The Williams Act: A Truly "Modern" Assessment

~ Abstract ~

The Williams Act: An Historical Perspective

Enacted in 1968, the Williams Act was a response to a wave of hostile coercive takeover attempts, primarily cash tender offers. At the time the Williams Act was passed, the vast majority of shares were owned by individual shareholders, a fragmented and ill-informed group unprepared to exert their rights as shareholders. Cash tender offers posed the real risk of destroying value by forcing shareholders to tender their shares on a compressed timetable.

The Williams Act was designed to protect these investors, who faced serious dilemmas when "corporate raiders" launched attempts to take over companies in which they owned stock. It was intended to fill gaps in federal and state corporate law, as Federal securities laws already included disclosure requirements for proxy fights and share-for-share exchanges, while no laws applied to cash tender offers.

At the same time, Congress recognized that takeovers of underperforming companies could benefit shareholders and the economy as a whole, and also recognized that unduly impeding the acquisition of large block holdings comes at a significant cost to efficiency and the markets. Congress, therefore, sought to balance the interests of managers, potential acquirers, and shareholders.

Evolution of Corporate Governance

Since the 1960s, the corporate governance landscape has evolved dramatically in three key ways which suggest that it may be time for a comprehensive review of the provisions of the Williams Act and the protections it affords.

First, the enactment of new federal and state corporate antitakeover laws and implementation of corporate defense mechanisms have effectively closed the legal gaps that existed and put an end to the coercive tender offers that the Williams Act sought to address. It is difficult today to find a publicly held company that is not shielded by a poison pill or antitakeover statute, or both, such that incumbent management now has the upper hand in corporate governance contests.

Second, the composition of shareholders of public companies has changed significantly. In the 1960s, individual shareholders, who were widely dispersed and did not have the resources or the incentives to stay well-informed, held more than 80% of shares in U.S. corporations. Today, they account for only one-third of equity holdings. Most shares are owned by institutional investors who do have the resources and incentives to be engaged, hold larger concentrated blocks of stock, vote their interests more actively, and are far better informed. Because institutional investors are active participants in shareholder democracy it is nearly impossible today for a minority shareholder to individually dictate the outcome of a proxy contest or otherwise take control of a company through accumulations of a 10% (or even higher) position.

The third important development has been the emergence, over the last two decades, of a new breed of investors – active shareholders – who pursue investment strategies entirely different from the corporate raiders of the past. These engaged investors do not seek to acquire control of companies, but

instead seek to bring about operational, strategic, governance, capital allocation or other changes in order to create value for both passive and active shareholders. In the process they undertake the transaction costs, reputational risks, and legal and economic liabilities necessary to effect corporate change. Engaged investors, therefore, provide a market-driven mechanism for positive change.

The Current Debate

Recently, outside law firms that typically represent U.S. public company incumbent boards and management have called for piecemeal changes to the Williams Act's Section 13(d) disclosure regime that would place greater burdens on and reduce the economic incentives for active shareholder engagement across all U.S. corporations. The proposals include (1) shortening the current ten-day reporting period for disclosure of greater than 5% ownership positions and (2) expanding historic concepts of "beneficial ownership" to include synthetic or cash-settled derivatives to widen the scope of positions counted towards the threshold for disclosure. In addition, the Securities and Exchange Commission staff recently indicated that the Commission may consider rule changes in this area.

This paper argues that the calls for narrowly targeted changes to the Williams Act from pro-management commentators rely on several faulty premises. Furthermore, they undermine the market-based incentives for active shareholder engagement, and thus, these proposals would chill the market for engaged investing, making it less likely that such activity occurs at all. Without that activity, no one would obtain the benefits of the value creation that currently results from engaged investing, and corporate democracy would be weakened by narrowing in many cases the choices available to shareholders.

It strongly urges that the Commission should review the history and policy underlying the Williams Act's disclosure regime before adopting piecemeal changes that only benefit one side of the debate. The fundamental question in any proposed modernization of the Williams Act should be: Would changes benefit or harm shareholders? Moreover, this paper suggests that expanding the disclosure requirements of the Williams Act would not only fail to add anything to investor protection, but it would actually hurt investors and the economy as a whole, and that a comprehensive policy review would support changes to the Section 13(d) regime that encourage greater active shareholder involvement, including, among other things, an upward revision of the 5% disclosure threshold which currently relies on outdated notions regarding corporate control.

Despite its origins as a response to hostile takeovers, the current Williams Act disclosure regime sets the current balance between providing incentives for engaged investors to make investments and allowing passive, long-term shareholders to benefit from those investments. Whatever the Commission does, we believe any changes must be supported by clear evidence and driven by sound policy decisions, and that any changes should be preceded by an open and informed reassessment of all aspects of the Williams Act and the modern corporate landscape in which both shareholders and management participate.

NOTE: This paper includes statistical information that is preliminary in nature. Prior to the finalization of any policy changes, the Commission should undertake a comprehensive review of this and other pertinent information. The need for this review is the main point of this paper.

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~ EXECUTIVE SUMMARY ~

The Williams Act: A Product of Its Time. The Williams Act, which added Section 13(d) to the Securities Exchange Act of 1934, requires investors to file a disclosure statement within ten days of acquiring "beneficial ownership" of more than 5% of the equity of a public company. The Act was passed in the 1960s in response to a wave of hostile takeover attempts, mostly through tender offers, and was intended to fill a gap in federal and state corporate law, neither of which regulated tender offers. The Act sought to strike a careful balance in the market for corporate governance by providing shareholders with the information and time needed to evaluate tender offers and by allowing incumbent managers an opportunity to "make their case" to shareholders. Legislative history of the Act makes it clear that it was not intended to make takeover attempts unduly difficult to proceed, as Congress recognized that takeovers and takeover attempts can be beneficial means for holding incumbent managers accountable for their performance.

The Williams Act's share-acquisition disclosure threshold (5%) and filing deadline (ten days after reaching that threshold) were the measures that Congress ultimately chose to achieve that balance. The initial version of this legislation required investors to provide 20 days' advance notice before acquiring a 5% equity interest, but this combination was abandoned following opposition from the Securities and Exchange Commission, which characterized the bill as "difficult[]," "burdensome," and "impossible." The next iteration of the bill required a person acquiring 10% of a company's equity to provide notice within seven days, but was once again met with opposition, this time from those who argued that antitakeover measures would make it too difficult for shareholders to hold managers accountable.

The third and final version of the bill, which set a later filing deadline and set the disclosure threshold at 10%, was deemed to achieve the appropriate balance and "avoid tipping the scales either in favor of management or in favor of the person making the takeover bids." When Congress later amended Section 13(d) to lower the disclosure threshold from 10% to 5%, Senator Harrison Williams, the chief sponsor of the Act, noted that "[s]tock holdings of between 5 and 10 percent in [large] companies are in many instances a controlling interest" and therefore "the full disclosure requirements of the Securities Exchange Act are necessary for adequate investor protection."

Dramatic Changes In The Markets Since 1968. Since the passage of the Williams Act, the corporate governance landscape has evolved dramatically in three key ways that are relevant here.

Antitakeover Laws and Devices. State antitakeover legislation and newly devised corporate defense mechanisms, coming largely in response to the hostile takeover wave of the 1980s, have effectively put an end to the coercive tender offers addressed by the Williams Act. At the time of the Act's passage, Congress had not previously enacted an antitakeover statute, and only one state had done so. Today, almost every state has statutes dedicated to regulating (mostly with the effect of impeding) takeovers, most notably "business combination statutes," and issuers have devised numerous antitakeover defenses, most notably the poison pill and staggered boards, with the same effect. In sharp contrast to the era in which the Williams Act was passed, it is difficult today to find a publicly held company that is not shielded by a poison pill or antitakeover statute, or both. As a result, attempts to acquire companies through coercive tender offers are largely a relic of the past. Management now has the upper hand in corporate governance contests, with the result that CEO performance has declined but CEO pay has increased.

The Rise of Institutional Shareholders. The composition of shareholders has dramatically changed since the 1960s. When the Williams Act was passed, the vast majority of shares were owned by individual shareholders who were atomized and ill-informed. Today most shares are owned by institutional investors who have the resources and incentives to be engaged. Because of this pattern of investing, it is nearly impossible today to gain control of a company through accumulations of a 10% (or even higher) position. In fact, while individuals held more than 80% of shares in U.S. corporations when the Williams Act was passed, today they account for only one-third of equity holdings. Institutional investors hold larger concentrated blocks of stock than individual investors of the 1960s, more actively vote their interests, and are far better informed, making it impossible in almost all cases for a minority shareholder to individually dictate the outcome of a proxy contest or otherwise take control of a company.

Growth of Active Shareholder Engagement. The third significant development is the rise of active shareholder engagement by investors, typically hedge funds, who do not seek to acquire control of companies, but instead seek to bring about operational, strategic, governance, capital allocation or other changes in order to create value for themselves and all other shareholders. This activity stands in sharp contrast to a hostile coercive tender offer, where the acquirer has different economic motivations from other shareholders and seeks to maximize value only for itself, while offering as little value as possible for other shareholders. The positions sought by engaged investors are relatively small compared to the stakes sought by corporate raiders of the past. Studies have found that the median "activist" hedge fund stake is 6.7% in a large cap company, 8% in a mid cap company, and 9.8% in a small cap company.

Benefits of Engaged Investing, And Costs of Deterring Engaged Investors. Not surprisingly, incumbent management and boards subject to challenges from shareholders have sought to limit shareholder engagement. Most recently, outside law firms that typically represent incumbent boards and management have called for piecemeal changes to the Williams Act regime that would place greater burdens on and reduce the economic incentives for active shareholder engagement. The proposals include (1) shortening the current ten-day reporting period for disclosure of greater than 5% ownership positions and (2) expanding historic concepts of "beneficial ownership" to include synthetic or cash-settled instruments to widen the scope of positions counted towards the threshold for disclosure.

Expanding the disclosure requirements of the Williams Act would not only fail to add anything to investor protection, but it would actually hurt investors and the economy as a whole. Engaged investors add value to shareholders, corporations, and the economy at large. Empirical evidence strongly suggests that shareholder engagement benefits shareholders in both the short and long-term. Market forces also support the proposition that these investors generate value for shareholders; when investors with a track record of successful corporate engagement announce their intentions, a company's share price typically rises in anticipation of that value creation.

Indeed, in arguing for changes to the Section 13(d) rules, commentators have acknowledged this dynamic by arguing that this value creation should be made available to more shareholders through earlier disclosure. But the truth is that expanded disclosure requirements would make share acquisition by engaged investors much more expensive, in many circumstances too expensive to justify the resources, time and effort for such activities. By undermining the market-based incentives for active shareholder engagement, these proposals would chill the market for engaged investing, making it less likely that such activity occurs at all. Without that activity, no one would obtain the benefits of the value creation that currently results from engaged investing, and corporate democracy would be weakened by narrowing in many cases the choices available to shareholders.

