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September 24, 2009

SEC Publishes Section 13(d) and 13(g) Compliance & Disclosure Interpretations

On September 14, 2009, the staff of the Division of Corporation Finance of the Securities and Exchange Commission published new and updated interpretations regarding Sections 13(d) and 13(g) of the Securities Exchange Act, Regulation 13D-G, and Schedules 13D and 13G. The interpretations, which replace and revise those included in the July 1997 Manual of Publicly Available Telephone Interpretations, are in the form of 37 questions and answers and are available here.

The interpretations address a variety of issues that have arisen in connection with the filing of Schedules 13D and 13G, including events which trigger a filing, timing for initial filings and amendments, eligibility to utilize Schedule 13G, calculations of outstanding share amounts, reporting obligations applicable to debt securities, accidental purchases, involuntary changes in percentage ownership resulting from changes in the number of outstanding securities, formation of groups, effects of short sales, and the steps to be taken upon a failure to make a timely filing. They generally memorialize longstanding positions of the Staff previously communicated in no-action letters and oral conversations with counsel over the years and address various scenarios affecting the requirements of Schedule 13D and the three types of Schedule 13G described in Rule 13d-1 – for institutional investors under Rule 13d-1(b), passive investors under Rule 13d-1(c) and for other holders of five percent or more of a public equity security under Rule 13d-1(d).

Noticeably absent, however, is any guidance relating to the appropriate treatment of equity securities underlying cash-settled derivatives such as the total return swaps at issue in *CSX Corp. v. The Children's Investment Fund Management* (S.D.N.Y. June 11, 2008), which is discussed in our June 13, 2008 memorandum titled "Ruling Creates Uncertainty Under Section 13(d)."

The Staff included several interpretations addressing questions in connection with an involuntary or unintentional crossing of the five percent beneficial ownership threshold. For example, in interpretation 103.08, the Staff indicated that if an investor becomes the holder of more than five percent of a class of outstanding equity securities as a result of an involuntary change to the number of outstanding securities,

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such as a stock repurchase, the investor is still required to timely file a beneficial ownership report under Rule 13d-1(d). In this circumstance, because the crossing of the five percent threshold was not the result of an “acquisition” of securities, the investor may file a short-form Schedule 13G pursuant to Rule 13d-1(d) within 45 days after the end of the year of the stock repurchase, rather than a more detailed and immediate Schedule 13D or a passive acquisition Schedule 13G pursuant to Rule 13d-1(c), each of which requires a filing within 10 days of crossing the threshold. In this context, control intent by the investor is not relevant (unlike the requirements relevant to the eligibility of institutional investors or passive investors to file on Schedule 13G following an acquisition of securities). However, the Staff takes the position that a Schedule 13D would be required if the investor is a person (such as an officer or director) who influences or controls the decision to change the number of outstanding securities.

With respect to amendments, interpretation 103.08 confirmed that, under Rule 13d-2(a), an investor who had already filed a Schedule 13D would be required to file an amendment to reflect any material change in ownership (which, under the Rule, always includes changes of one percent or more of the outstanding shares) that resulted from the change in the number of outstanding securities regardless of whether such person influences or controls the action which resulted in the change to the number of outstanding securities. Under the same circumstances, Rule 13d-2(b) provides that an investor who had previously filed a Schedule 13G would not have to file a year-end amendment. The Staff did not, however, indicate whether an institutional or passive investor that had filed a Schedule 13G under Rule 13d-1(b) or (c) would be required to file an amendment under Rule 13d-2(c) or (d) (which contain separate requirements to amend those types of Schedule 13G if the filer’s ownership position exceeds ten percent or increases by five percent).

Interestingly, in interpretation 103.09, the Staff also took the position that the receipt of securities in a spin-off that did not require the approval of the parent’s security holders does not constitute an "acquisition" within the meaning of Rule 13d-1. As such, an investor whose ownership crosses the five percent threshold as a result of such a spin-off may file a Schedule 13G pursuant to Rule 13d-1(d) within 45 days following the end of the year, rather than a Schedule 13G pursuant to Rule 13d-1(c) or a Schedule 13D within 10 days following the spin-off, unless the investor influences or controls the parent’s decision to effect the spin-off.

In interpretation 101.06, the Staff advised that an investor must file a beneficial ownership report if its broker purchased in excess of five percent of an outstanding class of equity securities even if the investor specifically directed the broker to purchase only up to 4.9% of the shares, did not pay for the additional securities and instructed the broker to sell the excess shares. In that case, an acquisition of more than five percent of the stock has occurred and intent is irrelevant. Whether the investor has to file a Schedule 13D or a Schedule 13G would depend on whether the investor met the institutional investor or passive investor requirements of Rule 13d-1(b) or (c) for Schedule 13G.

In interpretation 103.07, the Staff took the position that an investor that was originally required to file on Schedule 13D (for example, if it has acquired more than five percent with non-passive intent) may not later switch to a Schedule 13G even if its intent becomes passive. In contrast, the Staff explained that, under Rule 13d-1(h), an investor who was eligible to file on a Schedule 13G and was thereafter required to file a Schedule 13D may switch back to a Schedule 13G if the investor subsequently reestablishes passive intent. This interpretation does not specifically address whether an investor who is eligible to file a Schedule 13G, but who voluntarily (or out of an abundance of caution) makes an initial filing on Schedule 13D, may switch to a Schedule 13G at a later date.

The Staff also addressed reporting questions that have arisen when an investor reduces its economic exposure to shares reported on a Schedule 13D or Schedule 13G. For example, in interpretation 104.01, the Staff explained that a short sale does not result in a change in beneficial ownership for purposes of Schedules 13D or 13G because the investor continues to have "voting or investment power" over the shares. The Staff noted, however, that if the investor had filed a Schedule 13D, it may need to amend its filing to address other disclosure requirements such as a change in investment purpose, source of funds or the existence of a contract with respect to the securities of the issuer (and attach a copy of that contract). In interpretation 104.07, the Staff concluded that if an investor reporting on Schedule 13D sells all of its securities after the record date for a shareholder meeting, but before the date of the meeting, it should promptly file an amendment to report the sale of more than one percent of the outstanding securities, but that it should not file a final amendment until after the meeting because it continues to have the right to vote the securities.

In interpretation 110.07, the Staff is critical of the practice of utilizing Schedule 13D disclosures as a vehicle for influencing proxy solicitations without complying with the proxy rules. The Staff notes that investors must analyze their Schedule 13D disclosures and exhibits to determine whether any disclosures or communications (such as letters expressing opposition to a merger for which shareholder approval is being sought) reasonably constitute soliciting material subject to the proxy rules and require additional filings under Regulation 14A.

Finally, the Staff reiterated (in interpretation 110.06) that a "plan or proposal" requiring an amendment to Item 4 of an investor's Schedule 13D is not deemed to exist only upon execution of a formal agreement or commencement of a tender offer, solicitation or similar transaction. According to the Staff, Item 4 must be amended when the investor has formulated "a specific intention" with respect to a disclosable matter, despite the existence of generic disclosure reserving the right to engage in any of the kinds of transactions enumerated in Item 4.

The updated compliance and disclosure interpretations usefully put in one place various interpretations concerning the requirements of Schedule 13D and Schedule 13G, including several interpretations that had not previously been issued in written form. While much of what is contained in the interpretations will not come as a surprise, the Staff's issuance of revised interpretations, its refinement of certain positions,

and its emphasis on the need for investors to consider when they must amend their filings reflects the increased emphasis the Staff, including the Division of Enforcement, has placed on beneficial ownership reporting over the past several years.

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If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or the attorneys listed below.

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