen & Katz to Elizabeth M. Murphy, Secretary, U.S. Sec. & Exch. Comm'n (Mar. 7, 2011), *available at* http://www.sec.gov/rules/petitions/2011/petn4-624.pdf [hereinafter Petition].

[2] *See* Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at the Transatlantic Corporate Governance Dialogue (Dec. 15, 2011), *available at* http://www.sec.gov/news/speech /2011/spch121511mls.htm.

[3] *See* Securities and Exchange Commission, *Beneficial Ownership Reporting*, *in* OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF INFORMATION AND REGULATORY AFFAIRS, UNIFIED AGENDA 2013 ("The Division is recommending that the Commission issue a concept release to . . . modernize the beneficial ownership reporting requirements . . . . [including], among other things, shortening the filing deadlines . . . ."), *available at* http://www.reginfo.gov/public/do/eAgendaViewRule? pubId=201210&RIN=3235-AK42 (last accessed January 21, 2013).

practices, the Petition contends, render the existing rules under Section 13(d) of the Securities Exchange Act of 1934, which governs blockholder disclosure, obsolete. And an article published by senior attorneys at the firm that filed the Petition similarly asserts that these developments are widely understood by market participants—but offers no evidence in support of this understanding.[4]

In two separate comment letters filed with the SEC, the four of us cautioned that the Petition does not rest on systematic empirical examination of the publicly available data, and that such empirical investigation is called for before any changes to the existing rules are seriously considered.[5] In a subsequent article, two of us stressed the need for such an empirical examination and discussed the empirical issues such an examination should seek to address.[6]

In response, in a recent article four senior partners of the firm that filed the Petition dismissed our claim that an examination of the evidence beyond the anecdotes described in the Petition is necessary.[7] The authors expressed concern that such an examination would be difficult and time-consuming and likely delay the "modernization" of Section 13(d) that they view as desirable.[8] Similarly, in a public debate at the conference board with one of us, Martin Lipton, the senior partner of the firm that authored the Petition, rejected the need for an empirical

---

[4] David Katz & Laura A. McIntosh, Corporate Governance Update: Section 13(d) Reporting Requirements Need Updating, N.Y. L.J., Mar. 22, 2012.

[5] Letter from Lucian A. Bebchuk, Professor, Harvard Law School & Robert J. Jackson, Jr., Associate Professor, Columbia Law School, to Elizabeth M. Murphy, Secretary, U.S. Sec. & Exch. Comm'n (Jul. 11, 2011), *available at* http://www.sec.gov/comments/4-624/4624-3.pdf; Letter from J.B. Heaton, Alon Brav & Wei Jiang to Elizabeth M. Murphy, Secretary, U.S. Sec. & Exch. Comm'n (July 5, 2011), at 2, *available at* http://www.sec.gov/comments/4-624/4624-2.pdf.

[6] Lucian A. Bebchuk & Robert J. Jackson, Jr., *The Law and Economics of Blockholder Disclosure*, 2 HARV. BUS. L. REV. __ (2012).

[7] Adam O. Emmerich, Theodore N. Mirvis, Eric S. Robinson & William Savitt, *Fair Markets and Fair Disclosure: Some Thoughts on* The Law and Economics of Blockholder Disclosure (Columbia Law and Economics Working Paper No. 428) (Aug. 27, 2012), *available* at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2138945.

[8] *See, e.g.*, *id.* at 19 (such an examination "is neither prudent nor legally required," and moreover would "sacrifice [the Petition's objectives] on the altar of endless and ultimately inconclusive academic debate about the costs and benefits of shareholder activism").

examination of these questions.[9] In our view, however, given that data on Section 13(d) filings is publicly available, the SEC should not proceed with rulemaking before examining this evidence.

In light of the SEC's expected consideration of the Petition, this Article uses data based on Section 13(d) filings to provide the first empirical analysis of this subject. We find that some key factual premises of the Petition—such as claims that pre-disclosure accumulations have increased over time due to changes in market practices and opportunities—are incorrect. Furthermore, our analysis provides empirical evidence that can inform the SEC's consideration and a foundation on which subsequent work, by SEC staff or other researchers, can build.

The Article proceeds as follows. Part II describes the universe of pre-disclosure accumulations we study and provides evidence about the incidence and magnitude of such accumulations. We examine the universe of all Section 13(d) filings by activist hedge funds from 1994 through 2007. We find that hedge fund activists do indeed use the opportunity not to disclose immediately upon crossing the 5% threshold, with over 40% taking advantage of a large part of the ten-day window. Indeed, we find that about 10% of all filings are made after the specified ten-day window, which suggests that the Commission should consider more effective enforcement of the existing deadline before examining whether the deadline should be shortened.

Moreover, our examination of the ownership stakes revealed in Section 13(d) filings indicates that the five anecdotes noted in the Petition are not representative of the magnitude of stakes accumulated by hedge fund activists prior to disclosure. The evidence shows that hedge fund activists typically disclose substantially less than 10% ownership, with a median stake of 6.3%.

Part III investigates a key claim of the Petition: that changes in market practices have, over time, enabled activist investors to increase the magnitude of pre-disclosure accumulations, making existing rules obsolete and requiring "modernization." We show that the evidence does not support this claim. In contrast to the concerns expressed in the Petition and subsequent work by the

---

[9] *See* The Conference Board, *Director Roundtable: The Law and Economics of Blockholder Disclosure* (Nov. 11, 2012), *available at* http://www.conference-board.org/governance/index.cfm?id=13474.