Flawed Proposals For Piecemeal Reform. In addition to their potential to chill highly beneficial economic activity, calls for narrowly targeted change from pro-management commentators rely on several faulty premises.

First, the pro-incumbent management advocates have argued that the ten-day filing period is a reflection of the technology of the 1960s. There is no evidence, however, from the legislative history that supports the notion that the "state of technology" – especially, the state of word processing at the time – was a deciding or even significant factor in setting the ten-day window. Instead, the choice likely reflects a judgment by Congress about the appropriate balance among interests affected by takeover attempts. This type of balance is not unique in the securities laws.

Second, these advocates have suggested that short-term selling shareholders who dispose of their shares in the period before a large-block investor discloses its purchases are harmed in some fashion. In fact, the opposite appears to be the case, as empirical evidence shows that share prices rise (sometimes substantially) *before* 13(d) filings are publicly filed. Therefore even these short-term sellers benefit from engaged investors' share acquisition activity. In addition, large-block investors provide liquidity to short-term sellers, affording them an opportunity to exit their investments on an uncoerced basis, at a time of their choosing and at a price they deem attractive. Even leaving these facts aside, pro-management advocates have failed to offer any rational policy justification for why shareholders who have made the short-term decision to sell should be afforded priority over the overwhelming majority of other shareholders who retain their interests and the engaged shareholders who propose changes intended to benefit all shareholders. These calls for reform are curious since the suggested changes would in fact chill value-creating activity and thus deprive all shareholders of the benefits.

Third, these commentators have incorrectly suggested that the current 13(d) regime permits concentrated, engaged shareholders to obtain "control" of U.S. public companies prior to disclosure of their ownership interests. In fact, because shareholder bases are no longer largely comprised of dispersed and ill-informed individual shareholders, it is nearly impossible to acquire "control" of a company through 10% (or even greater) positions. It is important to distinguish the situation where a minority shareholder exercises *de facto* control over a company due to the disaggregation of shareholders (a situation that the Williams Act sought to address) from the situation where a minority shareholder has the incentive and ability to win the support of a majority of well-informed shareholders by effectively advocating for change (which the drafters of the Williams Act acknowledged is already governed by the proxy rules in any event). In this latter instance, control has not been passed to the engaged investor. Rather, the majority of disaggregated shareholders continues to control the company (including retaining the expectation of a control premium if the company is later sold), but have chosen for themselves new representatives of their interests. This is not a harm from which shareholders should be protected. This is corporate democracy at work.

In fact, in arguing for greater burdens on large-block share accumulations, these commentators have adopted the parlance of the hostile tender offer, including terms such as “raiders” and “attacks,” which only confuses the modern pattern of shareholder engagement with the earlier hostile tender offers that the Williams Act was intended to address. These market activities are, of course, entirely different. Coercive hostile tender offers at the time of the Williams Act posed the real risk of destroying value by forcing disaggregated and ill-informed shareholders to tender their shares on a compressed timetable (often a few days) before managers had time to adequately respond. Today’s actively engaged shareholders seek instead to create value for all shareholders (themselves included), and boards, by virtue of the proxy rules, state law, and widely prevalent advance-notice corporate bylaws, are guaranteed a long period of time to “make their case” to shareholders for the status quo. Moreover, today’s engaged investors do not seek “control” but instead to make a case for change on the merits to all other shareholders, who are free to accept or (as often happens) reject such change and in all instances remain in “control” of the outcome. By blurring the clear lines between hostile tender offers and active shareholder engagement, these commentators seek to avoid what should be the fundamental question in any proposed modernization of the Williams Act: Would changes benefit or harm shareholders? As discussed in this paper, we believe it is clear that these changes would clearly harm shareholders.

In short, before granting piecemeal changes that only benefit one side of the debate regarding shareholder engagement of U.S. corporations, the Commission should review the real impact of those proposed changes and decide what best serves overall shareholder interests. Moreover, the result of a comprehensive policy review would likely be strong support for changes to the Section 13(d) regime that encourage *greater* active shareholder involvement, including, among other things, an upward revision of the 5% disclosure threshold which currently relies on outdated notions regarding corporate control. Whatever the Commission does, however, we believe any changes must be supported by clear evidence and driven by sound policy decisions, and that any changes should be preceded by an open and informed reassessment of all aspects of the Williams Act and the modern corporate landscape in which both shareholders and management participate.

I. The Williams Act

Enacted in 1968, the Williams Act was meant to protect individual shareholders who faced serious dilemmas when "corporate raiders" launched attempts to take over companies in which they owned stock. Congress perceived that retail investors, often lacking sophistication, needed information about the would-be acquirer's intentions to decide how to respond to cash tender offers, which were otherwise unregulated under federal or state law.

The 1960s saw "a changing market for corporate control, characterized by a huge surge in the number of takeovers, particularly in the form of cash tender offers." Jonathan R. Macey & Jeffrey M. Netter, *Regulation 13D and the Regulatory Process*, 65 Wash. U. L.Q. 131, 133 (1987). Whereas mergers and acquisitions had previously been "relatively uncommon," they became "daily fare for the readers of the financial page" in the 1960s. Note, *Cash Tender Offers*, 83 Harv. L. Rev. 377, 377 (1969). In particular, although corporate-control contests had previously been conducted by proxy fights or consensual share-for-share exchanges, the 1960s gave rise to the unsolicited cash tender offer as a legal device to effect takeovers. As noted by Senator Williams, the cash tender offer had "become an increasingly favored method of acquiring corporate control…. [I]n 1960 there were only 8 such offers involving listed companies as compared to 107 in 1966." 113 Cong. Rec. 9339 (1967).

In a typical cash tender offer of the time, "the offeror publicly propose[d] to buy a certain percentage of the outstanding securities of the target corporation with the aim of acquiring control. Newspaper advertisements [were] published inviting current shareholders to tender their stock to the offeror and announcing the offer at a price which includes a certain premium above the current market price. The offeror's obligation to purchase (take up) tendered shares [was] typically conditioned on the tender of a set minimum number of securities." *Cash Tender Offers*, 83 Harv. L. Rev. at 377-378. In the most extreme cases – known as "Saturday night specials" – the tender offer would be valid for just a few days, leaving shareholders and management almost no time to weigh the costs and benefits of the proposal. Therefore, unlike proxy fights or share-for-share exchanges, the "essential problem" of cash tender offers was that they allowed corporate raiders "to operate in almost complete secrecy concerning their intentions, their commitments and even their identities." 113 Cong. Rec. 855 (1967).

Cash tender offers fell within a regulatory gap that existed at the time. The federal securities laws already included disclosure requirements for proxy fights and share-for-share exchanges, but no laws applied to cash tender offers. As Senator Williams noted, "[t]he failure to protect investors in connection with a cash takeover bid is in sharp contrast to the regulatory requirements applicable where one company offers to exchange its shares for those of another, or the protections applicable to a proxy fight for corporate control." 113 Cong. Rec. 855 (1967); *see also id.* at 857 (noting that the "dangerous threats" from "so-called corporate raiders" were "immune" from regulation).

Congress had never enacted an antitakeover statute, and only one state, Virginia, had passed such a statute – just two months prior to passage of the Williams Act. Thus, "the law [did] not even require that [a cash tender offeror] disclose his identity, the source of his funds, who his associates are, or what he intends to do if he gains control of the corporation. As a practical matter, … the investor [was] severely limited in obtaining all of the facts on which to base a decision whether to accept or reject the tender offer." S. Rep. No. 90-550, at 72 (1967). As the Supreme Court has explained, the Act "was the congressional response to the increased use of cash tender offers in corporate acquisitions, a device that had removed a substantial number of corporate control contests from the reach of existing disclosure requirements of the federal securities laws. The Williams Act filled this regulatory gap." *Edgar v. MITE Corp.*, 457 U.S. 624, 632 (1982) (internal quotation marks omitted).

The Williams Act underwent extensive revision during its journey through Congress, as Congress sought to strike the right balance in regulating tender offers. As initially framed, it was a conscious effort to insulate target companies from the unsolicited takeover attempts that were prevalent in the 1960s. During the legislative process, however, Congress recognized that takeovers of underperforming companies could benefit shareholders and the economy as a whole, and also recognized that unduly impeding the acquisition of large block holdings comes at a significant cost to efficiency and the markets. Congress, therefore, sought to balance the interests of managers, potential acquirers, and shareholders.

On October 22, 1965, Senator Williams proposed a bill that would have amended the Exchange Act to require any person to provide 20 days' advance notice before acquiring – either by open-market purchase or cash tender offer – 5% "beneficial ownership" in a company's equity. S. 2731, § 2, 89th Cong. (1965). Under that proposal, the potential acquirer would have had to disclose "the purpose of the purchases or prospective purchases and, if made to acquire control of the business of the issuer of the securities or to obtain representation on its board of directors, the plans of such persons with respect to the conduct and continuation of the business of such issuer." *Id.* The antitakeover purpose of the bill was openly noted by Senator Williams: "In recent years we have seen proud old companies reduced to corporate shells after white-collar pirates have seized control with funds from sources which are unknown in many cases, then sold or traded away the best assets, later to split up most of the loot among themselves." 111 Cong. Rec. 28257 (1965). Senator Williams acknowledged that the bill would "obviously work to the disadvantage of any corporate takeover specialists," *id.*, and "penalize the raider[s]." *Id.* at 28260.

The bill was soon dropped after it met opposition from the Securities and Exchange Commission. In a memorandum to Senator Williams, the Commission characterized the bill as "difficult[]," "burdensome," and "impossible" due to its advance-notice requirement. 112 Cong. Rec. 19004 (1966). Soon after, Senator Williams had "numerous staff discussions with the Securities and Exchange Commission, members of the New York Stock Exchange, private industry, and other interested parties," and "[a]s a result of these discussions, [he] substantially revised the original bill." 113 Cong. Rec. 854 (1967). The revised bill, which was introduced on January 18, 1967, would have required that a person acquiring 10% of the "beneficial ownership" of a company's equity provide disclosure within seven days of reaching the threshold. S. 510, § 1, 90th Cong. (1967). Additionally, any person seeking to make a cash tender offer for a company's securities would have had to provide five days' advance notice to the Commission. *Id.* § 2.

Senator Williams indicated that this new bill – including its provision for disclosure seven days after reaching the 10% threshold – was intended to be neutral as between acquirers, targets, and shareholders. "I have taken extreme care with this legislation to balance the scales equally to protect the legitimate interests of the corporation, management, and shareholders without unduly impeding cash takeover bids. Every effort has been made to avoid tipping the balance of regulatory burden in favor of management or in favor of the offeror." 113 Cong. Rec. 854 (1967).

