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Legislation Asks Activist Shareholders for Greater Transparency

By Lindsay Frost April 11, 2016

New legislation proposed in mid-March by Senators **Tammy Baldwin** (D-Wisc.) and **Jeff Merkley** (D-Ore.) seeks to give companies more prompt notification that activist investors are amassing a significant stake of shares in a specific company.

The Brokaw Act would force activist investors to disclose their investments through a 13D filing within two days after accumulating a 5% stake or more, as opposed to filing within 10 days as the current rules call for.

The act, which is co-sponsored by Senators **Bernie Sanders** (I-Vt.) and **Elizabeth Warren** (D-Mass.), would also force groups of investors working together to file as a single entity if their combined stakes reach 5%. The measure aims to prevent hedge funds from using the 10-day window to disclose as a means to confer with other investors and potentially join forces, according to a press release about the legislation.

"Currently, [the SEC] allows for this long time frame for investors to build a giant position that the rest of the market doesn't know about," says **Dennis Chookaszian** , former CEO and chair of **CNA Insurance** and current director at **CME Group**. "I'm a big fan of transparency in all regards. There's no reason to wait two weeks [to file a 13D]. When you've begun accumulating [stock], you know your intentions and I think you should disclose it."

Sources say this rule can be advantageous to boards and protect companies as it makes investor intentions clearer sooner. Meanwhile, some shareholders think there are few practical implications to this act and that it could thwart shareholder involvement in improving company strategy and performance.

The bill was named after Brokaw, Wisc., which went bankrupt after **Wausau Paper**, the town's largest employer, shut down. Activist fund **Starboard Value**'s pressure to sell the company resulted in its closure.

The 13D filing rules have been on the books since 1968, and sources say stakeholders have been asking for a change for a long time. The Dodd-Frank law already grants the **SEC** the authority to shorten the disclosure time frame, but the agency has not done so.

Faster Public Disclosure

Investors have pushed for more transparency from companies through speedier and more robust public disclosures in recent years, and corporate leaders say investors should be held to their own standard.

The faster disclosure time could be especially advantageous to boards, Chookaszian says, because it could give them more time to create a defense plan in the potential event of a proxy contest. “You have to give the board the opportunity to do its job,” Chookaszian says.

It could also benefit other shareholders. “If I were a shareholder ..., I would want to know if someone is acquiring the stock so as not to be an unfair advantage to building a position,” he says.

Bob Lamm, co-chair of law firm **Gunster**’s securities and corporate governance practice, adds that companies need more information on their investors in general, and “it’s fair that the issuer community should also have information about who is accumulating stock if the investors want more information too.”

Experts say the act would also make the filing system fairer for companies and investors, because SEC rules call for shorter filing windows for mandatory company filings.

“Bringing it down to two business days makes a lot of sense because, frankly, if you look at other Form 4 or 8-K filings for companies, those are all two or four business days, so why is this rule 10?” says **Doug Chia**, executive director of the **Conference Board**. “Investors say more disclosure is always better, and they have been pushing for faster disclosure times except when it comes to their own disclosures.”

However, those arguing against the act say quicker public disclosure would be a major roadblock in an investor’s plan, and that the bill is an attempt to allow corporations to avoid accountability for certain actions.

“This legislation is another attempt to try to curb activism without regard to its value and the underlying facts of most activist situations,” writes **Marc Weingarten**, partner and co-chair of the global shareholder activism group at **Schulte Roth & Zabel**, in an e-mail. “The ten-day reporting window was not adopted because people lacked the ability to file sooner; it was determined to be a fair amount of time before the report needed to be made. Nothing has changed since then. The only reason to shorten the window is to limit what activists buy in order to limit their influence.”

Nick Donatiello , a lecturer at **Stanford**; president and CEO of **Odyssey**, a research firm that specializes in home entertainment and technology; and a director at **Dolby Laboratories**, says the SEC should be careful about forcing institutional investors into the limelight through limiting the disclosure window.

“The SEC shouldn’t put institutional investors in a position where those that are looking to be long-term holders of a stock can’t accumulate a position before having to signal to the market that they are doing so,” Donatiello says. “It would make these investors more careful about investing in smaller-cap, low-float companies, and that’s not good.”

Wolf Packs and Derivatives

The bill also addresses the possibility of “wolf packs” — groups of investors who are interested in making changes at a company but do not overtly announce a partnership and secretly work together to enact the change without filing mandatory group 13Ds. The bill would more clearly define what a “group” entails in 13D filing rules.

Wolf packs create more pressure on companies, Chookaszian says. Forcing these groups to file together through this rule will allow a company to be better prepared. Lamm also commends the SEC for addressing wolf packs.

“The definition of a group in current 13D rules is kind of loose; there are some filers that apply the definition more liberally,” Lamm says.

“There needs to be a mechanism in determining what level of communication and cooperation constitutes a wolf pack; people shouldn’t avoid these rules by acting in concert,” Donatiello adds.

However, those against the rule argue that the wolf-pack portion of the proposal may deter union, pension fund and institutional investor involvement with activists because they wouldn’t want the public exposure. The overall effect would be negative for improving company performance and governance.

“The only thing that adding ‘wolf packs’ to the mix does is to attempt to intimidate shareholders from speaking to one another and exchanging ideas,” writes **Eleazer Klein**, partner and co-chair of the global shareholder activism group at Schulte Roth & Zabel, in an e-mail.

Another part of the act would require an activist hedge fund to disclose the derivatives it has in connection with the company — including net shorts. This would make the company and other shareholders aware if the fund was betting against the company because it stands to profit from losses.

“Investors use these positions as a tool for a sneak attack,” the Conference Board’s Chia says.

The SEC will no doubt review many issues before enacting the Brokaw Act. How institutional investors view different disclosure window time frames, clearly defining what wolf packs are and determining if companies have enough lead time to address investor concerns are among the most prominent issues to consider.

Sources interviewed for this story agree that the bill is unlikely to pass this year, but that it opens the door to future discussions.

“Whether it will actually pass is hard to say,” says Chia. “It’s hard to be optimistic because efforts in the past have proven to be futile.”

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