2013

Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy

Lucian A. Bebchuk

Alon Brav

Robert J. Jackson Jr.

Wei Jiang

Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy

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

ABSTRACT

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

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

* *A substantial majority of 13(d) filings are actually made by investors other than activist hedge funds, and these investors often use a substantial part of the ten-day window before disclosing their stake.*
* *A significant proportion of poison pills have low thresholds of 15% or less, so that management can use 13(d) disclosures to adopt low-trigger pills to prevent any further stock accumulations by activists—a fact that any tightening of the SEC's rules in this area should take into account.*
* *Even when activists wait the full ten days to disclose their stakes, their purchases seem to be disproportionately concentrated on the day they cross the threshold and the next day; thus, the practical difference in pre-disclosure accumulations between the existing regime and the rules in jurisdictions with shorter disclosure windows is likely much smaller than the petition assumes.*
* *About ten percent of 13(d) filings seem to be made after the ten-day window has*

* Lucian A. Bebchuk, William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics and Finance and Director of the Program on Corporate Governance, Harvard Law School; Alon Brav, Professor of Finance, Fuqua School of Business, Duke University; Robert J. Jackson, Jr., Associate Professor of Law and Milton Handler Fellow, Columbia Law School; Wei Jiang, Arthur F. Burns Professor of Free and Competitive Enterprise, Finance and Economics Division, Columbia Business School. We wish to thank Ronald Gilson, Jeffrey Gordon, and June Rhee, along with participants at the Conference on Markets and Owners hosted by the Columbia Project on Investment, Ownership, and Control in the Modern Firm, for valuable comments. We are also grateful to the Harvard Law School and the Columbia Law School for financial support.

expired; the SEC may therefore want to consider tightening the enforcement of existing rules before examining the proposed acceleration of the deadline.

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

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

I. INTRODUCTION

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

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

Notably, the Petition offers no systematic evidence on stock accumulations. Instead, the Petition repeatedly refers to several anecdotes concerning recent cases in which activist hedge funds purchased large amounts of stock (or securities convertible to stock) prior to disclosure. The Petition argues that these anecdotes underscore a new, more general, phenomenon of secret stock accumulations made possible by changes in trading technologies that demand immediate changes in the disclosure rules. Recent developments in market practices, the Petition contends, render the existing rules under Section 13(d) of the Securities Exchange Act of 1934, which governs blockholder disclosure, obsolete. And an article published by senior attorneys at the firm that filed the Petition similarly asserts that these developments are widely understood by market participants—but offers no evidence in support of this understanding.[4]

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

---

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

2. *See* Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at the Transatlantic Corporate Governance Dialogue (Dec. 15, 2011), *available at* http://www.sec.gov/news/speech /2011/spch121511mls.htm (stating that the SEC is considering shortening the ten-day filing window).

3. *See* *View Rule*, REGINFO.GOV, http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201210&RIN=3235-AK42 (select the "Spring, 2013" hyperlink) ("The Division is considering recommending that the Commission issue a concept release to identify possible revisions to [relevant rules] to modernize the beneficial ownership reporting requirements. The concept release would solicit comment on, among other things, . . . shortening the filing deadlines . . . .") (last visited Jan. 13, 2014). Although the Commission has recently narrowed its near-term agenda to include only regulatory projects already in process or mandated by statute, the Commission has indicated that it may return to the Petition's proposal in the future. *See id.* (select the "Fall, 2013" hyperlink) ("The Commission is withdrawing this item from the Unified Agenda . . . because it does not expect to consider this item within the next 12 months, but the Commission may consider the item at a future date.").

4. David Katz & Laura A. McIntosh, *Corporate Governance Update: Section 13(d) Reporting Requirements Need Updating*, N.Y. L.J., Mar. 22, 2012, at 5.

5. Letter from Lucian A. Bebchuk, Professor, Harvard Law Sch. and Robert J. Jackson, Jr., Assoc. Professor, Columbia Law Sch., to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (July 11, 2011),

empirical examination and discussed the empirical issues such an examination should seek to address.[6] In response, in a recent article four senior partners of the firm that filed the Petition dismissed our claim that an examination of the evidence beyond the anecdotes described in the Petition is necessary.[7] The authors expressed concern that such an examination would be difficult and time-consuming and likely delay the "modernization" of Section 13(d) that they view as desirable.[8] Similarly, in a public debate with one of us, Martin Lipton, the senior partner of the firm that authored the Petition, rejected the need for an empirical examination of these questions.[9] In our view, however, given that data on Section 13(d) filings are publicly available, the SEC should not proceed with any rulemaking in this area before examining this evidence.

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

The Article proceeds as follows. Part II describes the universe of pre-disclosure accumulations we study and provides evidence about the incidence and magnitude of such accumulations. We examine the universe of all Section 13(d) filings by activist hedge funds from 1994 through 2007. We find that hedge fund activists do indeed use the opportunity not to disclose immediately upon crossing the five-percent threshold, with over 40% taking advantage of a large part of the ten-day window. Indeed, we find that about ten percent of all filings are made after the specified ten-day window, which suggests that the Commission should consider more effective enforcement of the existing deadline before examining whether the deadline should be shortened. Moreover, our examination of the ownership stakes revealed in Section 13(d) filings indicates that the five anecdotes noted in the Petition are not representative of the magnitude of stakes accumulated by hedge fund activists prior to disclosure. The evidence shows that hedge fund activists typically disclose substantially less than 10% ownership, with a median

---

available at http://www.sec.gov/comments/4-624/4624-3.pdf; Letter from J.B. Heaton, Alon Brav & Wei Jiang, to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (July 5, 2011), at 2, *available at* http://www.sec.gov/comments/4-624/4624-2.pdf.

6. Lucian A. Bebchuk & Robert J. Jackson, Jr., *The Law and Economics of Blockholder Disclosure*, 2 HARV. BUS. L. REV. 39, 59–60 (2012).

7. Adam O. Emmerich et al., *Fair Market and Fair Disclosure: Some Thoughts on* The Law and Economics of Blockholder Disclosure, *and the Use and Abuse of Shareholder Power*, 3 HARV. BUS. L. REV. 135, 153–54 (2013).

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

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

stake of 6.3%.

Part III investigates a key claim of the Petition: that changes in market practices have, over time, enabled activist investors to increase the magnitude of pre-disclosure accumulations, making existing rules obsolete and requiring "modernization." We show that the evidence does not support this claim. In contrast to the concerns expressed in the Petition and subsequent work by the Petition's authors,[10] the size of pre-disclosure accumulations of stock have not increased over time. Indeed, the median stake at the time of disclosure has remained relatively stable throughout the 14-year period we study, and more extensive regression analysis does not identify a time trend. Thus, changes in existing rules can at most be justified as necessary to address longstanding policy questions, not as a "modernization" required by changes in the marketplace.

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

Part V provides data with respect to an aspect of this subject that seems to have been overlooked by the authors of the Petition but that the SEC should take into account when considering changes to the rules under Section 13(d): the actual identity of the investors who disclose under the statute. While the Petition and its authors have focused on activist investors, we show that Section 13(d) filings by activist hedge funds represent only a small minority of all such filings. We document the large number of filings made under Section 13(d) by investors other than activist hedge funds—and show that it is common for these investors, too, to make full use of the ten-day period prior to disclosure to accumulate more than five-percent ownership in the firm by the time they disclose their stakes. Thus, in examining the consequences and costs of the proposed tightening of the Commission's rules under Section 13(d), it is important to take into account that most of the investors to which tightened rules would apply would not be the activist hedge funds on which the Petition has focused.

In Part VI, we investigate how activists' purchases beyond five-percent ownership are likely distributed in the ten-day window after the investors cross the five-percent threshold. We investigate this subject by identifying abnormal trading turnover during the ten-day period. We find that, even when activists choose to wait the full ten days after

10. *See* Emmerich et al., *supra* note 7, at 137 (asserting that modern trading techologies allow blockholders to accumulate significant quantities of stock during the ten-day period).

crossing the five-percent threshold to disclose their stakes, their purchases are likely concentrated on the day they cross the threshold as well as the following day. Thus, whatever the benefits of the existing ten-day period for activist investors, the practical difference in pre-disclosure accumulations between the existing regime and the rules in jurisdictions with shorter disclosure windows—which the Petition holds out as a model for modern reform—is likely much smaller than the Petition assumes.