But even the revised bill generated concerns that excessively stringent antitakeover measures would make it difficult for shareholders to hold managers accountable. As explained by Stanley Kaplan, one of the acclaimed corporate-law professors of the era, it is "imperative that corporate management should be made to recognize – and to feel poignantly – that it will be subject to replacement if its performance is not of reasonably high caliber. Otherwise, I think that management tends to become old and stale." *Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearing Before the Subcomm. on Securities of the S. Comm. on Banking & Currency*, 90th Cong. 134 (1967) (hereinafter "Senate Hearings").

After the hearing, Senator Williams acknowledged that "[i]t has been strongly urged that takeover bids should not be discouraged, since they often serve a useful purpose by providing a check on entrenched but inefficient management." 113 Cong. Rec. 24664 (1967). He therefore proposed a third iteration of the bill, which required that a person acquiring more than 10% of a company's equity had to provide disclosure within a longer period, ten days, of reaching the 10% threshold. S. 510, § 2, 90th Cong. (amended Aug. 31, 1967). Senator Williams stated that the revised bill "carefully weighed both the advantages and disadvantages to the public of the cash tender offer," took "extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids," and was "designed solely to require full and fair disclosure for the benefit of investors" by "provid[ing] the offeror and management equal opportunity to present their case." 113 Cong. Rec. 24664 (1967). With minor modifications, this third bill became law. Pub. L. No. 90-439, 82 Stat. 454 (1968).

Two years later, Senator Williams proposed – and Congress ultimately passed – an amendment to the 1968 law that lowered the threshold for disclosure from 10% to 5%. Pub. L. No. 91-567, 84 Stat. 1497 (1970). Senator Williams explained that "[s]tock holdings of between 5 and 10 percent in [large] companies are in many instances a controlling interest" and therefore "the full disclosure requirements of the Securities Exchange Act are necessary for adequate investor protection." 116 Cong. Rec. 3024 (1970). Similarly, Congressman William Springer, who led the charge for the amendment in the House, noted that "it is possible with only 10 percent to determine what will happen to a corporation … because 10 percent in some corporations gives you almost control." 116 Cong. Rec. 40188 (1970).

II. Changes to the Corporate Governance Landscape Since the Williams Act

The market for corporate governance has changed dramatically since the Williams Act was passed, in three principal respects. *First*, corporate management has acquired an arsenal of weapons to oppose takeovers, making coercive tender offers largely a relic of the past. These tools today give management the upper hand in any corporate governance contest. *Second*, the composition of shareholders has been turned upside-down since passage of the Williams Act. In 1968, individual shareholders were prevalent, and institutional shareholders were relatively rare. Today, individuals hold only a small portion of U.S. equities. They have been replaced by institutions, which are much more informed and more active in corporate democracy than the individual shareholders of the past, who were atomized and often at the mercy of a controlling shareholder, and which often acquire substantial blocks of shares in a company. As a result, it is nearly impossible for any minority individually to dictate the outcome of a proxy contest or otherwise take control of a company. *Finally*, the most engaged investors today (particularly, activist hedge funds) have an entirely different agenda than the corporate raiders who gave rise to the Williams Act. Engaged investors seek influence, not control, and they add value to companies for the benefit of all shareholders, rather than loot companies for themselves. And instead of operating through secretive tender offers, they use accepted channels of shareholder democracy to gain influence and persuade other shareholders and management to adopt their ideas for change.

In short, the composition of equity investors has dramatically changed since 1968, while the outdated assumptions regarding these investors embedded in the Williams Act's disclosure thresholds remain untouched.

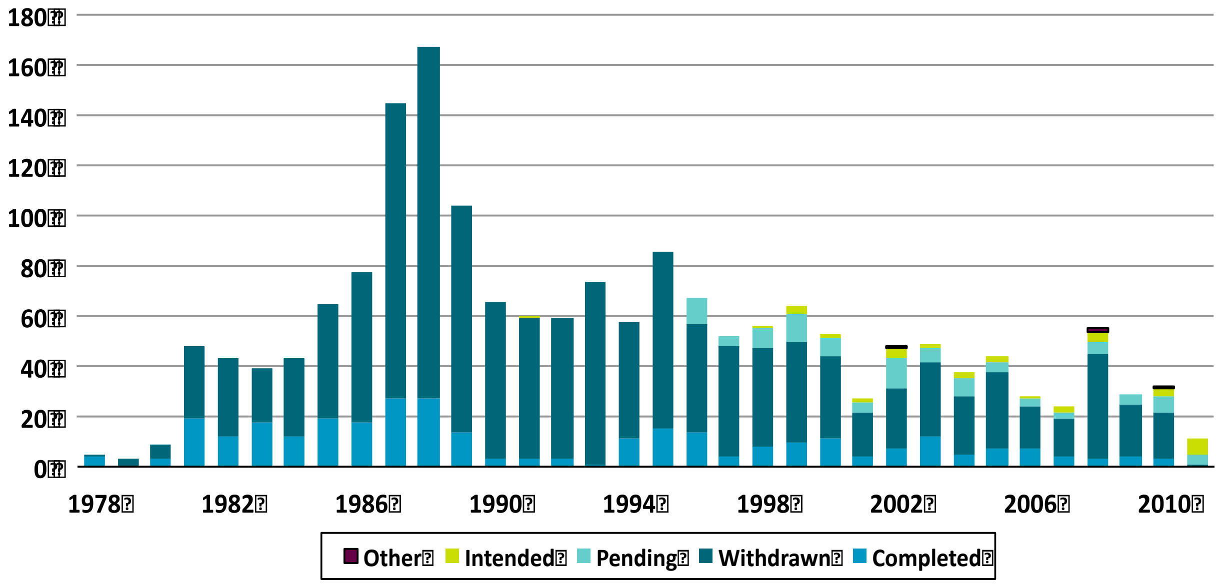
A. Proliferation of State Antitakeover Statutes and Takeover Defenses

In the 1960s, managers of target companies had few defenses to a hostile takeover. Management could only "communicate its opposition to the shareholders by letter or advertisement," persuade "allies" such as its banks and insurance companies to "buy stock in the market and thus push up the price," "buy some stock [itself] or raise its dividend," "attempt[] to arrange mergers with other companies," or "attempt[] to block the acquisition on the ground that it would violate the antitrust laws or some other regulatory statute." Arthur Fleischer, Jr. & Robert H. Mundheim, *Corporate Acquisition by Tender Offer*, 115 U. Pa. L. Rev. 317, 321-322 (1967). As a result, "offerors were free to structure offers in a manner designed to force shareholders to decide quickly whether to sell all or part of their shares at a premium," and "[t]he target's management consequently had little time to mobilize a defensive strategy to impede the offer." Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 Harv. L. Rev. 1161, 1162 (1981). These tactics translated into an active market for hostile takeovers.

This takeover boom that began in the 1960s and spilled into the 1970s and 1980s led to a backlash on two fronts. First, nearly every state in the U.S. adopted an antitakeover statute making it difficult, and usually impossible, for home-state corporations to be acquired without management's approval. In contrast to the Williams Act's stance of neutrality, these state antitakeover statutes heavily favor incumbent directors and managers. *Corporate Law: The Race to Protect Managers from Takeovers*, 99 Colum. L. Rev. 1168, 1177 (1999) (noting that "[s]tates have worked hard, and quite successfully, to make takeovers more difficult"). An antitakeover statute makes a state more attractive to a corporation as a home base: corporations (and their managers) can choose where to incorporate, and they are more likely to incorporate in states with robust antitakeover regulation. Bebchuk & Ferrell, 99 Colum. L. Rev. at 1173; *see also* Lucian A. Bebchuk et al., *Firms' Decisions Where to Incorporate*, 46 J.L. & Econ. 383, 411-417 (2003). Indeed, state antitakeover statutes are often passed at the behest of in-state firms. *See, e.g.*, Roberta Romano, *The Political Economy of Takeover Statutes*, 73 Va. L. Rev. 111, 122-123 (1987) (explaining by way of example that Connecticut's antitakeover statute "was promoted by a corporation incorporated in Connecticut, the Aetna Life and Casualty Insurance Company …, which enlisted the support of the most important business association in the state, the Connecticut Business and Industry Association").

HOSTILE ACTIVITY IN THE U.S.

Hostile / Unsolicited Deals



Source: Thomsen SDC. Excludes multiple listings for select deals. Hostile deals include potential transactions where the target Board of Directors officially rejects an offer but the offeror persists with its takeover attempt. Unsolicited deals include potential transactions where the offer is made not at the request of the target's board and where the target's board has not recommended the transaction.

The most prevalent antitakeover law is a "business combination statute," which "impose[s] a moratorium on specified transactions between the target and a shareholder holding a certain percentage of stock unless the stock acquisition or the transaction is approved in advance of the stock acquisition or the transaction by the target's board of directors." *Shareholder Rights*, 59 Geo. Wash. L. Rev. at 1439. More than 30 states have such statutes, including Delaware, New York, Pennsylvania, Illinois, and Virginia. In all, more than 90% of all U.S. public companies are subject to a business combination statute. For example, under Delaware's business combination law, a corporation "shall not engage in any business combination" – including a merger or acquisition – with a shareholder that owns 15% or more of its stock for three years after the shareholder reaches that threshold, unless the board provides advance approval, the shareholder goes from owning less than 15% stock to more than 85% in a single transaction, or the board provides concurrent or subsequent approval *and* the combination receives two-thirds vote at a meeting of shareholders. Del. Code tit. 8. § 203(a). In other words, the only way a hostile bidder can gain control of a firm in Delaware is to first acquire more than 85% of the company's shares. This barrier and later judicial opinions have effectively ended hostile takeovers in Delaware. *See Is Delaware's Antitakeover Statute Unconstitutional?*, Subramanian, et al., *Is Delaware's Antitakeover Statute Unconstitutional? Evidence from 1988-2008*, 65 Bus. Law. 685, 734, 721-722 (2010) (studying hostile bids in Delaware from 1988 to 2008 and finding that not one hostile bidder was able to reach the 85% mark).

There are numerous other flavors of antitakeover statutes: Control share acquisition statutes (upheld by the Supreme Court in *CTS v. Dynamics Corp. of America*, 481 U.S. 69 (1987)) give disinterested shareholders the opportunity to determine whether large-block shareholders should have voting rights for their shares; fair price statutes require bidders to offer a "fair price" to all shareholders of the target firm unless the offer receives supermajority approval by disinterested shareholders; directors' duties statutes give a company's board of directors very broad discretion (and limit their liability) in defending against a hostile takeover bid. *Shareholder Rights*, 59 Geo. Wash. L. Rev. at 1431. Regardless of their nature, however, all these statutes share a common feature: "State takeover laws are *anti* takeover laws. Their principal aim is not to maximize share values for target company investors, whether by eliminating coercion or otherwise …. Instead, their chief purpose is to protect *non* shareholders [i.e., in-state interests, including incumbent management]" from hostile takeovers. Johnson & Millon, *Missing the Point About State Takeover Statutes*, 87 Mich. L. Rev. 846, 848 (1989).

