Council of Institutional Investors®
The voice of corporate governance

Via email

October 5, 2023

Ms. Vanessa A. Countryman, Secretary
Securities & Exchange Commission
100 F Street, N.E.
Washington, D.C. 20459

Re: Rulemaking Petition from the Working Group on
Investor Protection in Public Offerings, File No. 4-801

Dear Ms. Countryman:

The Council of Institutional Investors ("CII" or the "Council") is pleased to submit these comments in support of this rulemaking petition, and we respectfully urge the Commission to issue a proposed rule as promptly as possible.

CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $5 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4.8 trillion in assets, and a range of asset managers with more than $55 trillion in assets under management.[1]

The rulemaking petition, filed by a working group of academics, former SEC officials and legal scholars, proposes that the Commission amend Rule 144 to limit sales of unregistered securities after the effectiveness of a registration statement. Specifically, the petition recommends the adoption of a holding period after that date as a means of balancing the interests of issuers and early investors in being able to sell unregistered shares against the interest of public shareholders in having an effective remedy under Section 11 of the Securities Act. The petition is available at https://www.sec.gov/files/rules/petitions/2023/petn4-801.pdf.

The Council has a strong interest in effective investor protections and has previously filed comments on proposed changes in exchange rules affecting direct listings of securities. Although the Council supports the adoption of a rule in this area, it l does not have a specific recommendation regarding the appropriate period of time for a holding period, but the petition provides a useful starting point for such a discussion by proposing a holding period that would be

[1] Additional information about the Council of Institutional Investors, including its board and members, is available on CII's website at http://www.cii.org.

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the later of: (1) 90 days after the effectiveness of the registration statement; or (2) the filing of the next Form 10-Q or Form 10-K after that date.

Discussion

Section 11 of the Securities Act provides a bedrock protection for investors in new, publicly traded companies by creating "virtually absolute" liability for companies, their directors, underwriters and advisors if there is any misrepresentation or omission of any material information in a registration statement. *Herman & MacLean & Huddleston*, 459 U.S. 375, 382 (1983).

A threshold requirement for any investor who seeks to file a Section 11 claim is establishing that the investor has standing to sue, *i.e.,* that the investor purchased shares pursuant to the registration statement. Differently put, the securities purchased by the investor must be "traceable" to the specific registration statement claimed to be false or misleading. This was the holding of a leading case written by Judge Henry Friendly, *Barnes v. Osofsky,* 373 F.2d 269 (2d Cir. 1967), an approach that was adopted by other federal appellate courts in Section 11 cases.

Traceability issues have traditionally not been an issue in Section 11 cases because underwriters generally required a lockup period of 180 days for insiders and early investors after the effectiveness of a registration statement. This lockup period prevented insiders and early investors from selling unregistered shares that they had acquired before the public offering. Once any such unregistered shares were sold into the marketplace, traceability could present a problem for investors.[2]

For a while, this traditional IPO practice worked to protect investors, but the lockup period was an industry practice, not a requirement. As the petition points out, investor protections became significantly eroded over the past decade by two developments:

First, underwriters became increasingly willing to waive lockup periods and to allow the sale of unregistered shares alongside shares registered during the IPO; and

Second, companies began utilizing direct listings of shares, which allowed insiders and early investors to sell their pre-existing, unregistered shares alongside shares offered pursuant to a registration statement.[3]

The issues presented by these changes came into sharp focus earlier this year when the U.S. Supreme Court affirmed the traceability requirement articulated in *Barnes* over 50 years ago. In *Slack Technologies LLC v. Pirani,* 143 S. Ct. 1433 (U.S. 2023) the Court overturned a lower

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[2] However, Law Professors John C. Coffee, Jr., and Joshua Mitts argue in a recent *amici curiae* that it is possible to establish traceability through transactional records using modern computing power. Brief for Amici Curiae Law and Business Professors in Support of Respondent, *Slack Technologies, LLC, fka Slack Technologies, Inc., et al., v. Fiyyaz Pirani*, No. 22-200, 2023 WL 2439655 (March 6, 2023).

[3] *See e.g.,* The Further Erosion of Investor Protection with Andrew Tuch, Voice Corp. Governance (Dec. 2022), *available at* https://www.cii.org/podcasts (discussing research about Section 11 of the Securities Act of 1933 and the erosion of investor protections as a result of a number of market developments, including direct listings).

court decision that departed from *Barnes* by narrowing the traceability requirement imposed on plaintiffs in Section 11 cases.

What all of this means is that the important investor protections in Section 11 have been significantly undermined, and it is time for the Commission to update the regulatory framework to address current conditions.

On numerous occasions over the past decade, the Council has urged the Commission to address the issue comprehensively, by adopting "proxy plumbing" regulations.[4] It has now been 13 years since the Commission issued a concept release inviting public comment on the need to enhance the accuracy and integrity of the shareholder voting process, including traceability issues of the sort presented here.[5] The Council continues to believe that an update of those rules would be the best way forward.

Nonetheless, as the *Slack Technologies* decision makes clear, there is a need for the Commission to mandate a required holding period after the effectiveness of a registration statement. There can be no doubt as to the Commission's legal authority to adopt this change. As the petition notes (at pp. 5-6), the Commission has at various times amended timing considerations in light of market developments in securities-offering practices; indeed, former SEC Chairman Jay Clayton and former SEC Commissioner Joseph A. Grundfest filed a brief as *amici curiae* in *Slack Technologies* in which they agreed that the Commission has this authority.[6] And during the *Pirani* argument, Supreme Court Justice Brett Kavanaugh noted the company's view that "we should leave it to the SEC and/or Congress, rather than ourselves, kind of departing from that longstanding body of law."

The Council does not have a specific recommendation as to the length of time a holding period should last. The suggestion in the petition of "90 days or the first 10-Q or 10-K filing" would seem to be a useful starting point for the receipt of public comments on an important topic.

Respectfully submitted,

Jeffrey P. Mahoney
General Counsel

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[4] *See, e.g.,* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission (January 16, 2020), available at https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-6660338-203855.pdf (urging SEC approval of proxy plumbing reform before approving NYSE direct listing proposal).

[5] SEC Release No. 34-62495, *Concept Release on the U.S. Proxy System* (July 14, 2010),75 Fed. Reg. 42982, available at http://sec.gov/rules/concept/20 IO/34-62495fr.pdf.

[6] Brief for Amici Curiae The Honorable Jay Clayton and the Honorable Joseph A. Grundfest in Support of Petitioners, S. Ct. No. 22-200, available at https://www.supremecourt.gov/DocketPDF/22/22-200/253996/20230203160500846_Brief%20of%20Amici%20Curiae%20The%20Honorable%20Jay%20Clayton%20and%20The%20Honorable%20Joseph%20A.%20Grundfest%20in%20Support%20of%20Petitioners.pdf.