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Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20459

CSX v. TCI, et al.

Dear Mr. Cartwright:

At the request of CSX Corporation, we write to address the questions posed to the Commission by The Honorable Lewis Kaplan in the above-titled litigation, and to respond, at least in part, to the related letter submitted to the Commission by Professor Bernard Black dated May 29, 2008. We believe Judge Kaplan's questions raise issues of importance for the markets and urge the Commission to consider our views as it formulates its response to the Court and considers its own actions.

After briefly describing our credentials (see Section I below), we describe the focus of this letter and summarize our view regarding the Commission's potential response to the Court's inquiry (see Section II below). In Section III of this letter, we address the anti-evasion prong of the beneficial ownership test, Rule 13d-3(b), and explain how Defendants' actions in this case clearly violate the Rule's anti-evasion provision. Our analysis, as described in Section III, allows the Commission and Court to distinguish legitimate uses of cash-settled equity swaps from applications that violate the anti-evasion provisions of Rule 13d-3(b). In Section IV, we explain a few of the problems with Professor Black's analysis. Finally, we explain how our approach promotes values consistent with those embodied in Section 13 and in the federal

securities laws more broadly (see Section V below), and set forth our conclusions (see Section VI below).

In sum, we urge that the Commission respond to Judge Kaplan’s inquiry with an interpretation of Rule 13(d) that simultaneously respects the language of the Rule as it currently stands yet emphasizes that Defendants, in clear violation of Rule 13d-3(b), engaged in a “scheme to evade the reporting requirements of section 13(d) or (g) of the Act”. As explained in detail below, Defendants engaged in six distinct forms of conduct that, taken together, establish a “scheme to evade the reporting requirements” as opposed to a legitimate, good-faith structuring of a transaction that relies on derivative market contracts in order legitimately to avoid Section 13(d) reporting requirements.

More precisely, the six factors present in this case that, taken together, are clearly sufficient to establish evasion are:

1. Defendants acquired a position in the derivative markets that, if held in the form of the registrant’s voting equity, would trigger a disclosure requirement. (We emphasize that this factor constitutes a necessary but insufficient condition for a violation of Rule 13d-3(b)’s anti-evasion provision.);
2. Defendants engaged in efforts to influence corporate management in a manner consistent with a course of conduct typical of activist shareholders holding positions in excess of five percent of a registrant’s voting equity who are required to file pursuant to Section 13(d);
3. Defendants engaged in efforts with the purpose or effect of influencing the voting position of counterparties who, by virtue of the foreseeable equity hedges held as a result of the equity swap positions at issue, own the registrant’s voting shares;
4. Defendants caused a pre-positioning of the registrant’s voting shares in a manner that materially facilitates the rapid and low-cost acquisition of a reportable position upon the termination or other unwind of the derivative transactions at issue;
5. Defendants caused the derivative positions at issue to be structured in a manner calculated to prevent counterparties from becoming subject to disclosure obligations under the Federal securities laws; and
6. The information regarding Defendants’ activities withheld from the market (e.g., Defendant’s equity or derivative positions) is material.

We respectfully submit that these factors demonstrate that Defendants have engaged in a “scheme to evade the reporting requirements of section 13(d) or (g) of the Act”, and have violated Rule 13d-3(b). We further suggest that if the foregoing conduct

does not constitute a “scheme to evade the reporting requirements of section 13(d) or (g) of the Act”, then Rule 13d-3(b) is rendered a nullity. Indeed, if the conduct present in this case does not constitute a “scheme to evade the reporting requirements of section 13(d) or (g) of the Act”, then we would respectfully request that the Commission describe the additional facts and circumstances that would be necessary to establish an evasion.

We believe that the factors on which we rely allow the Commission to address the obvious evasion of Rule 13(d)’s reporting requirements presented on the facts of this case without causing any dislocation of larger, well established market practices in the international markets for derivative securities.¹ Indeed, Defendants have presented no evidence that the narrow approach we advocate in this letter will have any adverse effect whatsoever on the operation of capital markets, and we believe that no such adverse effect exists.

I. Our Backgrounds and Credentials

Professor Joseph A. Grundfest: Professor Grundfest is a nationally prominent expert on capital markets, corporate governance, and securities litigation. His scholarship has been published in the Harvard, Yale, and Stanford law reviews, and he has been recognized as one of the most influential attorneys in the United States. Professor Grundfest’s article, The Limited Future of Unlimited Liability: A Capital Markets Perspective, 102 Yale L. J. 387 (1992), describes in detail the ability to use derivative instruments to synthesize equity positions for a wide range of purposes, and anticipates by more than a decade much of the current controversy regarding the application of derivative market transactions. Professor Grundfest founded the award-winning Stanford Securities Class Action Clearinghouse, which provides detailed, online information about the prosecution, defense, and settlement of federal class action securities fraud litigation. He also launched Stanford Law School’s executive education programs, and continues to co-direct Directors’ College, the nation’s leading venue for the continuing professional education of directors of publicly traded corporations. Professor Grundfest’s courses at Stanford cover equity swap market transactions, equity forwards, options, and credit derivative transactions. In addition, he co-directs the Arthur and Toni Rembe Rock Center for Corporate Governance, as well as the Stanford Program in Law, Economics, and Business.