Just as states were adopting antitakeover legislation, incumbent management began devising new defenses to corporate-control contests – defenses that were largely upheld in state courts (like Delaware's) that tend to be deferential to management initiatives. "By the early 1980s, most U.S. public companies were vulnerable to hostile bids, and takeover defenses were developed to mitigate that threat. Through the mid-1980s, companies adopted a number of takeover defenses in the form of charter amendments." Coates, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 Cal. L. Rev. 1301, 1306 (2001).

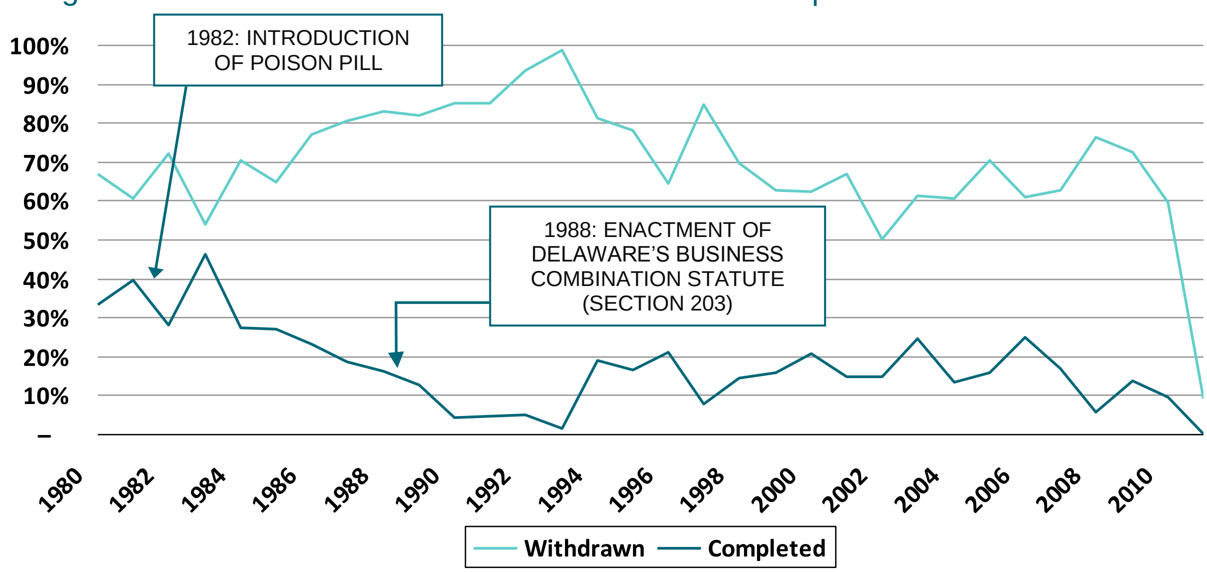
The most important defenses are the poison pill and staggered boards. The poison pill is "the ultimate defense against a hostile takeover," and "while in place, it is an absolute barrier to the consummation of a hostile takeover." Velasco, *The Enduring Illegitimacy of the Poison Pill*, 27 J. Corp. L. 381, 381-382 (2002). Poison pill plans are true to their name: the target company attempts to make its stock so toxic that no acquirer would wish to purchase it. In the most common variety of the pill – the "flip-in" – a company's board of directors adopts a (euphemistically named) "Shareholder Rights Plan" that provides shareholders the right to purchase additional stock at a discounted price. This right is usually triggered by any acquirer's purchase of a large percentage of the company's shares, but this right does not accrue to the acquirer. Thus if triggered, the pill dilutes the value of the would-be acquirer's shares, making the acquisition economically irrational.

There are only two ways to defeat the pill: convincing the company's board of directors to withdraw the pill (in which case the takeover will no longer be hostile) or replacing a majority of the board in a proxy contest. *See id.* at 382-384. As the Delaware courts recently reiterated, the pill is an "incredibly powerful and novel device" that has "no other purpose than to give the board issuing the rights the leverage to prevent transactions it does not favor by diluting the [acquirer's] interests." *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 129 (Del. Ch. 2011).

The poison pill becomes even more powerful when combined with a staggered (or classified) board. "In a company with a staggered board, directors are grouped into classes (typically three), with each class elected at successive annual meetings." Lucian Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards*, 54 Stan. L. Rev. 887, 893 (2002). The poison pill and the staggered board erect substantial hurdles for an unsolicited bidder: "the pill blocks any stock acquisition beyond the trigger level, and the staggered board forces the bidder to go through two proxy contests in order to gain control of the board and redeem the pill." *Id.* at 899. Indeed, these two defenses, working together, constitute "the most powerful antitakeover device in the current arsenal of takeover defense weapons." *Id.* at 950.

HOSTILE ACTIVITY IN THE U.S.

Percentage of Hostile / Unsolicited Deals Withdrawn and Completed



Source: Thomson SDC. Excludes multiple listings for select deals.

In recent landmark decisions, both the Delaware Supreme Court and the Delaware Court of Chancery confirmed the continued validity and strength of the poison pill and staggered boards in combating a hostile tender offer. The result is a *per se* rule that provides incumbent staggered boards that have adopted poison pills with at least a two-year window to resist corporate governance changes or to thwart unsolicited bids. *See Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182 (Del. 2010) (invalidating bylaw proposed by acquirer firm that would have prematurely terminated the terms of three of the target firm's board members by eight months, allowing the acquirer firm to gain control of the target board); *Air Prods & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48 (Del. Ch. 2011) (upholding target firm's rejection of all-cash, all-share tender offer and maintenance of the target firm's poison pill, while noting that the combination of "a poison pill in combination with a staggered board" invariably makes a hostile takeover attempt "prohibitively more difficult").

In sharp contrast to the era in which the Williams Act was passed, "[i]t is difficult today to find a publicly held company that is not shielded by a poison pill or antitakeover statute, or both."

Shareholder Rights, 59 Geo. Wash. L. Rev. at 1431. These developments have effectively put an end to "the last significant threat to managerial power." Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 Tex. L. Rev. 987, 1043 (2010). In fact, antitakeover statutes and defenses have led to "the virtual disappearance" of hostile takeovers. Gregor Andrade et al., *New Evidence and Perspectives on Mergers*, 15 J. Econ. Persp. 103, 105-106 (2001). In the 1980s, when antitakeover statutes and defenses were still being devised, 14% of takeover attempts were hostile. *Id.* at 106. In the 1990s, by which time management had consolidated its forces, only 4% of takeover attempts were hostile – and only 3% of those attempted transactions actually succeeded. *Id.* For example in Delaware, there were nearly as many hostile takeover attempts in 1988 and 1989 alone as there were for the entire period between 1990 and 2008. *Is Delaware's Antitakeover Statute Unconstitutional?*, 65 Bus. Law. at 739.

Studies show that these defenses have effectively entrenched, and enriched, management. After a company adopts a new antitakeover defense or becomes subject to a new antitakeover statute, CEO compensation rises but CEO performance falls. *See* Kenneth A. Borokhovich et al., *CEO Contracting and Antitakeover Amendments*, 52 J. Am. Fin. Ass'n 1495, 1515 (1997) (concluding that CEO compensation "increases significantly following" adoption of an antitakeover defense); Atreya Chakraborty & Shahbaz Sheikh, *Antitakeover Amendments and Managerial Entrenchment*, Q.J. Fin. & Acct. 81, 93-94 (2010) (concluding that "protection from takeover threat increases managerial entrenchment and gives CEOs the power to influence their compensation"); Marianne Bertrand & Sendhil Mullainathan, *Executive Compensation and Incentives: The Impact of Takeover Legislation* 29 (Nat'l Bureau of Econ. Research, Working Paper No. 6830, 1998) (concluding that "state anti-takeover laws raised mean CEO pay"); Scott W. Barnhart et al., *Do Firm and State Antitakeover Provisions Affect How Well CEOs Earn Their Pay?*, 21 Managerial & Decision Econ. 315, 326 (2000) (concluding that the "presence of both firm-specific and state antitakeover provisions" leads to lower CEO performance).

In short, "[t]he takeover wars are over. Management won." Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 Stan. L. Rev. 857, 858 (1993).

B. The Rise of Institutional Shareholders

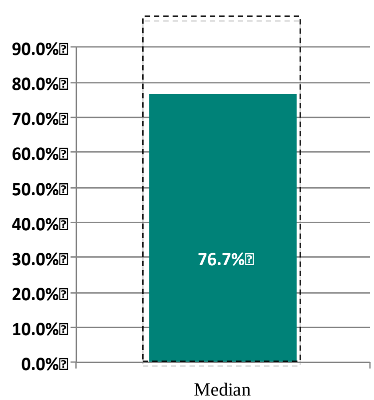
The fundamental premise of the Williams Act was that shareholders were atomized and dispersed, and lacked information and sophistication. Indeed, at the time the Williams Act was passed, more than 80% of investors were individuals. *See* Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States, 1965-1974, at 83 (2011). As scholars have long recognized, individual investors have almost no incentive to be active, informed shareholders. Because "[e]ach [individual] shareholder own[s] a small fraction of a company's stock, and thus receive[s] only a fraction of the benefits of playing an active role, while bearing most of the costs," "shareholder passivity [is] inevitable." Bernard S. Black, *Shareholder Passivity Reexamined,* 89 Mich. L. Rev. 520, 522 (1990).

Shareholder passivity became an acute problem during the Williams Act era, as corporate raiders sought to take advantage of dispersed and ill-informed shareholders by providing them with little time or information to decide whether to sell or surrender their shares. The Williams Act therefore sought to give shareholders time and information to consider tender offers adequately. *See Rondeau v. Mosinee Paper Co.*, 422 U.S. 49, 58 (1975) ("The purpose of the Williams Act is to insure that public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information regarding the qualifications and intentions of the offering party.”). Likewise, the Act reflected that, even short of making a tender offer, an investor could acquire a controlling interest in the company by acquiring a substantial number of shares on the open market and then proceed to institute changes in corporate governance that might benefit himself at the expense of other shareholders. For example, Congressman Springer suggested that “it [was] possible with only 10 percent to determine what will happen to a corporation that [an investor] buys into because 10 percent in some corporations gives you almost control.” 116 Cong. Rec. 40188 (1970).

In an era of dispersed individual shareholders, that may have been true in some cases. For instance, in the mid-1960s, after one corporate raider acquired “approximately 9.7% of the common stock of Wheeling Steel Corporation,” the result was “a management upheaval, a recognition of [the raider’s] control, and the election of officers satisfactory to him.” A.A. Sommer, Jr., *Who’s “In Control”? – S.E.C.*, 21 Bus. Law. 559, 569 (1966). This was possible because “the remainder of the stock was held by approximately 12,000 shareholders.” *Id.*

MEDIAN CONTESTED PROXY QUORUMS

68 Meetings from 2008-2011[1]

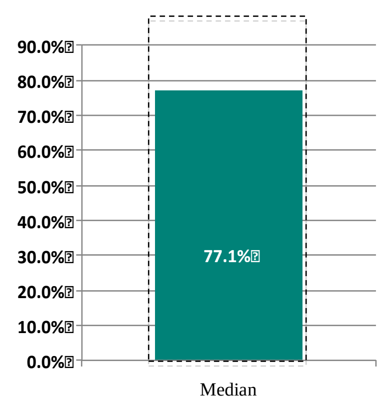


Source: Company Filings

1. Modern median quorums in contested proxy elections suggest holders would need to control 38.4% in order to dictate outcomes for elections of directors. Mean quorums for the sample universe were 74.0%.