Petition's authors,[10] the size of pre-disclosure accumulations of stock have not increased over time. Indeed, the median stake at the time of disclosure has remained relatively stable throughout the 14-year period we study, and more extensive regression analysis does not identify a time trend. Thus, changes in existing rules can at most be justified as necessary to address longstanding policy questions, not as a "modernization" required by changes in the market place.

Part IV examines the costs of tightening the rules under Section 13(d). Requiring activist investors to disclose their stakes in public companies more quickly will reduce these investors' returns by giving them less time to acquire shares before disclosing their presence—and will therefore reduce the incidence and magnitude of outside blockholdings in such companies. This reduction will in turn carry two costs for other investors in public companies. First, *ex post*, investors in general will benefit less frequently from the superior returns that have long been associated with the arrival of an activist blockholder. Second, investors can be expected to lose the gains associated with the mere possibility that a blockholder will emerge and reduce agency costs and managerial slack—because, *ex ante*, the probability that such an investor will emerge is reduced by the tightening of the rules under Section 13(d).

Part V provides data with respect to an aspect of the subject that seems to have been overlooked by the authors of the Petition but that the SEC should take into account when considering changes to the rules under Section 13(d). While the Petition and its authors have focused on activist investors, we show that Section 13(d) filings by activist hedge funds represent only a small minority of all such filings.

We document the large number of filings made under Section 13(d) by investors other than activist hedge funds—and show that it is common for these investors, too, to make full use of the ten-day period prior to disclosure to accumulate more than 5% ownership in the firm by the time they disclose their stakes. Thus, in examining the consequences and costs of the proposed tightening of the Commission's rules under Section 13(d), it is important to take into account that most of the investors to which tightened rules would apply would not be the activist hedge funds on which the Petition has focused.

---

[10] *See* Emmerich et al., *supra* note 6, at 4.

In Part VI, we investigate how activists' purchases beyond 5% ownership are likely distributed in the ten-day window after the investors cross the 5% threshold. We investigate this subject by identifying abnormal trading turnover during the ten-day period. We find that, even when activists choose to wait the full ten days after crossing the 5% threshold to disclose their stakes, their purchases are likely concentrated on the day they cross the threshold as well as the following day. Thus, whatever the benefits of the existing ten-day period for activist investors, the practical difference in pre-disclosure accumulations between the existing regime and the rules in jurisdictions with shorter disclosure windows—which the Petition holds out as a model for modern reform—is likely much smaller than the Petition assumes.

Finally, in Part VII we consider the relationship between the Petition's proposed tightening of the disclosure rules under Section 13(d) and the recent proliferation of low-threshold poison pills in the United States. We present evidence indicating that a significant proportion of poison pills at public companies have thresholds that fall substantially short of a controlling block. We argue that any consideration of reforming the rules under Section 13(d) should take into account the interaction of such reform with the use of these poison pills.

In particular, we suggest that the SEC should avoid adopting any reforms that would facilitate the use of these pills to cap the stakes that outside investors can acquire in public companies. To the extent that the SEC does choose to tighten its disclosure rules under Section 13(d), any such tightening should apply only to companies that adopt corporate-law arrangements that preclude the adoption of low-trigger poison pills.

Before proceeding, we would like to stress that, because we focus only on the evidence available from disclosures under Section 13(d), our analysis is limited to only a few of the empirical questions that an adequate assessment of the rules governing blockholders' acquisitions of public-company stock should consider. Any such assessment should include analysis of the benefits conferred on shareholders by outside blockholders as well as the effects of existing disclosure rules and state law on the incidence and size of block holdings in public companies.[11] The preliminary evidence provided in this Article, however, offers no support for the Petition's proposed change in the existing rules under

[11] *See* Bebchuk & Jackson, *supra* note 5, at ___-___.

Section 13(d)—and provides some basis for concern that the proposed changes would have adverse effects on public-company investors.

Finally, we note that we are open to serious reconsideration of the Section 13(d) rules that govern blockholder disclosure. It may be that changes are needed to the structure that Congress originally selected. The choices that Congress made may reflect an ad-hoc choice that may not be the product of optimal analysis of all of the implications of these rules. In our view, however, any reconsideration of these rules—and the rules governing the relationship between incumbents and outside blockholders more generally—should be based upon a full analysis of all of the available empirical evidence. In this Article, we offer a first step toward the systematic empirical analysis that should be the basis for any changes to the existing rules governing blockholder disclosure.

II. THE INCIDENCE AND MAGNITUDE OF PRE-DISCLOSURE ACCUMULATIONS

In this Part, we examine the frequency and magnitude of hedge-fund activists' accumulations of significant blocks of stock in public companies. As we explain below, a systematic review of the evidence suggests that the concerns and anecdotes described in the Petition are not representative of the evidence on activist hedge fund behavior more generally.

In Section A, we describe the source of the data we present throughout the Article—public disclosures filed by activist hedge funds under Section 13(d) over a fourteen-year period—along with summary statistics describing the incidence of these filings and the size of the blocks disclosed by activist hedge funds. In Section B, we examine the timing of these disclosures—and the relationships between the timing of these filings and the size of the stake that investors disclose. And in Section C we show that investors commonly violate existing rules by waiting more than ten days to disclose—suggesting that, before modifying these rules, the SEC should consider more consistent enforcement of existing law.