

July 3, 2008

De-Coupling of Ownership, Economic and Voting Power in Public Companies –  
The UK's Financial Services Authority (FSA) Moves Decisively to Close the Gap

Responding decisively to the continued proliferation of swaps and other equity derivatives, securities loans, and other non-traditional ownership and voting arrangements, and their corrosive influence on market transparency and fair disclosure, the Financial Services Authority (the United Kingdom's financial and securities markets regulatory authority) yesterday determined to require disclosure of cash-settled and other derivative contracts, on an aggregated basis with ownership of actual common stock, at the 3% level, which is the historical disclosure threshold under the UK's Disclosure and Transparency Rules (subject to certain 13G-like exceptions). The FSA's new policy is aimed squarely at undisclosed accumulations of significant stakes in publicly traded companies through derivative instruments (including cash-settled derivative instruments) and in other non-traditional ways. The policy thus contemplates an exemption for the writers of equity derivatives, who act as intermediaries, to reduce unnecessary disclosures. While the FSA has now resolved its approach to equity derivatives as a policy matter, detailed regulations will be published in September. The FSA's statements on this topic are available [here](#) and [here](#).

The FSA's action demonstrates again that existing disclosure and regulatory regimes – including most importantly those in the U.S. – are inadequate to effectively police the proliferation and variety of synthetic and temporary ownership techniques now in use by creative investors and financial intermediaries. These evolving investment techniques may allow stock or debt accumulations to fly beneath the radar of existing disclosure regimes, and often have unexpected or counter-intuitive consequences under arrangements such as change-of-control provisions in indentures and other instruments as well as under shareholder rights plans, and create voting arrangements quite different from the traditional coupling of economic interest with voting power in public companies. As we have previously written ([A Modest Proposal, March 3, 2008](#)), Section 13(d) reform is urgently needed to expand required disclosure to include within the definition of “beneficial ownership” all derivative instruments which provide the opportunity, directly or indirectly, to profit or share in any profit derived from any increase in the value of public equity securities, as well as to require disclosure of large short positions.

Pending such reform, these non-traditional ownership and voting arrangements should be approached with caution, by companies and investors alike. Companies should review their fundamental documents, including by-laws, shareholder rights plans, employee change-in-control contracts and other compensation plans, and debt and commercial arrangements with these non-traditional ownership arrangements in mind. In particular, corporations should consider including in their advance notice by-laws provisions that require stockholder proponents to disclose all ownership interests, hedges and economic incentives relating to the company's securities. Traditional advance notice by-laws which may provide simply for disclosure of common stock ownership should be updated to impose a more complete disclosure requirement. Our model by-law provision with language that does this can be accessed [here](#). Similar language can be used by companies which desire to amend their shareholder rights plans to prevent accumulation of large derivative positions.

Unless and until lawmakers and securities regulators in the U.S. adopt disclosure requirements in accord with what is now the overwhelming global consensus towards full and fair disclosure of equity derivatives and other synthetic and non-standard ownership and control techniques – which must and should be done promptly – U.S. corporations are well advised to adopt such self-help measures as may be available, including appropriate provisions in by-laws, rights plans and other arrangements with change-in-control protections.

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