MEDIAN CONTESTED MERGER QUORUMS

147 Contested Mergers from 2003-2011[2]



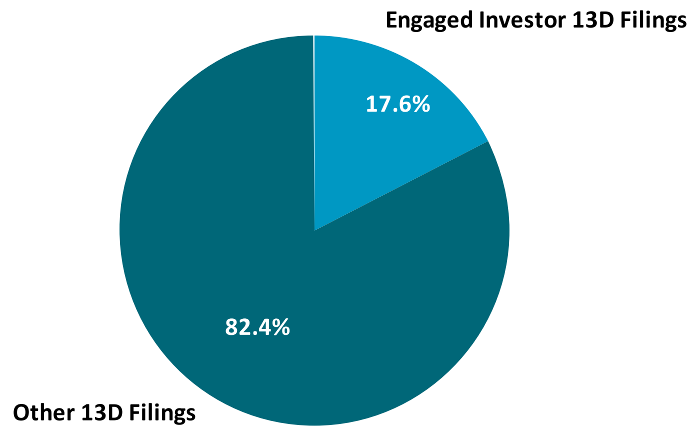
Source: Company Filings

2. Modern median merger quorums in contested mergers suggest that holders would need to control in excess of 27.1% to block management-supported transactions. Mean quorums for the sample universe were 76.0%.

But since 1968, institutional investors have largely replaced individuals in the equity markets. As noted above, when the Williams Act was passed in 1968, individuals held more than 80% of shares in U.S. corporations. By 1980, this measure had slipped below 70%. Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States, 1975-1984, at 83 (2011). By 1995, individuals held just over 50% of shares. Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States, 1995-2004, at 83 (2011), and today, they account for approximately one-third of equity holdings. Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States, 2005-2010, at 83 (2011). In fact, this figure might be overstated, since the Federal Reserve's data counts the holdings of hedge funds, nonprofit foundations, and pass-through entities in the individual category. Accordingly, the major players in the marketplace today are not "Mom and Pop," but rather hedge funds, pension funds, mutual funds, and index funds.

ENGAGED INVESTORS COMPRISE A SMALL PERCENTAGE OF ALL 13D FILINGS

13D Filings by Engaged Investors as a Percentage of all 13D Filings[3]



Source: 13D Monitor.

3. From 4/1/2006 to 5/12/2011, of the 3,154 13Ds filed, 555 were filed by engaged investors. Engaged investors include activist hedge funds identified by 13D Monitor regardless of the disclosure made in the filing, and any other investor that expressed specific activist intent in their filing. Excludes companies with market capitalizations of $100mm or less.

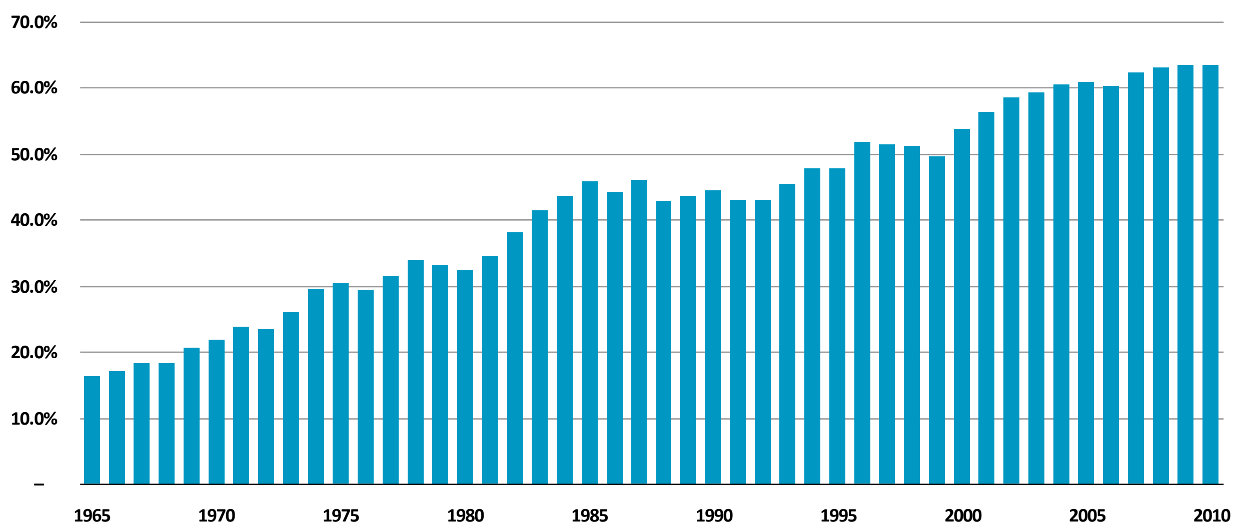
As a result of this rise of institutional investors, the concerns animating the Williams Act – that an investor could acquire control of a company by pressuring uninformed shareholders, or by secretly acquiring enough shares to gain control – are no longer valid.

First, institutional investors have greater incentives to monitor corporate management and the activities of other shareholders than the individual shareholders who owned the majority of shares in public companies in the 1960's. *See, e.g.*, Jens Dammann, *Corporate Ostracism: Freezing Out Controlling Shareholders*, 33 J. Corp. L. 681, 683 (2008) ("[L]arge shareholders do not suffer from the same collective action problems as small shareholders and can therefore be more effective at monitoring managers."). Institutional investors are active participants in shareholder democracy. In fact, many institutional investors are effectively required to vote their shares. See 68 Fed. Reg. 6585, 6587 (2003) (noting that investment advisers have a fiduciary duty to "monitor corporate actions and vote client proxies"); *see also* Rule 206(4)-(6) of the Investment Advisors Act of 1940 (Proxy Voting Rule); see also Rule 30b1-4 of the Investment Company Act of 1940 (Report of Proxy Voting Record); *see generally* 17 C.F.R. pt. 275. The incentives for institutional investors to be engaged make it exceedingly unlikely that any potential acquirer could gain control of a company by preying upon weak, uninformed, or apathetic shareholders.

Second, institutional investors have access to research and resources that are largely unavailable to individual investors. Not only do institutional investors have sophisticated in-house research capabilities, but they can obtain customized research from brokerage firms, investment banks, research firms, and rating agencies. Moreover, shareholder advisory firms, such as Institutional Shareholder Services, now advise pension and mutual funds on how to vote their shares on a broad range of matters, including use of the poison pill, director elections, and even the sale of the company. They thus "function as central coordinating and information agents who help create a unified front of institutional investors, and thereby increase collective institutional shareholder influence." Kahan & Rock, *Embattled CEOs*, 88 Tex. L. Rev. at 1007. As a result, many concentrated, large-block investors can now engage in self-help by simply voting their shares based on their informed views. In addition, passive institutional investors (such as index funds) can rely on more active large-block investors to solve collective action problems. When the Williams Act was passed in 1968, individual shareholders had no similar capabilities, and the process of becoming educated about corporate affairs was a burdensome one, well beyond the reach of most investors.

CHANGING MARKET PARTICIPANTS

Percentage of Corporate Equities Held by Institutional Investors[4]



Source: Flow of Funds Accounts of the United States, The Federal Reserve.

4. Includes the corporate equity holdings of state and local governments, federal government, holdings of U.S. issues by foreign residents, monetary authority, commercial banking, savings institutions, property-casualty insurance companies, life insurance companies, private pension funds, state and local government retirement funds, mutual funds, closed-end funds, exchange-traded funds, brokers and dealers, and funding corporations.

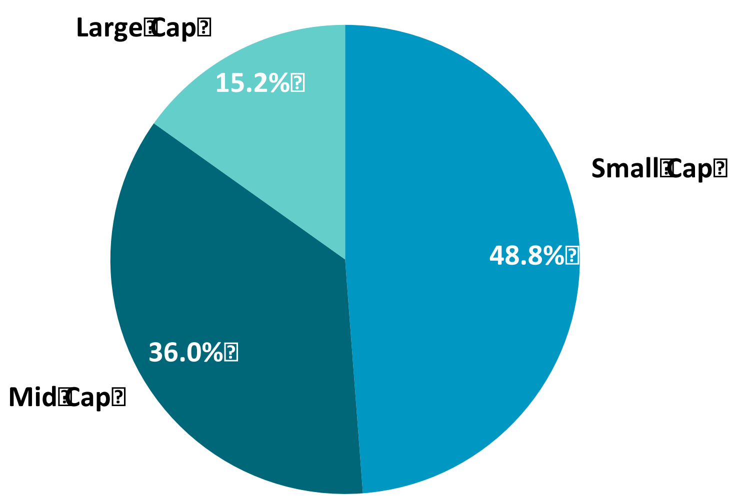
Third, the pattern of ownership by institutional shareholders makes it nearly impossible for a minority investor to gain a *de facto* controlling stake. It is rare for a sole institution to be the only large-block investor in a public company. To the contrary, most companies have several concentrated shareholders. Consider, for instance, the major shareholders in the largest U.S. public companies. At the end of 2009, Exxon Mobil's top three shareholders were BlackRock (3.85%), State Street (3.82%), and Vanguard (3.59%), and its top 25 shareholders each held at least 0.37% of the shares. Microsoft's top three shareholders were Capital Research Global Investors (4.26%), BlackRock (3.37%), and State Street (3.26%), and its top 25 shareholders each held at least 0.43% of the shares. Apple's top three shareholders were Fidelity (4.88%), BlackRock (3.90%), and Vanguard (3.53%), and its top 25 shareholders each held at least 0.48% of the shares. The Conference Board, 2010 *Institutional Investment Report* 30-31 (2010); *see also id.* at 32-42 (demonstrating the same pattern for the rest of the top 25 publicly-held companies). Gaining enough shares to "control" any of these companies and overcome opposition from a bloc of other institutional investors would be very difficult, if not practically impossible.

C. Growth of Active Shareholder Engagement

The Williams Act was directed at a particular phenomenon – corporate raiders. But the prime days of raiding are over. Today's active investors are engaged shareholders, who pursue investment strategies entirely different from the corporate raiders of the past. These investors, typically hedge funds, do not try to acquire companies, but instead try to bring about operational, strategic, governance, or other change to create value for themselves and all other shareholders. This activity stands in sharp contrast to a hostile coercive tender offer, where the acquirer has different economic motivations from other shareholders and often seeks to generate as little value as possible for other shareholders.

