



SEC Proposes Readoption of Rules 13d-3 and 16a-1 Regarding Beneficial Ownership in Light of Dodd-Frank

March 24, 2011

On March 17, 2011, the Securities and Exchange Commission (the “SEC”) proposed to readopt, without change, certain portions of Rules 13d-3 and 16a-1 (the “Rules”) under the Securities Exchange Act of 1934 (the “Exchange Act”).¹ The proposed readoption of the Rules is intended to preserve the existing application of the beneficial ownership rules promulgated under Sections 13 and 16 of the Exchange Act (the “Beneficial Ownership Rules”) to security-based swaps following the effectiveness of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The SEC is soliciting comments on the proposed readoption through April 15, 2011.

A. THE CONCERN DRIVING READOPTION

The SEC proposes to readopt the Rules to prevent potential confusion regarding the applicability of the existing Rules in light of Section 766 of the Dodd-Frank Act, which amends the Exchange Act by adding new Section 13(o) (effective July 16, 2011). This new Section 13(o) provides that a person shall be deemed to acquire “beneficial ownership” of an equity security based upon the purchase or sale of a security-based swap

“only to the extent that the Commission, by rule, determines after consultation with the prudential regulators and the Secretary of the Treasury, that the purchase or sale of the security-based swap . . . provides incidents of ownership comparable to direct ownership of the equity security, and that it is necessary to achieve the purposes of this section that the purchase or sale of the security-based swaps . . . be deemed the acquisition of beneficial ownership of the equity security.”

The Proposing Release notes the possibility that, absent further clarification, Section 766 “may be interpreted to render the beneficial ownership determinations made under Rule 13d-3 inapplicable to a person who purchases or sells a security-based swap” and may also have similar consequences in the determination of a 10% holder under Section 16 of the Exchange Act. The readoption of the Rules is intended to preserve the *status quo*.

¹ *Beneficial Ownership Reporting Requirements and Security-Based Swaps*, Release No. 34-64087, available at <http://www.sec.gov/rules/proposed/2011/34-64087.pdf> (the “Proposing Release”).

B. APPLICABILITY OF EXISTING BENEFICIAL OWNERSHIP RULES TO SECURITY-BASED SWAPS

The Proposing Release also discusses the Beneficial Ownership Rules' existing applicability to security-based swaps. Sections 13(d) and 13(g) of the Exchange Act require a person who beneficially owns more than 5% of any class of equity securities registered pursuant to Section 12 of the Exchange Act to disclose information relating to such beneficial ownership. The Proposing Release notes that, under the existing Beneficial Ownership Rules, the holder of a security-based swap may be subject to Section 13 beneficial ownership reporting to the extent the swap "confers voting and/or investment power (or a person otherwise acquires such power based on the purchase or sale of a security-based swap), grants a right to acquire an equity security, or is used with the purpose or effect of divesting or preventing the vesting of beneficial ownership as part of a plan or scheme to evade the reporting requirements."

A person who beneficially owns more than 10% of a class of equity securities as determined pursuant to Rule 13d-3 is subject to the reporting requirements of Section 16(a) and to potential short-swing profit liability under Section 16(b). Once a person is subject to Section 16, reporting obligations and short-swing profit recovery are based on a different definition of beneficial ownership, which includes any equity securities in which the person has or shares a direct or indirect pecuniary interest. Pecuniary interest is defined as "the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities." The Proposing Release notes that, under existing rules, fixed-price derivative securities, including security-based swaps (whether settled in cash or stock), create a pecuniary interest in the underlying securities.

Although its focus is security-based swaps, the Proposing Release also notes that other equity-linked rights, options, warrants, or conversion or certain revocation privileges that are acquired or held independently of a security-based swap will remain subject to the Beneficial Ownership Rules.

While the readoption of the Rules is intended to preserve the current interpretation, enforcement and applicability of the Beneficial Ownership Rules after the effectiveness of Section 766 of the Dodd-Frank Act on July 16, 2011, the Proposing Release notes that the SEC staff is engaged in a separate project to develop proposals to modernize beneficial ownership reporting. Accordingly, additional rulemaking initiatives from the SEC in this area may be forthcoming.

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For more information about the SEC proposal, please contact a member of the Firm's Derivatives Group or Capital Markets and Securities Group.

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