Before joining the Stanford Law School faculty in 1990, Professor Grundfest was a Commissioner of the Securities and Exchange Commission, served on the staff of the President’s Council of Economic Advisors as counsel and senior economist for legal and regulatory matters, and was an associate at Wilmer, Cutler & Pickering. Early in his

¹ While the factors discussed herein lead us to the firm conclusion that Defendants engaged in a plan or scheme to evade the reporting requirements, it does not necessarily follow that these factors are necessary elements of a violation under Rule 13d-3(b). Their combined presence here merely underscores the point that Defendants’ conduct was plainly in the zone of a plan or scheme to evade the reporting requirements.

career, he was a research associate at the Brookings Institution, and an economist and consultant with the RAND Corporation.

Professor Henry T. C. Hu: Professor Hu holds the Allan Shivers Chair in the Law of Banking and Finance at the University of Texas Law School. He has written on such matters as the corporate objective and fiduciary duty, the “decoupling” of shareholder voting rights from economic ownership, hedge fund and derivatives dealer behavior and regulation, investor illiteracy and mutual fund disclosure, corporate risk management and the hedging question, swaps and other financial innovations, time diversification and asset allocation, and Warren Buffett. The writings have appeared in law reviews (e.g., Columbia Law Review, University of Pennsylvania Law Review, and Yale Law Journal), specialist journals (e.g., Business Lawyer, Journal of Applied Corporate Finance, and Risk), and newspapers (i.e., Financial Times, Finanz und Wirtschaft, and New York Times). In 1996, an exchange-traded index derivative with the ticker symbol “HUI” (in recognition of one of his derivatives articles) was introduced. Today, the HUI is one of the world’s two key gold equity indices (according to a Financial Times story). Four times, an article as to which he was the sole or lead author was selected as one of the “Top 10 Corporate and Securities Articles” of the year in a nation-wide poll of law professors: 1996, 1997, 2000, and 2006. Professor Hu is the lead author (with Professor Bernard Black as co-author) of writings considered seminal to scholarship on “decoupling,” including: (1) The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership, 79 S. Cal. L. Rev. 811 (2006) (“Hu & Black (2006)”); and (2) Equity and Debt Decoupling and Empty Voting II: Importance and Extensions, 156 U. Pa. L. Rev. 625 (2008) (“Hu & Black (2008)”).

Professor Hu teaches subjects such as corporate law and securities regulation. He has also taught these subjects at Harvard Law School, where he served as the Bruce W. Nichols Visiting Professor of Law for the 1997-98 academic year. He was elected to the American Law Institute in 1991, was elected to a year term as the chair of the Association of American Law Schools’ Business Associations Section in 1996, and was appointed to the Legal Advisory Board of the National Association of Securities Dealers (now the “Financial Industry Regulatory Authority” or “FINRA”) in 2000, the NASD’s e-Brokerage Committee in 2001, the NASD’s Market Regulation Committee in 2006, and the NASDAQ Market Regulation Committee in 2007. In May 2007, he was appointed to the Editorial Board of the Capital Markets Law Journal (published by the Oxford University Press). He has testified before Congress on the collapse of the hedge fund Long Term Capital Management and on the regulatory implications of the New York Stock Exchange going public. He has also testified before the Securities and Exchange Commission on “equity decoupling” issues (e.g., “empty voting” and “hidden (morphable) ownership”). Professor Hu holds a B.S. (Molecular Biophysics & Biochemistry), M.A. (Economics), and J.D., all from Yale.

Professor Marti G. Subrahmanyam: Professor Subrahmanyam is the Charles E. Merrill Professor of Finance and Economics in the Stern School of Business at New York University. He holds a degree in Mechanical Engineering from the Indian Institute of Technology, Madras, a post-graduate diploma in Business Administration from the

Indian Institute of Management, Ahmedabad, and a doctorate in Finance and Economics from the Massachusetts Institute of Technology. Professor Subrahmanyam has published numerous articles and books in the area of corporate finance, capital markets and international finance. He has been a visiting professor at leading academic institutions in Australia, England, France, Universita Guido Carli LUISS, Rome, Italy, Singapore Management University and Churchill College, Cambridge University. He also sits on the boards of several companies including the ICICI Bank Ltd. (NYSE:IBN), Infosys Technologies Ltd. (NASDAQ:INFY), Metahelix Life Sciences (P) Ltd, Nomura Asset Management Inc., and the board of advisers of Apollo Management L.P. He serves as an advisor to international and government organizations including the Securities and Exchange Board of India.