Finally, in Part VII we consider the relationship between the Petition's proposed tightening of the disclosure rules under Section 13(d) and the recent proliferation of low-threshold poison pills in the United States. We present evidence indicating that a significant proportion of poison pills at public companies have thresholds that fall substantially short of a controlling block.[11] We argue that any consideration of reforming the rules under Section 13(d) should take into account the interaction of such reform with the use of these poison pills. In particular, we suggest that the SEC should avoid adopting any reforms that would facilitate the use of these pills to cap the stakes that outside investors can acquire in public companies. To the extent that the SEC does choose to tighten its disclosure rules under Section 13(d), any such tightening should apply only to companies that adopt corporate-law arrangements that preclude the adoption of low-trigger poison pills.

Before proceeding, we would like to stress that, because we focus only on the evidence available from disclosures under Section 13(d), our analysis is limited to only a few of the empirical questions that an adequate assessment of the rules governing blockholders' acquisitions of public-company stock should consider. Any such assessment should include analysis of the benefits that outside blockholders confer on shareholders as well as the effects of existing disclosure rules and state law on the incidence and size of block holdings in public companies.[12] The preliminary evidence provided in this Article, however, offers no support for the Petition's proposed changes to the existing rules under Section 13(d), and provides some basis for concern that the proposed changes would have adverse effects on public-company investors.

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

11. *Infra* Table 3.

12. Bebchuk & Jackson, *supra* note 6, at 59.

II. THE INCIDENCE AND MAGNITUDE OF PRE-DISCLOSURE ACCUMULATIONS

In this Part, we examine the frequency and magnitude of hedge fund activists' accumulations of significant blocks of stock in public companies. As we explain below, a systematic review of the evidence suggests that the concerns and anecdotes described in the Petition are not representative of the evidence on activist hedge fund behavior more generally. In Part A, we describe the source of the data we present throughout the Article—public disclosures filed by activist hedge funds under Section 13(d) over a 14-year period—along with summary statistics describing the incidence of these filings and the size of the blocks disclosed by activist hedge funds. In Part B, we examine the timing of these disclosures—and the relationships between the timing of these filings and the size of the stake that investors disclose. In Part C, we show that investors commonly violate existing rules by waiting more than ten days to disclose, suggesting that, before modifying these rules, the SEC should consider more consistent enforcement of existing law.

A. The Universe of Schedule 13D Filings by Activist Hedge Funds

In this Article, we build upon the original dataset, covering the period from 2001 to 2006, used in the first comprehensive study of hedge fund activism published by two of us along with Frank Partnoy and Randall Thomas.[13] This dataset was also studied by the same authors in subsequent work.[14] Two of us, with Hyunseob Kim, extended the data to include 2007 in a study analyzing hedge fund activism[15] and presented an updated sample covering the period from 1994 through 2007 in a more recent article considering the long-term effects of such activism.[16] Thus, this database has proven fruitful for previous analysis of several dimensions of hedge fund activism. In this Article, we use the updated dataset to provide the first systematic evidence on pre-disclosure accumulations of stock by hedge funds.

The dataset includes information concerning hedge fund activism drawn from disclosures required to be filed under Section 13(d), which are typically made on the SEC's Schedule 13D.[17] To begin, the dataset was constructed by first identifying all of the investors that filed Schedule 13Ds between 1994 and 2007. Then, based on the names and descriptions of the filers required to be disclosed under Item 2 of Schedule 13D,[18]

---

13. *See generally* Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729 (2008).

14. *See generally* Alon Brav et al., *The Returns to Hedge Fund Activism*, 64 FIN. ANALYSIS. J. 45 (2008).

15. Alon Brav et al., *Hedge Fund Activism: A Review*, 4 FOUND. & TRENDS FIN. 183, 188 (2009).

16. *See generally* Alon Brav et al., The Real Effects of Hedge Fund Activism: Productivity, Risk, and Product Market Competition (May 2013) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2022904.

17. *See* 17 C.F.R. § 240.13d-101 (2010) (describing the information required to be disclosed in Section 13(d) filings).

18. *See id.* Item 2 (requiring a description of the "name[,] principal business[, and] address of [the]

filer types such as banks, insurance companies, mutual funds, and other non-activist investors were excluded from our sample. In addition, based on the description of the purpose of the investment required to be included in Item 4,[19] we excluded events where (1) the purpose of the investor is to be involved in a bankruptcy or reorganization because of financial distress; (2) the purpose of the filer is to engage in merger- or acquisition-related risk arbitrage; or (3) the company in which the investment is made is a closed-end fund.

In addition, we conducted extensive news searches using the hedge fund and company names drawn from Schedule 13D. These searches allow for the inclusion in the dataset of additional information not available in the Schedule 13Ds, such as the hedge fund's motive and the target company's response. As a result of these searches, the dataset includes instances in which hedge funds maintained an activist position in a large public company but owned less than five percent of the company's stock (and, thus, were not required to file a Schedule 13D).[20]

Table 1 below provides summary data on the activist interventions in our dataset during the time period we study here, between 1994 and 2007. The Table describes the total number of such filings during the first half of that period, from 1994 to 2000, and during the second half of that period, between 2001 and 2007:

principal office" of the filer).

19. *See id.* Item 4 (requiring investors to disclose the "[p]urpose of [the t]ransaction," including, *inter alia*, any plans relating to the acquisition of additional stock or a corporate event such as a merger or acquisition).

20. Because of the significant amount of capital required to own five percent or more of the stock of a large public company, relying exclusively on Schedule 13D filings might exclude cases in which outside investors maintained significant holdings of stock. For further discussion, see Brav et al., *supra* note 13, at 1739. For a more detailed description of the procedure for assembling the dataset, see Brav et al., *supra* note 15, at 193–95.

Table 1: Incidence of Interventions by Activist Hedge Funds

Year	Number of 13D Filings by Hedge Fund Activists	Year	Number of 13D Filings by Hedge Fund Activists
1994	10	2001	96
1995	37	2002	134
1996	99	2003	127
1997	212	2004	148
1998	161	2005	237
1999	118	2006	269
2000	120	2007	272
Total 1994–2000	757	**Total 2001–2007**	1,283
Total, 1994–2007	2,040		

As Table 1 shows, there has been some increase in the frequency of hedge fund activism over time. More importantly, the evidence shows that the dataset includes a significant number of events in nearly every year, with more than 100 events in every year except for four throughout our 14-year sample. Indeed, except for the first three years of our sample period—1994 through 1996—the dataset includes a significant number of events for each year in our study. In this Article, we draw on these events to examine the important evidentiary questions left open by the Petition and its supporters.

The dataset includes 42 events in which the activist hedge fund did not file a Schedule 13D because it held less than five percent of the stock of the target company. These events were excluded from the analysis of Schedule 13D filings in the remainder of the Article. Our analysis of such filings is thus based on a dataset of about 2000 such filings.[21]

B. The Timing of Schedule 13D Filings

To examine the costs and benefits of the Petition's proposed acceleration of the time within which investors are required to disclose their stakes, it may be useful to know when investors choose to disclose during the existing ten-day period. Thus, we begin by describing when activist investors file their Schedule 13Ds after crossing the five-percent threshold. Table 2 describes the number of Schedule 13Ds in our sample that were filed

---

21. As will be noted, some of the tests we conduct below (especially our regression results) are based on a somewhat smaller sample because relevant data was not available for some of the events for which 13D schedules were filed.

within certain ranges of days after the activist crossed the five-percent threshold:

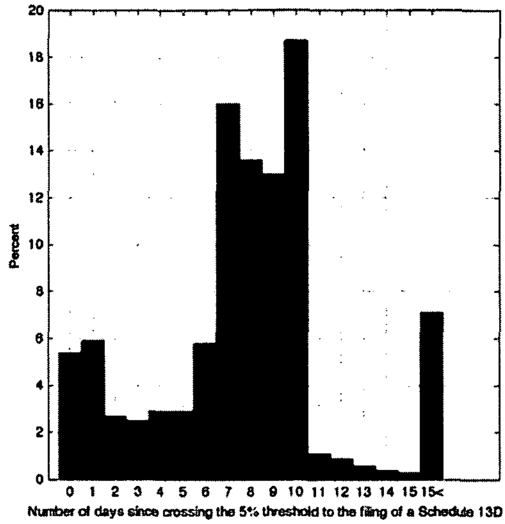
Table 2: Timing of Schedule 13D Filings by Activist Hedge Funds

	0–3 Days	4–7 Days	8–10 Days	11–15 Days	More than 15 Days
Number of 13Ds Filed	310	518	849	61	132
Percentage of Entire Sample	16.5%	27.6%	45.3%	3.3%	7.1%

As Table 2 shows, the bulk of activists filing Schedule 13Ds do so between eight and ten days after crossing the five-percent threshold.[22] One might expect that the bulk of these filings would be concentrated in the final few days of the ten-day period for permissible filings. Figure 1 below provides a histogram describing the percentage of filings in our sample that occur within a specified number of days after the investor crosses the five-percent threshold.

