SEC RELEASES SECTION 13 COMPLIANCE AND DISCLOSURE INTERPRETATIONS

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To Our Clients and Friends:

On September 14, the Securities and Exchange Commission released the SEC staff's Compliance and Disclosure Interpretations ("C&DIs") of Sections 13(d) and (g) under the Securities Exchange Act, which require disclosure by holders of more than 5% of an issuer's publicly traded securities. The new C&DIs, presented in question and answer format, contain a number of new interpretations.

Many of the interpretations are relatively straightforward. For example, question 103.05 confirms that the 10-day clock for filing a Schedule 13D starts on the trade date, not the settlement date, that would take a holder across the 5% threshold.

Some interpretations appear to reflect a continuing staff concern about the overall quality of Section 13 disclosure. Question 110.06 reaffirms the staff's position that a Schedule 13D disclosure stating that the filer has no current intention to engage in a control transaction, but reserving the right to do so in the future, does not inoculate the filer from the obligation to amend the 13D if it later determines to engage in such a transaction – for example, to take a company private. There remains, of course, a considerable gray area as to when a filer "determines" to take an action, or actually forms a plan or proposal, requiring disclosure.

Two previously published interpretations address situations where transactions do not themselves change "beneficial ownership" for Section 13 purposes, yet may nevertheless require disclosure. In question 104.01, the staff acknowledges that selling securities short does not change the filer's beneficial ownership because it does not change the amount of shares over which the filer has "voting or investment power" – but notes that selling short may trigger an obligation to disclose a change in the source of funds under Item 3, a change in investment purpose under Item 4, a "transaction" in the subject security under Item 5, a "contract, agreement, understanding, or relationship" with respect to the subject securities under Item 6, or an exhibit under Item 7. In question 110.01, the staff states that a Schedule 13D filer must disclose its acquisition of a warrant not exercisable within 60 days – not because it increases beneficial ownership, but rather because it would require disclosures under Items 4, 6 and 7.

In a new interpretation (question 101.06), the staff takes the position that a shareholder accidentally crossing the 5% threshold must still comply with Section 13 filing obligations, since "intent to acquire in excess of five percent is not a consideration with respect to the applicability of Sections 13(d) and 13(g)." In question 103.08, the staff advises that a shareholder crossing the 5% threshold solely as a result of a change in the number of outstanding securities must make a Section 13 filing – although such a shareholder may file a Schedule 13G, rather than a Schedule 13D, as long as the shareholder does not have a control intent. The staff also notes that a Schedule 13D filer would need to amend its filing to reflect any material change in the percentage of securities owned – even if that resulted solely from an action by the issuer, such as a stock buyback.

In another new interpretation (question 103.07), the staff advises that a Schedule 13D filer cannot switch to filing on the less burdensome Schedule 13G – if, for example, the filer develops a passive investment intent – unless the filer was initially eligible to report on Schedule 13G. It is not intuitively obvious why a shareholder who initially has no control intent, later develops such an intent, and then abandons it should be eligible to file on a Schedule 13G, while a shareholder who begins with a control intent and later abandons it must continue to file on Schedule 13D.

The staff cautions against the use of Schedule 13D filings as a forum to express opposition to management, its initiatives or pending transactions without due regard for the application of the proxy rules. The staff notes in question 110.07 that "[b]eneficial ownership reporting was not intended to create an additional exception to the application of Regulation 14A" – and, therefore, filers must consider whether their disclosures constitute "soliciting material" subject to the proxy rules. The staff also notes that complying with the proxy rules by contemporaneously filing soliciting material under Rule 14a-12 is available only to persons intending actually to file and disseminate a proxy statement.

Overall, the interpretations evince a modest, though distinct, tightening of the Section 13 requirements – a not unsurprising reaction in light of various criticisms that have been leveled in recent years at Section 13's efficacy as a means of providing the marketplace with real information about the holdings and intentions of significant shareholders.

Please feel free to contact us with any questions.

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