MARKET CAPITALIZATION ANALYSIS

13D Filings by Market Capitalization[5]



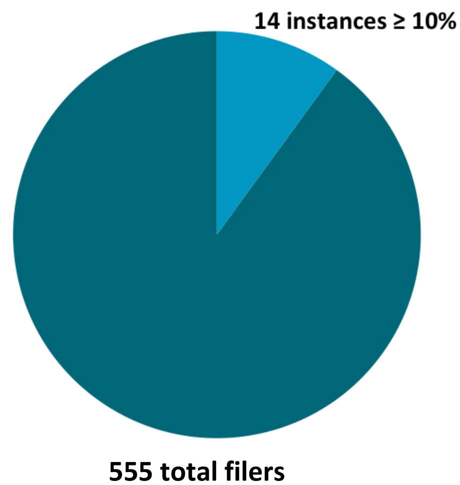
Source: 13D Monitor.

5. Breakdown by market capitalization of target company of the 555 13D filings made by engaged investors between April 1, 2006 and May 12, 2011. Small cap: Less than $500mm market cap. Mid cap: Between $500mm and $2.5 bn. Large cap: Greater than $2.5 bn. Excludes companies with market capitalizations of $100mm or less.

The most salient difference between corporate raiders and engaged investors is the scope of their investments. Corporate raiders sought huge blocks of shares in a company, sufficient to give them operational control. Engaged investors, by contrast, generally acquire stakes that are sufficiently substantial to give them a voice that will be heard in corporate affairs but not sizeable enough to constitute control of the company. Studies find that the median "activist" hedge fund stake is 6.7% in a large cap company, 8% in a mid cap company, and 9.8% in a small cap company. Bratton, 95 Geo. L.J. at 1389. In fact, excluding companies with market capitalizations of $100 million or less, over the last five years, there were more than 3,000 Schedule 13D filings, but only 14 filers used the 10 day window to accumulate beneficial ownership positions of 10% or greater. These minority holdings do not allow engaged investors to control the company. Indeed, Delaware courts have found that a non-majority shareholder is not a "controlling shareholder" unless it exercises actual control over the company. *See Gilbert v. El Paso*, 490 A.2d 1050, 1055 (Del. Ch. 1984) ("For controlling stock ownership to exist in the absence of a numerical majority there must be domination by a minority shareholder through actual exercise of direction over corporate conduct."); *In re Sea-Land Corp. S'holders Litig.*, 1988 WL 49126, at *3 (Del. Ch. 1988) ("A stockholder is not deemed controlling unless it owns a majority of the stock, or has exercised actual domination and control in directing the corporation's business affairs."). That is unlikely to be true in the case of an engaged investor with a newly acquired minority stake in a company.

ENGAGED INVESTORS WITH LARGE INITIAL OWNERSHIP STAKES

Number of Active Investments with Initial Schedule 13D Beneficial Ownership of 10% or More[6]



Source: 13D Monitor

6. 4/1/2006 to 5/12/2011. Only 14 filers used the 10 day window to accumulate beneficial ownership positions of 10% or greater.

Moreover, the goals of actively engaged shareholders are also quite different from the corporate raiders of prior decades. Many hedge funds – unlike corporate raiders – are not short-term investors, in search of a quick profit and rapid exit. To the contrary, "most [activists] commit to their targets for at least the intermediate term." Bratton, 95 Geo. L.J. at 1413; *see also* Dent, 35 Del. J. Corp. L. at 118, Brav, et al., 63 J. Fin. at 1749; Nicole M. Boyson & Robert M. Mooradian, *Hedge Funds as Shareholder Activists from 1994-2005*, at 23 (Feb. 2008), *available at* http://ssrn.com/abstract=992739. And unlike takeover attempts in the 1980s, which "tended to have all or nothing outcomes – either the activist took over the firm, the firm went private or otherwise paid off its shareholders with the proceeds of a leveraged restructuring, or the firm stayed independent, perhaps after making a greenmail payment," Bratton, 95 Geo. L.J. at 1427, today, engaged shareholders are usually motivated by the goal of influence, not control.

That is, they do not seek to acquire companies, but instead seek to bring about capital allocation, operational, strategic, governance or other change they believe will create value for themselves and all other shareholders. Their engagement with companies in which they acquire substantial positions runs the gamut "from public pressure on a portfolio company to change its business strategy, to the running of a proxy contest to gain seats on the board of directors, to litigation against present or former managers." Kahan & Rock, 88 Tex. L. Rev. at 1029. And they tend to seek influence through proxy solicitations, which take a long time and are highly regulated and public and therefore do not raise the secrecy concerns raised by the tender offers of the pre-Williams Act era. *See* Bratton, 95 Geo. L.J. at 1403; *see generally* Thomas Hazen, *Treatise on the Law of Securities Regulation* 51-78 (6th ed. 2009) (discussing relevant proxy solicitation regulations).

This pattern of investing by engaged shareholders is quite different from the conduct at which the Williams Act was directed – "attempt[s] to obtain control of [a company], either by a cash tender offer or any other device." *Rondeau*, 422 U.S. at 59. The engaged investors of today generally do not seek such control. *See* Brav et al., *Hedge Fund Activism*, 4 Foundations & Trends in Fin. 17 (2010) ("It therefore appears that the activist hedge funds do not generally aim to take control of their targets. Rather, they hope to facilitate value-enhancing changes as minority shareholders….These features distinguish the activist hedge funds from the corporate raiders in the 1980s who sought to obtain full control to internalize all the benefits from their intervention.").

Actively engaged investors in fact serve as a market-driven mechanism to address the fundamental principal-agent issue of corporate governance. As scholars have long recognized, because of the separation of corporate ownership (by the shareholders) and corporate control (by management), there is an inherent "agency" problem in corporations: the interests of shareholders, who seek to maximize firm value, do not always align with the interests of managers, who may seek to further their self-interest. *See, e.g.*, Andrei Shleifer & Robert W. Vishny, A Survey of Corporate Governance, 52 J. Fin. 737, 740 (1997); Ronald J. Gilson & Jeffrey N. Gordon, Doctrines and Markets: Controlling Controlling Shareholders, 152 U. Pa. L. Rev. 785, 785 (2003). Effective corporate governance requires effective monitoring of management, to ensure that managers are pursuing shareholder interests rather than their own. However, as explained above, investors typically have little incentive to be active, informed shareholders. Actively engaged investors help address this problem by building positions large enough to justify the costs of their involvement in time, effort and resources, but not so large that they can dictate the outcome of their efforts.

* * *

These three developments in the corporate governance landscape significantly undermine recent calls for piecemeal change to the Williams Act to expand disclosure requirements. The Act was intended to protect individual shareholders at a time of dispersed investing and corporate raiding. Today, equity markets are characterized by institutional ownership and engaged shareholding. The conditions are not present that would justify changes that would make the

Williams Act regime even more restrictive. In fact, they are more supportive of changes that would encourage greater shareholder participation.

III. Narrow "Reforms" to The Williams Act Regime Would Likely Discourage Activity Which Benefits All Shareholders

Expanded disclosure requirements are not only unnecessary, they would also be affirmatively harmful to shareholders, the markets, and the economy as a whole. Reform proposals that are narrowly focused on expanding disclosure requirements fail to acknowledge that such enhanced disclosure will make share acquisition by engaged investors much more expensive – perhaps prohibitively so. The resultant chilling of share acquisition activity by engaged investors would be seriously detrimental to all participants in the markets, for engaged investing conveys broad benefits to the markets and to the economy as a whole. Engaged investors provide benefits to all investors through researching undervalued companies and acquiring and using meaningful equity stakes to influence management to create value for shareholders. New initiatives favoring more onerous disclosure requirements, proposed under the guise of modernizing the Williams Act's disclosure regime, are likely to jeopardize these benefits.

A. Actively Engaged Investing Provides Real Benefits to All Investors

The market is the best indicator of whether engaged investing produces benefits, and it usually sends strong and positive signals when an engaged investor acquires a block of shares in a company. Empirical studies have concluded that, because engaged investors (particularly hedge funds) are able to discover underperforming companies and encourage them to adopt new strategies or directions to generate greater value, share prices in those companies make substantial gains as a result of engaged investing. *See, e.g.*, Brav et al., 63 J. Fin. at 1773 ("[H]edge fund activism generates value on average … because [activists] credibly commit upfront to intervene in target firms on behalf of shareholders and then follow through on their commitments."); Dent, 35 Del. J. Corp. L. at 118 ("When one or more investors acquire a large block of a company's stock, the company's stock price … tends to keep growing."); April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. Fin. 187, 188 (2009) ("[O]n average, the market believes activism creates shareholder value."); *see also* Dent, 35 Del. J. Corp. L. at 116 n.77 (citing other studies).

Indeed, "returns to stocks of companies targeted by activist hedge funds show significant positive returns in the one-year, two-year, and three-year periods following the fund's acquisition of the stock." *Id.* at 122; *see also* Bratton, 95 Geo. L.J. at 1419-20; Boyson & Mooradian, at 11, *available at* http://ssrn.com/abstract=992739 ("The results of [our] analysis indicate that target firms have better post-activism short and long term performance than the matched sample of firms, evidence that, in general, hedge fund activism adds value."). As a result, engaged investing provides substantial value to other, more passive shareholders. Indeed, because of concentrated accumulations by large block investors, share prices rise even in the period immediately *before* 13(d) filings by those shareholders. Therefore, even short-term sellers who sell prior to the 13(d) filing benefit from engaged investors' share acquisition activity. *See* Brav et al., 63 J. Fin. at 1756-1757.

The benefits of engaged investment go beyond adding value to shareholders, also redounding to the entire corporate enterprise and the economy as a whole. By providing a needed check on management, engaged investors help corporations run more smoothly. *See, e.g.*, *id.* ("Companies with large outside shareholders tend to perform better and have less waste than other companies."). "The presence of these hedge funds and their potential for intervention exert a disciplinary pressure on the management of public firms to make shareholder value a priority." Brav et al., *Hedge Fund Activism*, 63 J. Fin. at 1774; *see also* Klein & Zur, 64 J. Fin. at 225; Alon Brav et al., *The Returns to Hedge Fund Activism* 1 (ECGI, Law Working Paper No. 098/2008, 2008), *available at* http://ssrn.com/abstract=1111778 ("Target firms experience increases in payout, operating performance, and higher CEO turnover after [hedge fund] activism."). In general, then, "hedge fund activists … can act as agents of corporate change, improving both the short-term market and long-term operating performance of the firms they target." Boyson & Mooradian at 22; *see also* David Haarmeyer, *The Revolution in Active Investing: Creating Wealth and Better Governance*, 19 J. Applied Corp. Fin. 25, 26 (2007) ("[T]oday's active investors, through their ownership, influence or actual participation on boards, are improving corporate efficiency and increasing corporate values by reducing the gap between ownership and control.").