22. Indeed, as Table 2 indicates, more than ten percent of our observations include cases in which the hedge fund failed to file a Schedule 13D within ten days of crossing the five-percent threshold, as required by existing law. For further discussion of this finding, see *infra* Part II.C. In our initial analysis of these filings, we actually observed that more than *20%* of our observations involved cases in which the activist waited until after the ten-day period had expired to disclose. Such late filings may occur in part because activists count business days, rather than calendar days, when determining when the filing deadline arrives. *But see Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting*, SEC. & EXCHANGE COMMISSION, http://www.sec.gov/divisions/corpfin/guidance/reg13d-interp.htm (noting, in Question 103.10, that the period is measured in calendar days). Nevertheless, to be conservative we recalculated our calendar-day count to a business-day count for purposes of Table 2. Still, as that Table shows, in more than ten percent of our events, the hedge fund failed to file a Schedule 13D within ten business days of crossing the five-percent threshold.

Figure 1: Histogram of Number of Days After Crossing Five Percent



As one might expect, Figure 1 suggests that hedge fund activists make use of the ten-day period. A majority file their Schedule 13D between seven and ten days after they have crossed the five-percent threshold, with nearly 20% filing on the tenth day itself.

The data also permit us to examine whether the activists who take longer to file their Schedule 13D after crossing the five-percent threshold disclose larger stakes than investors who file immediately after crossing the threshold. Table 3 describes the percentage of ownership disclosed by the hedge fund activists in our sample, sorted by the number of days between the time the investor crosses the five-percent threshold and the time the investor files a Schedule 13D:

Table 3: Percent Ownership Disclosed by Delay Between Crossing 5% Threshold and Filing Disclosures Under Section 13(d)

		Delay Between Crossing 5% Threshold and Filing of Schedule 13D			
Percentile	All	0–1 Days	2–4 Days	5–7 Days	8–10 Days
5%	5.0%	5.0%	5.0%	5.1%	5.1%
10%	5.1%	5.1%	5.0%	5.1%	5.1%
25%	5.4%	5.4%	5.2%	5.4%	5.4%
50%	6.3%	7.4%	6.0%	6.1%	6.2%
75%	8.8%	9.9%	8.75%	8.4%	8.4%
90%	14.6%	16.5%	13.8%	11.3%	14.2%
95%	21.2%	19.8%	20.2%	19.9%	21.2%
Average	8.8%	9.1%	8.0%	7.9%	8.8%

As Table 3 suggests, the evidence does not indicate that activists who take longer to disclose their positions under Section 13(d) emerge with larger stakes than investors who disclose more quickly after crossing the five-percent threshold. Our dataset, however, also permits us to consider the key factors that are associated with the amount of time it takes activist hedge funds to file their disclosures—including, among other factors, the relationship between the amount of time activists take to disclose their position and the level of ownership that the activist discloses. In multivariate regression models described in more detail in the Appendix, we find that firm size and abnormal stock returns around the disclosure date are positively associated with the number of days the investor waits after crossing the five-percent threshold before disclosing its position, while the size-adjusted stock returns for the company in the period leading up to the disclosure is negatively associated with the number of days until the filing.[23] Consistent with the

23. For more extensive detail describing our regression analyses, see *infra* Appendix at Part II.B. As those models show, although we identify positive and statistically significant relationships between the number of days before activist investors file their disclosures and, for example, firm size, we find no statistically significant relationship between the percentage of ownership revealed in Section 13(d) filings and the number

summary data described in Table 3, however, we find no evidence suggesting that activists who take longer to file a Schedule 13D emerge with larger stakes.

Similarly, the dataset permits us to explore which variables *do* meaningfully predict the activists' ownership stake at the time they made their initial disclosures under Schedule 13D. In multivariate regression analysis described in more detail in the Appendix, we identify several important determinants of the amount of ownership that activists disclose in their filings under Section 13(d).[24] Consistent with the findings described above, however, the evidence does not suggest that the number of days before the investor discloses its position is meaningfully associated with the percentage of ownership the investor discloses.

C. The Surprising Incidence of Violations of Existing Rules

Finally, our analysis shows that a surprising number of investors violate existing rules by failing to disclose their stakes under Section 13(d) within ten days after crossing the five-percent threshold. The striking evidence that a substantial proportion of investors disclose too late suggests that, before accelerating the timing of disclosure under Section 13(d), the SEC should consider more stringent enforcement of existing law.

As indicated in Table 2 above, 193 of the disclosures in the sample were filed more than ten days after the investor crossed the five-percent threshold. These disclosures represent more than 10% of our sample, indicating that about one in ten activist hedge fund filings under Section 13(d), by their terms, do not comply with existing law. Of course, we do not suggest that these investors deliberately flout their obligations under federal securities law. Some of these filings may result from an inadvertent failure to comply with, or a misinterpretation of, the SEC's existing Section 13(d) rules. However, the fact that more than ten percent of the disclosures in our sample were filed more than ten days after the investor crossed the threshold—and more than seven percent were filed more than 15 days after the threshold was crossed—deserves further examination.

In our view, before the SEC explores a redesign of its current rules, it should consider enforcing existing law more effectively. The SEC should work to ensure that investors strictly comply with its existing rules governing blockholder disclosure, particularly because investors currently appear not to comply with these rules in many cases. Moreover, the SEC should consider this evidence when considering whether to make changes to those rules.

In sum, the evidence shows that hedge fund activists do indeed use the ten-day period not to disclose immediately upon crossing the five-percent threshold. But these investors typically do not acquire stakes of the magnitude described in the Petition prior to disclosure. Instead, hedge fund activists typically own much less than ten percent when they disclose. Finally, the evidence indicates that a significant proportion of investors do not comply with the existing ten-day rule, suggesting that, before proceeding with a

---

of days until the investor files their disclosure.

24. *See infra* Appendix at Part II.B.

reexamination of that rule, the SEC should pursue more consistent enforcement of current law.

III. CHANGES OVER TIME

The Petition and its authors argue that, because of changes in trading practices and technologies, the incidence and magnitude of pre-disclosure accumulations above five percent by hedge fund activists have increased over time. The Petition itself urged that "[t]he advent of computerized trading . . . allowing massive volumes of shares to trade in a matter of seconds . . . has accelerated the ability of investors to accumulate economic ownership of shares."[25] More recently, several senior partners of the law firm that authored the Petition have contended that "changes in capital markets and trading technologies make rapid accumulations" by outside investors "much easier today than . . . when the Williams Act was enacted."[26]

The Petition, however, offered only four anecdotes over the last five years to support the claim that investors "frequently do" engage in large accumulations of stock during the ten days after they cross the five-percent threshold.[27] The only other citation offered by the Petition for this proposition is a *New York Times* article, which, in turn, relied upon a Memorandum issued by the firm that authored the Petition.[28]

More recently, Martin Lipton, the senior partner of the firm that authored the Petition, presented the firm's views in more detail at a Director Roundtable sponsored by the Conference Board.[29] In that presentation and others, the firm has noted two additional anecdotes in which investors engaged in significant stock accumulations after crossing the five-percent threshold.[30] But both anecdotes were drawn from foreign jurisdictions in which the Williams Act does not apply.

In response to the regulatory commentary and papers that we have written questioning these premises,[31] four senior partners of the firm that authored the Petition simply state in a forthcoming article that "[i]t cannot seriously be contested that changes in capital markets and trading technologies make rapid accumulation of stock much easier today than in 1968."[32] These partners have similarly suggested that it is widely

---

25. Petition, *supra* note 1, at 3.

26. Emmerich et al., *supra* note 7, at 150.

27. *See* Petition, *supra* note 1, at 5–6, 8, 10.

28. *Id.* at 3 n.9 (citing Andrew Ross Sorkin, *Big Investors Appear Out of Thin Air*, N.Y. TIMES DEALBOOK (Nov. 1, 2010, 8:25PM), http://dealbook.NYTimes.com/2010/11/01/sorkin-big-investors-appear-out-of-thin-air/).

29. *See Director Roundtable: The Law and Economics of Blockholder Disclosure*, *supra* note 9.

30. *See id.* (PowerPoint presentation on file with Wachtell, Lipton, Rosen & Katz); *see also* Section 13 of the Securities Exchange Act: A Modest Proposal for Modernization 5 (May 11, 2012) (unpublished presentation) (on file with authors).

31. *See, e.g.*, Bebchuk & Jackson, *supra* note 6 (discussing the SEC's consideration of the Petition); Letter from Heaton et al., *supra* note 5.

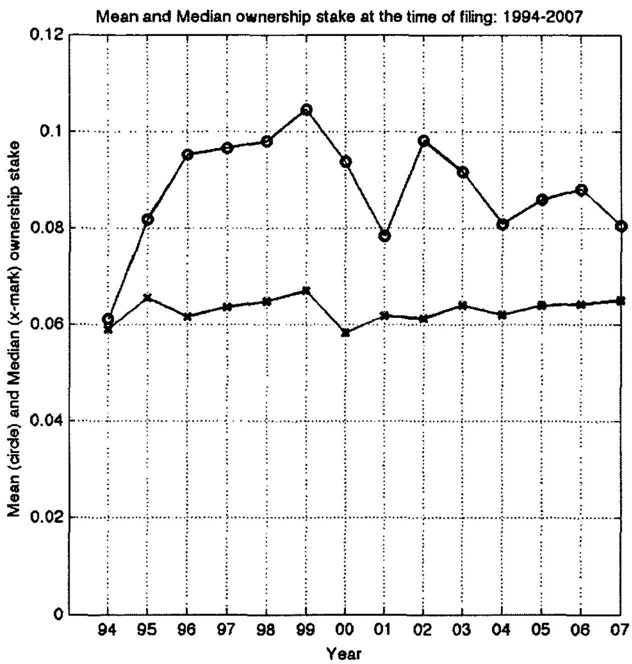
32. Emmerich et al., *supra* note 7, at 150.

understood that "developments in market liquidity and trading—which allow massive volumes of public company shares to be traded in fractions of a second—have made the Section 13(d) reporting regime's ten-day reporting window obsolete, allowing blockholders to contravene the purposes of the statute."[33]

We are not familiar, however, with any research establishing this claim. In any event, the question whether this proposition is correct can be resolved directly by consulting the extensive, publicly available data that can be drawn from investors' disclosures under Section 13(d). This Part uses this evidence to evaluate the Petition's claim that, over time, investors have increasingly used the ten-day window available under Section 13(d) to accumulate positions in excess of the five-percent threshold.

We begin with summary data describing the percentage ownership of activist investors when they disclose their positions under Section 13(d) over time. Figure 2 below describes, from 1994 through 2007, the average and median ownership stake of the investors in our sample at the time they file their initial disclosures under Section 13(d).

Figure 2: Median Ownership at the Time of Filing: Evolution Over Time



33. *Id.* at 135.

As Figure 2 suggests, the data do not support the claim that, over time, activists have increasingly disclosed positions far in excess of the five-percent threshold. We can examine this claim more closely, however, through multivariate regression analysis. To do so, we specify models in which the dependent variable is the percentage of ownership the investor discloses in its initial filing under Section 13(d) and control for variables that are important determinants of that percentage. We then separately model the relationship between the percentage of ownership disclosed and a dummy variable identifying a year trend, as well as a dummy variable indicating whether the observation occurred in the final five years of our sample. Table 4 below describes the estimated correlation coefficients, z-statistics, and significance associated with each of those variables in our models:

Table 4: The Relationship Between the Passage of Time and Ownership Disclosed by Activist Investors[34]

	Ownership Disclosed in Activist Filings	Ownership Disclosed in Activist Filings
Time-Trend Control Variable	-0.001 [-0.20]	
Dummy Variable Indicating Final Five Sample Years		-.0004 [-1.32]
Controls for Market Value, Institutional Ownership, Analyst Coverage, Liquidity, Prior Stock Returns, Short-Run Abnormal Return, and Days Until Filing?	+	+
Number of Observations	1,398	1,398
Pseudo R^2	10.2%	5.5%

34. Throughout this Article, when presenting results of regression analysis, we use standard identifiers of statistical significance: "***" indicates significance at 99% confidence, "**" indicates significance at 95% confidence, and "*" indicates significance at 90% confidence. For further detail on the results of these models, see *infra* Appendix at Part II.B.

As Table 4 shows, the evidence offers no support for the Petition's claim that, over time, changes in trading practices have enabled activist investors to acquire larger blocks of public-company stock than was previously possible. Neither the variable indicating the trend of disclosed ownership percentages over time, nor the dummy variable indicating observations in the final five years of our sample period, suggests that the percentage of disclosed ownership has increased in recent years. To the contrary, the coefficients for these variables are both *negative*, suggesting the opposite trend—although, to be sure, neither model suggests that the relationship is statistically meaningful. At bottom, a systematic review of the empirical evidence on hedge fund activists does not support the Petition's anecdotal contention that changes in trading technology have enabled activists to accumulate larger blocks of public-company stock in recent years.

IV. THE COSTS OF TIGHTENING SECTION 13(D)

Although the evidentiary basis for the Petition's claims about the need to address recent changes in trading practices is unclear, there is no question that tightening the Section 13(d) rules as suggested in the Petition would carry significant costs for public-company shareholders. These costs arise from the simple fact that requiring activist investors to disclose their ownership in public companies more quickly will reduce these investors' returns—thereby reducing the incidence and magnitude of outside blockholdings in large public companies.[35]

For two reasons, tightening the SEC's rules under Section 13(d) would likely deter outside investors from accumulating large blocks of stock in public companies. First, as we have shown, the evidence indicates that, in more than half of the events in our sample, activist hedge funds file their Schedule 13Ds between seven and ten days after they cross the five-percent threshold. Reducing the amount of time that investors have before they are required to disclose their position will likely reduce their profits—and, thus, their incentives to accumulate large blocks of public-company stock. Second, the tightening proposed by the Petition would enable incumbents to adopt low-trigger poison pills that make it impossible for outside blockholders to accumulate additional shares after they cross the five-percent threshold. In previous work by two of us, we show that, among the 805 public companies in the Sharkrepellent dataset that currently have poison pills in place, 76% have pills triggered by ownership of 15% or less, while 15% have pills triggered by 10% or less.[36]

Tightening the Section 13(d) rules will impose two types of costs on public company shareholders. For one thing, shareholders will sustain direct costs, because they will benefit less frequently from the superior stock returns that occur when an activist

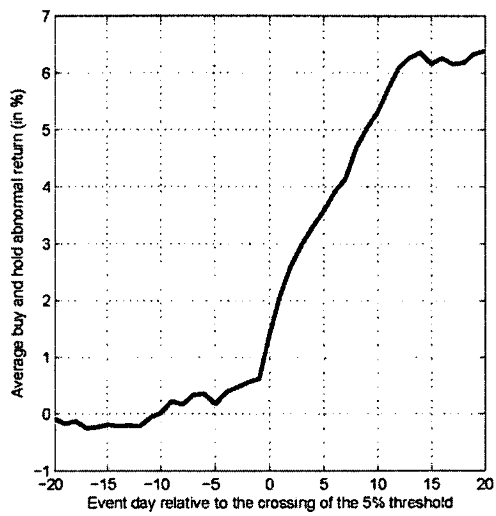
35. *See supra* notes 25–29 and accompanying text; *see also* Bebchuk & Jackson, *supra* note 6, at 9 (describing how the changes urged by the Petition would deter investors from accumulating and holding large blocks of public-company stock).

36. *See* Bebchuk & Jackson, *supra* note 6, at 56 (citing Factset Research Data Systems, Inc., *Dataset*, SHARKREPELLENT.NET, *available at* http://www.sharkrepellent.net).

investor appears. Shareholders will also incur indirect costs in the form of increased managerial slack.

First, reducing the incidence and magnitude of outside investments in large blocks of public-company stock will impose direct costs because shareholders will no longer enjoy the superior returns long associated with the arrival of an activist, five-percent blockholder. Figure 3 below describes the average abnormal buy-and-hold returns beginning 20 days before an activist hedge fund crosses the five-percent threshold and ending 20 days after the investor crosses the threshold:

Figure 3: Abnormal Returns Before and After Activists Cross the Five-Percent Threshold



As Figure 3 shows, the direct costs of tightening the Section 13(d) rules for public-company shareholders are likely to be substantial. The average abnormal returns observed during the 20-day period before and after an investor crosses the five-percent threshold are approximately six percent. If the Section 13(d) rules are tightened, shareholders are less likely to benefit from the significant *ex post* gains that shareholders enjoy after an investor crosses the five-percent threshold.