In addition, engaged investors provide liquidity to markets. *See Hearing Before the S. Comm. on Banking, Housing & Urban Affairs*, 109th Cong. (2006) (statement of Christopher Cox, Chairman, Sec. & Exch. Comm'n), *available at* http://www.sec.gov/news/testimony/2006/ts072506cc.htm ("[Hedge funds] contribute substantially to capital formation, market efficiency, price discovery, and liquidity."); *see also* Dale A. Oesterle, *Regulating Hedge Funds*, 1 Entrepreneurial Bus. L. J. 1, 6-7 (2006). As now-Treasury Secretary Timothy Geithner has observed, "[h]edge funds play a valuable arbitrage role in reducing or eliminating mispricing in financial markets. They are an important source of liquidity, both in periods of calm and stress. They add depth and breadth to our capital markets." Timothy F. Geithner, President and CEO, Fed. Reserve Bank of New York, Keynote Address at the National Conference on the Securities Industry: Hedge Funds and Their Implications for the Financial System (November 17, 2004), *available at* http://www.ny.frb.org/news-events/speeches_archive/2004/gei041117.html.

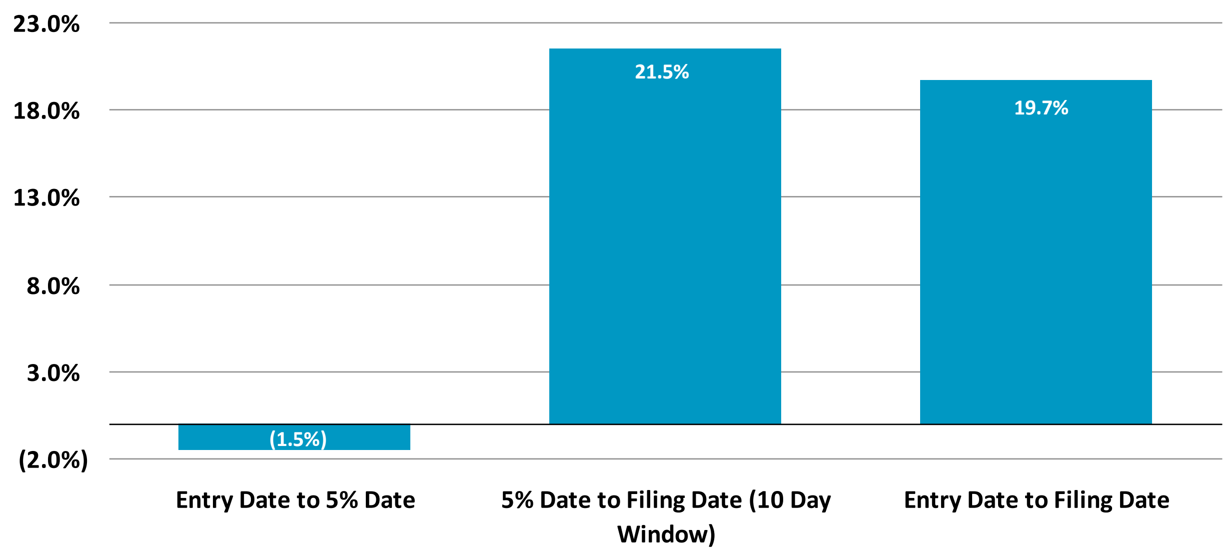
In sum, engaged investors benefit other shareholders, and the economy at large, by undertaking the transaction costs, reputational risks, and legal and economic liabilities necessary to effect corporate change. Although engaged investors make profits for themselves, many other market participants are also able to share in the rewards of their investment ideas. Engaged investors, therefore, provide a market-driven mechanism for positive change.

B. Expanding Disclosure Requirements Will Deter Engaged Investment Activity

The Williams Act regime, as it currently stands, already serves as some deterrent to engaged investing, because its disclosure requirements result in share-price increases following disclosure. "[T]he Williams Act, by imposing on outside[] [investors] a quasi-fiduciary duty of disclosure …, greatly reduces the incentive" to make a large-block investment. Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 Tex. L. Rev. 1, 14 (1978); *see also* Macey & Netter, 65 Wash. U. L.Q. at 132 ("To the extent that bidders must turn over to target shareholders the fruits of their research and disclose their insights as to the true value of the target firm, such bidders lose not only their incentive to undertake such research but also their incentive to acquire the skills necessary to locate undervalued firms."). In fact, the share price increases following the disclosure of an engaged shareholder's investment are quite sizeable. One study has shown that companies in which hedge funds invest earn about a 10% premium during the period surrounding the 13D disclosure. *See* Klein & Zur, 64 J. Fin. at 188.

ENGAGED INVESTORS DRIVE VALUE IN THE 10 DAY WINDOW

Average Return Captured by Shareholders[7]



Source: 13D Monitor, Company Filings, Capital IQ.

7. Returns reflect the 14 instances where engaged investors used the 10 day window to accumulate beneficial ownership stakes of 10% or more from 4/1/2006 to 5/12/2011. Excludes companies with market capitalizations of $100mm or less.

The narrow calls for reform advocated by defenders of corporate management, principally by expanding disclosure requirements, seek to reduce the incentives for active shareholder engagement even further and, in the process, threaten all the benefits that it brings to the markets and the economy. The activities that make engaged investing potentially profitable – researching companies, discovering inefficiencies, and divining plans to fix these inefficiencies – are costly in terms of time, effort and resources. If the investors that make it their business to do this valuable work cannot reap sufficient benefits of their discoveries to justify this effort, they will have markedly less incentive to engage in that work in the first place. As scholars have long recognized, "[f]or the market for corporate control to function effectively, outsiders must have adequate incentives to produce information" to serve as the basis for acquiring an equity stake, and "[t]he incentive to produce this information is the expected gain from the appreciation of the offeror's equity investment." Fischel, 57 Tex. L. Rev. at 13.

Despite its origins as a response to hostile takeovers, the current Williams Act disclosure regime sets the current balance between providing incentives for engaged investors to make investments and allowing passive, long-term shareholders to benefit from those investments. The piecemeal changes advocated by pro-management commentators would alter this balance and require actively engaged investors to pay a much higher price for their stakes, since the required disclosure – and the accompanying price increase – would come earlier. This would unquestionably reduce the market-driven economic incentives for engaging in activity that create value, price discovery and liquidity for other investors. *See* Macey & Netter, 65 Wash. U. L.Q. at 42 ("Requiring premature disclosure of [the fact the company is undervalued] deprives bidding firms of any incentive to gather this information in the first place.").

In other words, although the reforms called for by pro-management groups are made under the guise of creating shareholder value, they would have the opposite effect. Instead of transferring wealth from engaged shareholders to passive shareholders, more restrictive disclosure requirements would deprive both groups of this value and decrease overall shareholder value: engaged shareholders will be less likely to enter the market, and consequently the benefits of their activities flowing to other shareholders will be diminished. Indeed, the only winners would be underperforming managers who would less frequently face challenges to the status quo. Federal policies for the capital markets should not promote such management entrenchment. The Commission should therefore hesitate before adopting a proposal that could risk the loss of billions of dollars of shareholder value.

IV. Rather Than Responding to Piecemeal Requests for Reform that Benefit Management, The Commission Should Undertake A Comprehensive Study That Evaluates The Role of The Williams Act in The Modern Corporate Landscape

Following passage of the Dodd-Frank Act and calls for narrow changes to the Section 13(d) disclosure regime, the Commission has signaled its intention to examine the need for "modernization" of this disclosure regime. Unlike other sections of Dodd-Frank, Congress did not require the Commission to change any rules in this area, but only authorized the Commission to examine the need to change specific rules under Section 13(d). We agree that the Commission should carefully consider how the Williams Act fits in the modern world, and as this paper has shown, the fit is a very uneasy one.

None of the three constituencies considered by the Williams Act – management, shareholders, and acquirers – resembles what it did more than 40 years ago, when the Act was adopted, and consequently the intervening years have eroded many of the assumptions underlying the Williams Act in the regulation of corporate governance. Whereas the Act originally filled a vacuum in the regulation of takeovers, it has since been displaced by state antitakeover statues, many of which transparently favor target boards over acquirers. Those statutes, along with innovative takeover defenses, have given company management powerful weapons to kill any hostile takeover. As empirical data suggest, corporate managers today – most worryingly, underperforming managers – are in as strong a position as ever.

Acquirers have also changed. In fact, the term "acquirer" is no longer appropriate in this debate. Unlike the corporate raiders of the past, who sought to seize and loot companies – and at whom the Williams Act was directed – today's engaged shareholders are focused on creating value that benefits themselves and all other shareholders. Their objective is to discover and invest in undervalued firms and to help those firms succeed.

The last constituency, shareholders, has undergone the most dramatic changes. The Williams Act was passed when individual investors constituted the majority of the marketplace. The Act was passed to protect those individual investors. But today, sophisticated institutional investors constitute the majority of the market. These institutions have a wealth of resources and information at their disposal, and they are well-equipped to best decide who should be representing their interests in the boardroom. As a result, it is nearly impossible for one investor to gain a controlling stake in a company without the informed consent of other shareholders.

These changes alone tip the scales against any piecemeal reforms to the Williams Act regime. Further weighing against reforms is that the rise of engaged investors in the last two decades has created a tremendous amount of value for shareholders and has bolstered corporate governance. Despite the ability of poor managers to entrench themselves, the regulatory regime still has some flexibility to allow incentives for engaged shareholders to seek out undervalued firms in which to make substantial, long-term investments.

But if the Commission were to tilt the regulatory playing field further against engaged shareholders – which would be the inevitable consequence of the piecemeal changes to the Section 13(d) rules advocated by some commentators – it would undoubtedly dampen the incentives for engaged shareholding, to the detriment of the markets at large. It should therefore come as no surprise that commentators have deemed the possible reforms to the Section 13(d) regime "a remedy in search of a problem." Steven M. Davidoff, *New Front in War Between Companies and Hedge Funds*, N.Y. Times, Mar. 15, 2011. Accordingly, before making any changes to a regulatory regime that has been in place for more than 40 years, we believe the Commission must determine whether the benefits of such a change would outweigh its costs, such that changes are, in fact, necessary. Most importantly, the Commission must decide whether modifications to the Williams Act's disclosure requirements would effectuate the purpose of the Act – shareholder protection.

Of course, we fully recognize that other stakeholders have different views (and perhaps different interpretations of empirical evidence). But that is all the more reason for the Commission to study this problem as closely as possible before coming to a conclusion. With every industry and every constituency in the market likely to be affected by the Commission's decision, the situation demands nothing less than a comprehensive, empirical study on the role and efficacy of the Section 13(d) disclosure requirements.

V. The Narrow Calls for Reform Benefitting Management Are Flawed

In any event, the proposals for piecemeal changes to the Williams Act regime raised by advocates of incumbent management are self-serving and flawed. As already explained, further disclosure restrictions on engaged investors will have widespread and detrimental impact to the markets and will benefit only underperforming managers. Moreover, the proposals rely on several faulty premises.