Second, investors will also suffer indirect costs from tightening the Section 13(d) rules—and these could be even more substantial. In addition to the gains described in Figure 3, to the extent that the rules urged by the Petition and its supporters reduce the incidence and magnitude of outside blockholdings, investors can also expect to lose some gains associated with the mere *possibility* that an activist will emerge to reduce agency costs and managerial slack because the probability that such an investor will emerge will be reduced by the tightening of the rules under Section 13(d). This possibility is consistent with the longstanding and significant evidence showing that corporate governance provisions that shield incumbents from shareholder oversight are associated with lower firm value and shareholder returns.[37]

V. BEYOND ACTIVIST HEDGE FUNDS

The Petition devotes the bulk of its attention to activist hedge funds, and our analysis thus far has focused on Schedule 13D filings and pre-disclosure accumulations by such funds. However, an examination of the data on Schedule 13D filings reveals a further dimension that has been overlooked by the Petition, but which the SEC should take into account. The majority of Schedule 13D filings, including filings that use all or most of the ten-day period prior to disclosure, are not made by activist hedge funds. Thus, any tightening of the Section 13(d) rules would apply to a much larger universe of cases than those on which the Petition focuses. To provide an empirical sense of the scope of this issue, Table 5 below provides information on the percentage of all Schedule 13D filings made by hedge fund activists between 1994 and 2007.

37. *See, e.g.*, Lucian Bebchuk et al., *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783, 790 (2009) (describing this literature); Paul A. Gompers et al., *Corporate Governance and Equity Prices*, 118 Q. J. ECON. 107, 110 (2001) (noting the earliest developments in this literature and establishing that governance provisions that provide shareholders with stronger oversight authority are associated with significantly positive abnormal returns); *see generally* John Core et al., *Does Weak Governance Cause Weak Stock Returns? An Examination of Firm Operating Performance and Investors' Expectations*, 56 J. FIN. 655 (2006) (evaluating the relationship between governance arrangements and stock returns).

Table 5: Activists Within the Broader Incidence of Section 13(d) Filings

Year	Total Number of 13D Filings	Percentage of Filings Made by Activist Hedge Funds	Year	Total Number of 13D Filings	Percentage of Filings Made by Activist Hedge Funds
1994	283	5.3%	2001	2,590	6.3%
1995	611	7.2%	2002	2,390	8.6%
1996	2,161	6.7%	2003	2,541	7.8%
1997	3,552	8.3%	2004	2,366	9.4%
1998	3,152	7.4%	2005	2,479	14.8%
1999	2,981	6.5%	2006	2,700	15.6%
2000	2,954	7.5%	2007	2,680	16.4%
	Total Number of 13D Filings		Percentage of Filings Made by Activist Hedge Funds		
1994–2007	33,440		9.5%		

As Table 5 indicates, during this period as a whole, activist hedge funds made less than one-tenth of these filings—and this fraction did not exceed one-sixth in any of the years for which we have data. Thus, any tightening of the SEC's rules under Section 13(d) would apply to a universe of filings by investors who are *not* hedge fund activist investors that would be several times larger than the set of filings by activists. Of course, some might argue that non-activist investors are unconcerned about the SEC's rules under Section 13(d) because these investors typically disclose their positions immediately—or, even if they disclose later on, they generally do not purchase shares beyond the five-percent threshold before they disclose. Our dataset allows us to explore this claim empirically—and we find that it is incorrect.

We selected the Section 13(d) filings from June 2011 at random and collected information from each filing regarding the length of time between the date on which the investor crossed the five-percent threshold and the filing date, as well as the investor's ownership stake. Table 8 provides summary statistics of the ownership stake at filing and the number of days between crossing the five-percent threshold and disclosure for both the hedge fund activists and the non-activist investors in our sample for June 2011. As Table 8 indicates, slightly less than 65% of filings occur within ten days of crossing the five-percent threshold for *both* activists and non-activists. Similarly, as Table 6 shows we find little significant difference in the typical stakes described in activist and non-activist disclosures: the median initial ownership stake revealed by hedge fund activists in their initial Schedule 13D is 9%, while the median stake disclosed by non-activists is 20%.

Table 6: Activist and Non-Activist Filings Under Section 13(d)[38]

	Days Between Crossing 5% Threshold and Disclosure		Ownership Stake Disclosed Upon Initial Filing	
	Hedge Fund Activists	Non-Hedge Funds	Hedge Fund Activists	Non-Hedge Funds
25th Percentile	7 days	6 days	6%	9%
50th Percentile	10 days	10 days	9%	20%
75th Percentile	10 days	13 days	22%	39%

To pursue a more systematic analysis of these questions, we constructed two sets of multivariate regression models to explore whether there are statistically significant differences between the disclosure behavior of hedge fund activists and non-hedge fund activists. In the first set, the dependent variable is the number of days between the time the investor crosses the five-percent threshold and its disclosure under Section 13(d). In the second set, the dependent variable is the initial ownership disclosed by the investor. Table 7 below describes the estimated coefficients, and standard errors, produced by those models.

38. *Id.* The number of hedge fund activists in the sample described in Table 6 is 20; the number of non-activist investors in the group is 154. We note that the ownership stakes associated with non-activists is relatively high because many of these non-activists eventually seek control. Moreover, many of our non-activist observations featuring high ownership stakes involve conversions of debt into stock or negotiated block trades rather than open-market purchases. A recent study in this area shows that among all Schedule 13D filings from 1994 to 2010, the median ownership stake disclosed for investors engaging in open-market purchases was 6.11%, similar to our median figure of 9% for hedge fund activists. Pierre Collin-Dufresne & Vyacheslav Fos, Do Prices Reveal the Presence of Informed Trading? 50 (July 22, 2013) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2023629.

Table 7: Activist and Non-Activist Disclosure Behavior[39]

	Days to File		Percentage Ownership Upon Disclosure	
	(a)	(b)	(c)	(d)
Percentage Owned at Disclosure	0.8482 [1.27]	0.007 [1.51]		
Open-Market Purchase	0.2593 [0.65]	-0.003* [-1.69]	-0.2417*** [-5.59]	
Hedge Fund Dummy	0.0898 [-0.18]	-0.003 [-0.40]	-0.0121 [-0.21]	-0.1389*** [-2.42]
R^2			18.2%	3.3%
Observations	174	174	174	174

Table 7 offers two important insights on the differences between activist hedge funds and other investors subject to the SEC's rules under Section 13(d). First, we find no statistically meaningful difference between the two groups of investors with respect to the number of days each waits to disclose its position under Section 13(d). Second, we find no meaningful difference between the two groups of investors with respect to the ownership stake revealed at the time of the filing—although one model indicates that the hedge fund investors in our sample disclose statistically significantly *smaller* stakes than non-hedge fund activists, consistent with the comparison of the median stakes described above.

In sum, the evidence suggests that the tightening of the rules under Section 13(d) proposed by the Petition would apply to a universe of investors many times larger than the activist hedge funds with which the Petition is principally concerned. Moreover, these investors currently follow a similar approach to compliance with the SEC's rules under Section 13(d), both in terms of the amount of time they wait before disclosing their stakes and in terms of the magnitude of the ownership they disclose under Section 13(d)—and, if anything, non-activists amass larger stakes than their activist hedge fund counterparts. The evidence indicates that the Petition's proposed changes to the SEC's rules would have a significant effect on a substantial group of investors not considered in the Petition's analysis. Before adopting the tightening of the rules proposed in the Petition, the SEC should consider the effects of the proposed changes on these investors as well.

39. In Table 7, models (a) and (c) provide the results of an ordered-logit regression. Models (b) and (d) describe the results of a two-sided tobit regression.

VI. THE TIMING OF POST-FIVE-PERCENT PURCHASES

Thus far, we have focused on the consequences of allowing some time to pass between the time when the investor reaches the five-percent threshold and when it is required to disclose its holdings under Section 13(d). The Petition, however, seeks merely to shorten this delay—not eliminate it altogether. Specifically, the Petition contends that this period should be reduced to one day, arguing that doing so would reduce the ability of outside blockholders to emerge with large blocks far exceeding the five-percent disclosure threshold. And, as the Petition notes, many other jurisdictions permit a delay between two and five days before investors must disclose the accumulation of an outside block.[40]

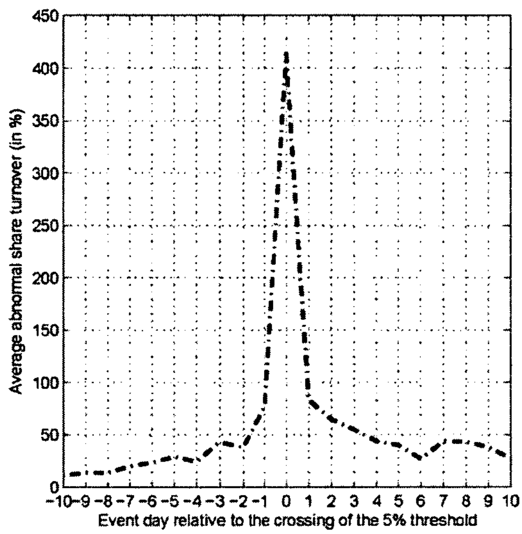
Thus, we note several implications of our evidence for the consequences of reducing the period of time that investors have before disclosing outside blockholdings. As we explain below, the evidence suggests that, to the extent that blockholders do purchase stakes beyond five percent, these purchases are likely disproportionately concentrated on the day on which the investor crosses the five-percent threshold and, to a lesser extent, the immediately following day. Consequently, it is far from clear that reducing the disclosure window to two days—or even one day—would reduce the frequency or size of blocks of stock significantly above five percent, as the Petition might hope.

To begin, we consider when activists might attempt to accumulate significantly more than five-percent stakes in public companies. Figure 4 below describes the average abnormal share turnover (that is, trading volume) in our sample relative to the date on which the activist crosses the five-percent ownership threshold[41]:

40. *See* Petition, *supra* note 1, at 4, 8.

41. For purposes of Figure 4, normal trading turnover is measured for each company over a 200-day period that ends ten days before the date on which the activist crosses the five-percent threshold. Abnormal turnover is the ratio of the actual turnover on the relevant date to normal turnover.

Figure 4: Abnormal Trading Volume Before and After Activists Cross the Five-Percent Threshold



As Figure 4 shows, the evidence indicates that the bulk of abnormal trading volume typically occurs during the day the activist investor crosses the five-percent threshold. Turnover on the day the activist hedge funds cross the five-percent threshold is about 400% higher than normal. In sum, to the extent that activists seek to engage in significant purchases that allow them to accumulate stakes far above the five-percent threshold, the evidence suggests that these purchases are most likely to occur on the day on which the activist crosses the threshold.

From a policy perspective, the evidence described above indicates that accelerating the current ten-day period would not produce a proportionate reduction in the acquisition of stakes over five percent. To illustrate, if one were to shorten the existing ten-day period to four days (a 60% reduction in the amount of time investors have to disclose their stakes), as in the jurisdictions noted in the Petition,[42] our data suggest that accumulations above five-percent would not similarly decline by 60%. Thus, the practical differences between the SEC's current rules and the rules in other jurisdictions are less significant than they seem, and moving toward those regimes would not result in a major change in pre-disclosure accumulations above the five-percent threshold.

The Petition and its advocates argue that existing rules in several jurisdictions,

---

42. *See* Petition, *supra* note 1, at 4 (noting disclosure deadlines of two to four days in jurisdictions such as the United Kingdom, Germany, Australia, and Hong Kong).

including the United Kingdom,[43] Australia,[44] Canada,[45] and Hong Kong,[46] provide support for their position insofar as they provide shorter disclosure windows (from two days to four days). Citing these jurisdictions, a partner in the firm that authored the Petition argued in subsequent work that "[i]n the absence of updated requirements, the U.S. markets are more vulnerable than those in other jurisdictions to . . . exploitat[ion] of the [ten]-day window."[47] The evidence provided above indicates that, in terms of pre-disclosure accumulations, the practical difference between the current ten-day window and the shorter windows used in the countries described in the Petition is likely much less significant than the Petition assumes.

Beyond its implications for the policy debate over the rules governing blockholder disclosure, the evidence provided by Figure 4 also identifies an interesting issue for additional research: Why is trading volume concentrated on the single day in which the activist crosses the five-percent threshold? One possible explanation may be that activist hedge funds cross the threshold only when they are able to identify a seller of a large block of shares—and only then choose to provide liquidity to that seller.[48] Still, given that the activist hedge fund will not be required to disclose its stake for ten days after such purchase—providing it with an opportunity to acquire additional shares at lower prices—one still might ask why we do not observe abnormal levels of trading volume that are more evenly distributed over the ten-day period. We hope that this question will be addressed by future research.

VII. DISCLOSURE REFORM AND LOW-THRESHOLD POISON PILLS

In this Part, we provide evidence on the recent proliferation of low-threshold poison pills and discuss the relevance of this empirical phenomenon to the Petition's proposal to

43. *See* Katz & McIntosh, *supra* note 4, at 4 (citing FINANCIAL SERVICES AUTHORITY HANDBOOK ch. 5 (2013), *available at* http://fsahandbook.info/FSA/html/handbook/DTR/5) (noting that the United Kingdom "imposes a two-trading-day deadline for disclosure of acquisitions in excess of 3 percent of an issuer's securities").

44. *See id.* (citing *Guidance Note 20: Equity Derivatives*, TAKEOVERS PANEL 9 (2008), http://www.takeovers.gov.au/content/Guidance_Notes/Current/downloads/GN20_2008.pdf) (noting that Australia requires disclosure within two business days).

45. *See id.* (citing Province of Ontario Securities Act, R.S.O. 1990, c. S.5, § 102.1 (Can.)) (noting that Canadian law requires "prompt disclosure" and "limit[s] additional acquisitions or offers to acquire until one business day after the required disclosure has been made in the market").

46. *See id.* (citing Hong Kong Securities and Futures Ordinance, (2012) Cap. 571, § 311 (H.K.)) (noting that "Hong Kong securities laws require a report within three business days of the acquisition of a 'notifiable interest'").

47. *Id.*

48. Activist trading in the period leading to the filing of a Schedule 13D and the implication of such trading for liquidity is studied in Collin-Dufresne & Fos, *supra* note 38, as well as in Nickolay Gantchev & Pab Jotikasthira, Hedge Fund Activists: Do They Take Cues From Institutional Exit? (Feb. 2013) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2139482.

reform the rules governing disclosure under Section 13(d).[49] We argue that any consideration of reforming these rules should take into account the interaction of such reforms with the use of these poison pills. In particular, the SEC should avoid adopting any reform that would facilitate the use of low-threshold poison pills. Accordingly, if the SEC does choose to tighten the disclosure rules under Section 13(d), any such tightening should apply only to companies that adopt corporate law arrangements that preclude the adoption of low-trigger poison pills.[50]

As we have noted, the Petition's supporters have argued that requiring investors to disclose their petition more quickly will benefit public investors by enabling selling shareholders to obtain higher prices for their stock.[51] Of course, any such benefit should be weighed against the costs to investors from discouraging activist outside shareholders.[52] Whatever view one takes of this tradeoff, however, it is clear that earlier disclosure under Section 13(d) would provide significant benefits to corporate insiders. In particular, tightening the disclosure requirements under Section 13(d) will not only alert the market to the investor's presence but also incumbent directors and executives—who can then put takeover defenses in place more quickly in response to the news that a significant shareholder has emerged.

The initial drafters of what is now Section 13(d) envisioned a landscape that would allow outside investors who were not seeking control of a public company to accumulate stakes beyond the five-percent threshold, provided that they made the required disclosures.[53] But companies in the United States have increasingly been using poison pills with low thresholds to limit the stakes that outside shareholders can acquire.

Poison pills were developed in the 1980s to enable incumbent directors and executives to block a hostile acquisition of the firm.[54] Over time, however—and without sufficient attention from investors or public officials—public companies in the United States have started to use poison pills to prevent acquisitions of stakes that fall substantially short of a controlling block.[55] Available data indicates that an increasingly

---

49. This Part draws on a recent *New York Times* column by one of us. *See* Lucian A. Bebchuk, *Don't Make Poison Pills More Deadly*, N.Y. TIMES DEALBOOK (Feb. 7, 2013, 2:29 PM), http://dealbook.nytimes.com/2013/02/07/dont-make-poison-pills-more-deadly/.

50. Any tightening of these rules should apply only to companies that adopt charter arrangements that preclude the use of low-trigger poison pills. Such charter provisions could then only be altered with the mutual assent of the company's board of directors and its shareholders. *See* DEL. CODE ANN. tit. 8, § 242(b) (2013).

51. *See* Petition, *supra* note 1, at 3.

52. *See* Bebchuk & Jackson, *supra* note 6, at 50.