A. Proposed Reforms to the Disclosure Window Should be Rejected

The management advocates call for a shortening of the disclosure window to just one day and also seek a two-day "cooling-off" period. But the arguments for the proposal are misguided.

First, advocates of incumbent management have suggested that the ten-day period chosen by Congress reflected the state of the markets and technology in the 1960s – *i.e.*, that it would have taken ten days for a potential acquirer, after reaching the pertinent threshold, to be in a position to acquire additional blocks of stock and to assemble the information required for disclosure. But nothing in the legislative history of the Williams Act suggests that the Act was intended to accommodate the primitive state of "word processing" in the 1960s. Rather, the ten-day period likely reflects Congress's determination not to "tip[] the scales" in favor of management or acquirers. Congress recognized that tender offers and other takeover attempts can benefit shareholders and serve a socially useful function, and that it was necessary to choose some period of time to permit takeovers to go forward while ensuring that shareholders would receive useful information to evaluate tender offers. Indeed, many of the criticisms of the initial versions of the Act were based on those bills' failure to recognize, "first, that takeover bids could often serve a useful function, and, second, that entrenched management, equipped with considerable weapons in battles for control, tended to be successful in fending off possibly beneficial takeover attempts." *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 30 (1977). Congress thus purposefully chose a ten-day window to reflect an "optimal balance" between awareness of a possible takeover and the operation of a "free and open auction market." *Hyde Park Partners, L.P. v. Connolly,* 839 F.2d 837, 851 (1st Cir. 1988).

Second, the pro-management advocates contend that short-term sellers – *i.e.,* those who sell within the pre-disclosure window – miss out on the resulting rise in share prices that occurs following the 13(d) filing. In fact, engaged investing actually brings substantial benefits to these short-term selling shareholders, and those benefits would not exist if these engaged investors had no incentive to acquire shares. The pro-management advocates fail to acknowledge that if engaged investors are chilled from entering the market, short-term sellers will get *no* benefit and will thus be worse off.

Even leaving these facts aside, it is far from clear that Congress intended, in the Williams Act, to elevate the interests of shareholders who have made the short-term decision to sell their shares over the majority of other shareholders who retain their interests. As the Supreme Court has explained, "the principal object of the Williams Act is to solve the dilemma of shareholders desiring to respond to a cash tender offer," because such shareholders did not have adequate information to know whether they should hold on to their shares in the *long* term, and "it is not at all clear" that the Act also meant to protect "the interests of … shareholders who either sold their stock…at predisclosure prices or would not have invested had they known that a takeover bid was imminent." *Rondeau*, 422 U.S. at 59-60. The rise in share prices is not an unjust transfer of wealth from uncoerced, willing, selling shareholders to engaged investors – rather, the rise in share price is attributable to the engaged investors' hard work.

More broadly, the notion that these short-term shareholders are somehow shortchanged if they sell shares without knowledge of the purchaser's intentions is inconsistent with fundamental predicates of securities law, and commercial law more generally. Indeed, parties to arm's-length transactions generally have no obligation to inform each other of their business plans. The Williams Act serves as a limited exception to this general rule of non-disclosure by requiring disclosure of certain information, but in that respect it is an anomaly in the law, and the case for expanding its reach has not been made. While that exception might have been justified at the time of the Williams Act's passage due to the problematic practices of tender offer bidders, expanding that limited exception makes little sense today, as it would harm the very actors the Williams Act sought to protect.

Third, the advocates for expanded disclosure requirements have also incorrectly suggested that the current 13(d) regime permits actively engaged shareholders to obtain "control" prior to disclosure of their interests. But as discussed above, in today's marketplace (and in contrast to the heyday of corporate raiders), it is nearly impossible to gain control of a company through a minority position, given that shareholder bases are no longer primarily composed of dispersed individuals with little access to information or incentive to be engaged. Despite these clear differences, pro-management commentators have adopted the parlance of the hostile tender offer, including terms such as "raiders" and "attacks," confusing the modern trend of shareholder engagement with the earlier trend of hostile tender offers, which the Williams Act was intended to address. They are, of course, entirely different.

Hostile tender offers at the time of the Williams Act posed the risk of destroying value through coercing disaggregated and ill-informed shareholders to tender their shares before managers had time to adequately respond. Today's actively engaged shareholders seek instead to create value for all shareholders (themselves included). By blurring the clear lines between hostile tender offers and active shareholder engagement, such commentators seek to avoid what should be the fundamental question in any proposed revision of the Williams Act: Would such change benefit or harm shareholders? As discussed at length above, such changes would only benefit underperforming management, while hurting the shareholders the Williams Act was meant to protect.

B. Proposed Reforms To The Commission's "Beneficial Ownership" Definition With Respect To Equity Swaps Should Be Rejected

Managerial advocates have also suggested that the Commission should expand the definition of "beneficial ownership" of stock that counts towards the 5% threshold to cover all equity derivatives, including cash-settled swaps. As explained below, however, the Commission's longstanding definition of beneficial ownership strikes an appropriate balance with respect to equity derivatives and heeds carefully to the purpose of the Williams Act. The case for further expansion has not been made.

Dodd-Frank requires the Commission to consider the "extent" to which "a person shall be deemed to acquire beneficial ownership of an equity security based on the purchase or sale of a security-based swap." Pub. L. No. 111-203, § 766. Although Congress could have instructed the Commission to consider all (or some) equity derivatives as conferring "beneficial ownership," it did not. Instead, it granted the Commission the discretion to decide which equity derivatives – if any – should be covered. The Commission need go no further than re-adopt its long-standing rules on equity derivatives, which strikes a careful and appropriate balance. The rules recognize – and the Commission staff has recently confirmed – that the vast majority of equity swaps are not comparable to direct ownership of the underlying shares. Accordingly, the rules extend Section

13(d)'s disclosure requirements only to those equity swaps that actually implicate the potential for corporate control.

In Rule 13d-3, 17 C.F.R. § 240.13d-3, the Commission has defined when an equity derivative is to be counted towards "beneficial ownership" for purposes of Section 13(d). Under Rule 13d-3(a), "a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares (1) [v]oting power which includes the power to vote, or to direct the voting of, such security; and/or, (2) [i]nvestment power which includes the power to dispose, or to direct the disposition of, such security." Under Rule 13d-3(b), "[a]ny person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement, or device with the purpose or effect of divesting such person of beneficial ownership of a security or preventing the vesting of such beneficial ownership as part of a plan or scheme to evade the reporting requirements of section 13(d) … shall be deemed for purposes of such sections to be the beneficial owner of such security." And under Rule 13d-3(d)(1), a person is "deemed to be the beneficial owner of a security" if he "has the right to acquire beneficial ownership of such security … within sixty days" – for instance, based on an option or warrant – or if he has acquired the right "with the purpose or effect of changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having such purpose or effect," regardless of when the right is exercisable.

Instead of applying indiscriminately to all equity derivatives, these rules surgically determine whether a person who does not own shares nonetheless should be held accountable as a "beneficial owner." The Commission made clear, when adopting these rules, that it sought to effectuate the purpose of the Williams Act – which, as explained above, was to provide information to existing shareholders when an investor was attempting to acquire control of a company through share acquisition. Thus, the Commission limited the scope of the rules to situations in which a person, despite not owning shares, nonetheless has power over voting or disposition of the underlying shares, or in which a person has sought to skirt Section 13(d)'s disclosure requirements.

Apart from these limited circumstances, the Commission disclaimed any interest in requiring disclosure for non-owners who only had "economic interests" in underlying shares but no power to direct the voting or disposition of those shares. 42 Fed. Reg. 12,342, 12,348 (Mar. 3, 1977). And the Commission has stated that "[a]n analysis of all relevant facts and circumstances in particular situation is essential" to decide whether a non-owner nonetheless qualifies as a "beneficial owner." *Id.* at 12,344.

These rules have held up well over time – and today, they sufficiently cover circumstances in which a holder of an equity swap should be counted as a "beneficial owner." As the Commission staff explained in its amicus letter to the district court in *CSX Corp. v. The Children's Investment Fund Management (UK) LLP*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008), the ordinary structure of a cash-settled equity swap does not – by itself – suggest that the swap-holder has "beneficial ownership" of the underlying shares. "[A]s a general matter, a person that does nothing more than enter into an equity swap should not be found to have engaged in evasion of the reporting requirements." SEC Amicus Letter at 4, *CSX*, 562 F. Supp. 2d 511 (S.D.N.Y. June 4, 2008). Mere "economic or business incentives, in contrast to 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." *Id.* at 2.

It is already the case that over-the-counter derivatives, such as swaps are required to be disclosed under existing Schedule 13D rules. However, unless the swap-holder acquires "voting power or investment power over shares [that the] counterparty purchases to hedge its position," or unless the swap-holder entered into the transaction "with the intent to create the false appearance of non-ownership of a security," *id.* at 2, 3, there is no reason to require the aggregation of economic exposure underlying a swap as part of an investor's "beneficial ownership" since the potential for corporate control – the basis for the Williams Act – would not be at issue. Again, the managerial advocates again seek a solution for a non-existent problem. While they claim that the use of equity derivatives to gain hidden ownership is endemic, only 43 of the over 3,000 Schedule 13Ds filed in the last six years used equity swaps (1.36% of the total).

Finally, if adopted, the proposals to consider all cash-settled swaps as conferring beneficial ownership of shares would create a serious challenge for the derivatives markets. It would require any holder of an equity derivative who crosses the 5% threshold to disclose its holdings – even if the holder is making a purely economic decision and has no interest whatsoever in influencing corporate policies. Given that the equity derivatives markets is worth trillions of dollars, and given that only a small fraction of those derivatives involve situations with which the Williams Act is concerned, the reforms would be a dramatic and unnecessary regulatory shift, which would surely unsettle and chill the markets. That consequence is not worth it for reforms that have no demonstrable benefit.

~ CONCLUSION ~

Although calls for narrow reform of the Williams Act have been couched in the language of shareholder interests and market transparency, their actual effect would be very different: they would entrench management by dramatically reducing the incentives for actively engaged investing, which in fact benefits all shareholders, the markets, and the economy as a whole.

The Commission has shown that it is serious about supporting shareholder democracy. To be faithful to that policy, the Commission should reject pro-incumbent management changes to the Williams Act. Indeed, for the good of all shareholders, before granting piecemeal requests that would take one side in the debate regarding shareholder engagement of U.S. corporations and would benefit one group of actors in the market for corporate governance, the Commission should undertake a comprehensive review of the role of the Williams Act as a whole in today's market, including but not limited to those proposed changes, and should decide what best serves overall shareholder interests.

Whatever the Commission decides, any changes must be supported by clear evidence and driven by sound policy decisions, and therefore should be preceded by an open and informed reassessment of the Williams Act and the modern corporate landscape in which both shareholders and management participate.