53. *See id.* at 44–45 (quoting 113 CONG. REC. 854 (1967)) (internal quotation marks omitted) (noting that the principal drafter of Section 13(d), Senator Harrison A. Williams, initially proposed a provision that would have made it unlawful for an investor to accumulate stock beyond the threshold without prior disclosure, but later withdrew that proposal and replaced it with one that sought to "balance the scales equally to protect the legitimate interests of the corporation, management, and shareholders").

54. *See, e.g.*, WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 522–23 (4th ed. 2012) (describing this history).

55. *See, e.g.*, *id.* at 524 n.20 ("When [poison pills] were first introduced in the 1980s, triggering events typically involved 30 percent of the company's stock. The size of the triggering threshold has steadily receded,

large group of public companies has moved in this direction. Table 8 below describes the thresholds that trigger the poison pill for a sample of 805 public companies that currently have a pill in place:

Table 8: Poison-Pill Thresholds at U.S. Public Companies[56]

Triggering Threshold	Number of Companies	Percentage of All Companies
Less than 10%	124	15%
Between 10% and 15%	5	1%
15%	483	60%
More than 15%	193	24%

Incumbent directors' and executives' freedom—and propensity—to adopt low-trigger poison pills is a highly relevant factor for any assessment of the rules governing the relationship between incumbents and outside shareholders. In particular, the SEC should recognize that tightening the current disclosure requirements under Section 13(d) could impose substantial costs on public investors and the economy by facilitating the use of such pills. Consider, for example, a situation in which an outside investor opposed by management makes a public announcement immediately upon accumulating a five-percent stake in the company. Then suppose that the company quickly adopts a poison pill with a low threshold that prevents, or significantly limits, further accumulation of stock by the buyer. In this case, the company's response to the immediate disclosure would not enable public investors to capture higher prices for shares they sell to the large shareholder; to the contrary, it would prevent these investors from selling shares to the outside shareholder at mutually beneficial prices. Furthermore, by entrenching insiders and insulating them from engagement by large outside shareholders, low-threshold poison pills could well impose costs on even those public shareholders who do *not* wish to sell their shares.

If the SEC does determine that tightening the disclosure rules under Section 13(d) is

however, and since 1990, triggers have typically been 10 percent.").

56. The data described in Table 8 were drawn from the Sharkrepellent database, which tracks the terms of poison-pill arrangements at U.S. public companies. *See Factset Research Systems, Inc., Dataset*, SHARKREPELLENT, http://www.sharkrepellent.net (last visited Apr. 8, 2012). We drew the data by searching the Sharkrepellent database for U.S. public companies with existing poison pills in place, identifying 805 companies in total. We then drew from the database the ownership thresholds triggering the pill for each of these companies. The data in the Table reflect the number of those 805 companies with thresholds of 10% or less, 15%, or 15% or more, respectively. As the table indicates, a majority of the companies in our sample have thresholds of 15% or less.

desirable, it should design its rules to avoid aiding the use of low-trigger poison pills. This could be achieved, for example, by limiting the application of any tightened disclosure rules to companies with charter provisions that prohibit the use of low-threshold poison pills. Proponents of the Petition—which has so far failed to attract any support from institutional investors—should endorse such a limitation to any reform. Doing so is necessary to address the concern that tightened disclosure rules are aimed at protecting entrenched insiders rather than public investors.

Furthermore, stressing that other advanced economies have shorter windows in which large shareholders must disclose significant stakes, the proponents of the Petition have urged the SEC to follow the example of these jurisdictions.[57] But no other developed economy grants corporate insiders the freedom to cap the ownership of blockholders they disfavor through the use of low-trigger poison pills, as is now permitted in the United States.[58] Thus, if the SEC adopts tightened disclosure rules that apply to companies that are also permitted to adopt low-threshold poison pills, outside shareholders in the United States would, overall, be at a significant disadvantage relative to their counterparts in other countries.

Therefore, to the extent that the Petition's supporters genuinely wish to draw from the experience of other jurisdictions, these considerations should also lead them to incorporate into any tightening of the SEC's rules under Section 13(d) a limitation applying the tightened rules only to companies that have charter provisions prohibiting the adoption of low-trigger poison pills. Even if the proponents of the Petition continue to insist upon rules that would facilitate low-threshold poison pills, the SEC should decline to pursue this objective. Given its mandate to protect investors, the SEC should ensure that it does not take any action that would harm public-company investors by facilitating the use of low-trigger poison pills.

VIII. CONCLUSION

Policymakers are now engaged in a significant debate over whether to tighten the rules governing the disclosure of accumulations of large blocks of stock in public companies. The Petition urging that these rules be tightened, however, is premised upon several factual assertions for which the Petition offers no empirical evidence. In this Article, we provide the first systematic empirical assessment of these assertions in order to contribute to the ongoing debate over whether changes to these disclosure rules are warranted.

We find that the evidence does not support some of the key factual claims on which the Petition relies. Although the Petition asserts that changes in trading technology over time have allowed activist investors to engage in significant acquisitions of stock above the five-percent threshold, the data show that the size of pre-disclosure accumulations of

57. *See, e.g.*, Emmerich et al., *supra* note 7, at 153 (noting the examples of Australia, the United Kingdom, Germany, France, Italy, and Spain).

58. *See* Bebchuk & Jackson, *supra* note 6, at 58.

stock has not increased over time. Thus, changes in the existing rules could be justified as necessary to address longstanding policy questions—but not as the "modernization" of the rules that the Petition claims is needed.

We also show that tightening the rules under Section 13(d) will carry considerable costs for investors that the SEC should consider, as changes to these rules would apply to a much larger group of non-activist investors than the activists on which the Petition focuses. Before making changes to the existing rules under Section 13(d), the SEC should evaluate the costs of any such changes for these non-activist investors. The evidence also shows that abnormal trading is concentrated on the day an activist investor crosses the five-percent threshold. This finding suggests that the practical difference in pre-disclosure accumulations between the existing ten-day window in the United States and the rules in countries with shorter disclosure windows—regimes held out as models for reform in the Petition—is likely significantly smaller than the Petition suggests. The pattern we identify also raises important questions for future research.

Finally, we have provided evidence on the recent proliferation of low-threshold poison pills—and the relevance of this development to any tightening of the SEC's rules under Section 13(d). Insiders' freedom to adopt such low-trigger poison pills, we have argued, suggests that the SEC should avoid adopting any reform that would facilitate the use of such pills to limit the stakes that outside investors can acquire in public companies. Thus, we have shown, if the SEC does choose to tighten the disclosure rules under Section 13(d), any such tightening should be applied only to companies that adopt corporate-law arrangements that preclude the adoption of low-trigger poison pills. Beyond these findings and policy implications, we have provided an empirical foundation on which the SEC, and future researchers, can build in evaluating the critical questions that will determine whether changing the existing rules governing blockholder disclosure is desirable. We hope that our analysis will be useful for the SEC and for other scholars as they pursue these important questions.

APPENDIX

I. DATA

The evidence presented in the Article is based on data drawn from filings pursuant to Section 13(d) of the Securities Exchange Act of 1934. Section 13(d) requires investors who are beneficial owners of more than five percent of any class of publicly traded securities to disclose their ownership within ten days of crossing the five-percent threshold.[59] All of the filings used to assemble the dataset are available on the SEC's website, and all of the data used in this Article are available upon request.

A. Dataset Assembly

As noted in the text, we used a top-down approach to construct a comprehensive sample of activism events that involve Section 13(d) filings by hedge funds during our sample period. We began with a list of all filers of Schedule 13D during our period and filtered this group through a list of activist hedge funds.[60] We identified hedge fund managers among the group of all filers based on the names and descriptions provided pursuant to Item 2 of Schedule 13D,[61] combined with Internet and news searches on the filers' identities.

Having identified the activist hedge funds to be included in our principal sample, we drew information on each event from every Schedule 13D filing. A Schedule 13D is a rich source of information, providing details on the identity of the filer, the shareholder's ownership, and the purpose of the investment.[62] As noted in the text, we collected this information for 2040 filings by activist hedge funds from 1994 through 2007. These data provide extensive detail on pre-disclosure accumulations for activist hedge funds during our sample period.

B. Constructed Variables

We then supplemented the information drawn from Schedule 13D filings with additional information on each activism event. Based upon our review of the description of the investment provided in the Schedule 13D,[63] we coded each event with a dummy variable indicating whether the investor had taken a hostile stance against the company's management, as well as variables indicating the purpose of the investment.[64]

---

59. *See* 17 C.F.R. § 240.13d-1 (2010).

60. Although there is no formal legal definition of a hedge fund, we adopt the generally accepted notion that a hedge fund is a pooled, private-investment vehicle that generally adopts performance-based compensation and is operated outside of the registration requirements of the federal securities laws.

61. *See* Sec. & Exch. Comm'n, Form of Schedule 13D, 17 C.F.R. § 240.13d-101 (2010) (outlining the information required in a Schedule 13D filing).

62. *Id.* Items 3–4.

63. *Id.* Item 4.

64. We classify an event as hostile if it involves open confrontation between the investor and the

We also supplemented the data drawn from Schedule 13D filings with variables addressing company-specific characteristics. To assess company size, we drew information on the ratio of the market capitalization of each company to the median value of all public companies at the end of the year prior to the Schedule 13D filing. We also included in our dataset the number of analysts covering the company at the end of the year prior to the Schedule 13D filing.[65] Building on previous work, we separately identified the relative liquidity of the market for each company's stock, using daily trading data, and included that information in our dataset as well.[66] We also supplemented the dataset with information on the size-adjusted stock returns of each company for the year before the Schedule 13D filing, adjusted for the value-weighted return of a portfolio of stocks of similar size. Finally, we drew information on the buy-and-hold returns for each company during the 20-day periods before and after the Schedule 13D filing that are in excess of the market return during the same period. These variables allowed us to control for both event-specific and company-specific characteristics in the analysis that follows.

II. Analysis

A. Determinants of the Time to Disclose

To explore the potential relationship between the number of days activists wait to file their disclosures under Section 13(d) and the percentage ownership that is revealed in those findings, we specified two types of multivariate regression models in which the dependent variable is the number of days that pass after the day on which the activist crossed the five-percent threshold before the activist disclosed its position under Section 13(d). Models (a) through (c) provide the estimated coefficients and standard identifiers of statistical significance for ordered logit models; models (d) through (f) describe the results for two-sided tobit models. Models (a) and (d) include the controls described in the table below, while models (b) and (e) introduce a dummy variable, described above, controlling for whether the activist's disclosure identified a hostile posture towards management. Models (c) and (f) include controls for dummy variables identifying the objective, if any, identified in the activist's filings, as well as controls for dummy variables identifying the tactics the activist used to pursue those objectives.

---

company's management. For example, when the hedge fund threatens to wage a proxy fight in order to gain board representation or to sue the company for breach of fiduciary duty, we classify these events as hostile. Hostility also involves events in which the hedge fund launches a proxy contest to replace the board, sues the company, or states that it intends to take control of the company.

65. We identify these analysts through the First Call analyst database. *See, e.g.*, Thomson Reuters: About the Firm, FIDELITY INVESTMENTS, *available at* http://research2.fidelity.com/fidelity/research/reports/release2/Research/ThomsonReutersIBES.asp (describing the database from which these data were derived) (last visited Jan. 13, 2014).

66. We use the Amihud measure as a proxy for market liquidity. *See* Yakov Amihud, *Illiquidity and Stock Returns: Cross-Section and Time-Series Events*, 5 J. FIN. MARKETS. 31, 32 (2002).

Table A1: Determinants of the Number of Days Until Activist Investors Disclose Their Positions

	Ordered Logit Models			Two-Sided Tobit Models		
	(a)	(b)	(c)	(d)	(e)	(f)
Hostile (Initial)		-0.27 [-1.58]			-1.25** [-2.25]	
MV Ratio to Median	0.10* [1.74]	0.10* [1.83]	0.11** [2.03]	0.34* [1.81]	0.36* [1.92]	0.40** [2.15]
Institutional Ownership	0.19 [0.76]	0.71 [0.70]	0.15 [0.62]	0.85 [1.01]	0.77 [0.92]	0.80 [0.97]
# Analyst (Log)	-0.07 [-0.92]	-0.07 [0.94]	-0.0 [-0.91]	-0.43 [-1.63]	-0.44* [-1.67]	-0.42* [-1.59]
Amihud Liquidity Measure	0.04 [0.33]	0.04 [0.30]	0.04 [0.30]	0.07 [0.18]	0.05 [0.12]	0.07 [0.18]
Stock Return (Size Adjusted)	-0.21** [-2.02]	-0.21** [-2.06]	-0.21** [-2.08]	-0.82** [-2.38]	-0.84** [-2.44]	-0.81** [-2.39]
Percentage Ownership at Filing	-1.53 [-1.55]	-1.44 [-1.46]	-1.63 [-1.58]	-4.94 [-1.45]	-4.54 [1.34]	-5.36 [-1.55]
Short-Run Abnormal Return	0.44** [2.03]	0.46** [2.12]	0.49** [2.24]	1.75** [2.36]	1.85** [2.51]	1.94** [2.64]
Year Fixed Effects?	Yes	Yes	Yes	Yes	Yes	Yes
Pseudo R^2	2.51%	2.60%	4.11%			
Observations	1,398	1,398	1,398	1,398	1,398	1,398

B. Determinants of Ownership Stakes upon Filing

To identify the factors that determine activist investors' ownership stakes at the time they disclose their positions under Section 13(d), we specified multivariate regression models in which the investor's percentage ownership at the time of the filing is the dependent variable. Model (c) includes controls for dummy variables identifying the objective, if any, identified in the activist's filings, as well as controls for dummy variables identifying tactics the activist used to pursue those objectives.

Table A2: Determinants of Hedge Fund Activists' Ownership Stake at the Time of Filing

	(a)	*(b)*	*(c)*
Hostile (Initial)		0.009** [2.05]	
MV Ratio to Median (Log)	-0.003* [-1.72]	-0.003* [-1.81]	-0.001 [-0.89]
Institutional Ownership	-0.003 [-0.43]	-0.002 [-0.36]	-0.002 [-0.36]
Number of Analysts (Log)	-0.002 [-1.04]	-0.003 [-1.59]	-0.002 [-1.06]
Amihud Liquidity Measure	0.008** [2.45]	0.008*** [2.49]	0.009*** [2.68]
Stock Return (Size Adjusted)	-0.004 [-1.34]	-0.003 [-1.27]	-0.003 [-1.19]
Short-Run Abnormal Return	0.006 [1.06]	0.005 [0.95]	0.002 [0.39]
Number of Days To Disclosure	-0.001* [-1.83]	-0.001* [-1.68]	-0.001* [-1.85]
Year Fixed Effects?	Yes	Yes	Yes
R^2	5.3%	5.6%	11.8%
Observations	1,398	1,398	1,398

As noted in the text, the analysis described in Table A2 offers no evidence suggesting that activists who wait longer to disclose under Section 13(d) emerge with larger stakes when they reveal their positions. In fact, as noted in Table A2, a longer time before disclosure is associated with *lower* ownership at the time of filing. This relationship is marginally statistically significant, but the economic magnitude is small: even the maximum variation of ten additional days to file is associated with just 0.6 percentage points less ownership. Nevertheless, the analysis described in Table A2 provides no support for the claim that investors who take longer to disclose their stakes under Section 13(d) emerge with larger positions when they eventually disclose their investments.

C. Activists' Ownership Stakes over Time

To explore whether activists have disclosed increasingly large stakes in excess of the five-percent threshold over time, we specified multivariate regression models in which the dependent variable is the percentage of ownership disclosed by the activists in our sample, controlling for the other potential determinants of that percentage described in Table A2 above. Unlike in those models, however, where we employed year fixed effects to control for the passage of time,[67] here we use a year-trend variable along with a dummy variable indicating whether the observation occurred in the last five years of our sample to examine whether the disclosed ownership percentage increases over time.

Table A3: Activists' Disclosed Stake Over Time

	(a)	*(b)*
MV Ratio to Median (Log)	-0.003** [-2.15]	-0.004** [-2.46]
Institutional Ownership	-0.004 [-0.53]	-0.001 [-0.15]
Number of Analysts (Log)	-0.002 [-0.80]	-0.002 [-0.78]
Amihud Liquidity Measure	0.006** [2.01]	0.006** [1.87]
Stock Return (Size Adjusted)	-0.004 [-1.38]	-0.004 [-1.31]
Short-Run Abnormal Return	0.005 [0.81]	0.004 [0.79]
Number of Days To Disclosure	-0.001* [-1.76]	-0.001* [-1.92]
Year Trend	-0.0001 [-0.20]	
Last Five Years of Sample Dummy Variable		-0.004 [-1.32]
Psuedo R^2	3.8%	3.9%
Observations	1,398	1,398

67. *See supra* Table A2 (noting that all three models use year fixed effects to control for the passage of time).