Professor Subrahmanyam currently serves or has served as an Associate Editor of the *European Financial Management*, *Journal of Banking and Finance*, *Journal of Business and Accounting*, *Journal of Finance*, *Management Science*, *Journal of Derivatives*, *Journal of International Finance and Accounting*, and *Japan and the World Economy*. He is the Editor of an academic journal specializing in derivative securities and markets entitled *Review of Derivatives Research*. His research interests include valuation of corporate securities, options and futures markets, equilibrium models of asset pricing, market microstructure and the term structure of interest rates. He has published several papers in these areas in many of the leading international journals in economics and finance, including *Econometrica*, *The Quarterly Journal of Economics*, *Journal of Finance*, *Journal of Financial Economics*, and *The Review of Financial Studies*. His recent books include *Recent Advances in Corporate Finance* (Irwin, 1985) and *Financial Options: From Theory to Practice* (Dow Jones-Irwin, 1992). He is currently working on a new book, *Interest Rate Derivative Products*.

II. The Issue We Address and Our Conclusion

In a letter to the Commission dated May 23, 2008, Judge Kaplan requested the SEC's views on two issues in the pending litigation between CSX and TCI and 3G.² Those questions are: (1) Did Defendants have beneficial ownership, within the meaning of Regulation 13D, of the CSX shares held by their cash settled total return equity swap counterparties; and (2) What mental state is required to establish the existence of a plan or scheme within the meaning of Rule 13d-3(b)?

Apparently at the request of TCI and 3G, Professor Bernard Black of the University of Texas submitted a letter to the SEC on May 29, 2008, offering his opinions

² "CSX" refers to plaintiff CSX Corporation. "TCI" collectively refers to defendants The Children's Investment Fund Management (UK) LLP, The Children's Investment Fund Management (Cayman) Ltd., and The Children's Investment Master Fund. "3G" collectively refers to defendants 3G Capital Partners Ltd., 3G Capital Partners, L.P., and 3G Fund L.P. Like Professor Black, we focus on the TCI defendants; references herein generally to "Defendants" refer to them.

with respect to Judge Kaplan's questions. Professor Black appears to conclude, among other things, that cash-settled equity swaps cannot confer beneficial ownership within the meaning of Rule 13d-3. Significantly, Professor Black does not take the position that equity swaps can never be used as part of a scheme to evade Section 13(d) in violation of Rule 13d-3(b). Indeed, to take such a position would be to assume that there is a "safe harbor" under Section 13(d) for the application of equity swaps that does not apply to other capital market instruments -- a position for which there is absolutely no support in the law and that, if adopted, would eviscerate Rule 13d-3(b).

Further, to the extent Professor Black concludes categorically that an arrangement involving cash-settled equity swaps cannot under any circumstances confer beneficial ownership under Rule 13d-3(a), we disagree. Under Rule 13d-3(a), a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares: (1) Voting power, which includes the power to vote, or to direct the voting of, such security; and/or (2) Investment power, which includes the power to dispose, or to direct the disposition of, such security. A person is the beneficial owner of a security even if it only indirectly shares the power to direct the voting or disposition of the security. The rule has been interpreted to confer beneficial ownership upon a person who has the ability significantly to influence the voting or disposition of security.³ There is no reason why, in an appropriate case, an arrangement relating to cash-settled equity swaps, or a relationship with a counterparty, could not confer upon a swap holder the ability significantly to influence the voting or disposition of security.

As we believe the Commission is aware, Professor Subrahmanyam has explained that TCI's swap arrangements gave it the ability effectively to determine the acquisition, holding, and disposition of CSX shares by its swap counterparties and, as a result, the ability significantly to influence the voting of those shares. Professor Subrahmanyam explained that the economics of the swap business dictate that hedge fund managers expect the counterparties to their large equity swaps to hedge their exposure with matching physical shares and that this was in fact what happened with TCI: "[t]here is a direct -- indeed, essentially perfect -- correlation between TCI's purchases and sales of

³ Beneficial ownership is "interpreted ... broadly" and includes the "ability to control or influence the voting or disposition of the securities". Interpretive Release Applicable to Insider Reporting and Trading, Exchange Act Release No. 34-18114, 46 Fed. Reg. 48147-01 (Oct. 1, 1981) (emphasis added); Cavalry Holdings, Inc. v. Chandler, 948 F.2d 59, 63 (1st Cir. 1991) (Section 13(d) concentrates on those individuals with the ability to influence voting or disposition of the securities); SEC v. Drexel Burnham Lambert Inc., 837 F. Supp. 587, 607 (S.D.N.Y. 1993) (beneficial ownership "inquiry focuses on any relationship that, as a factual matter, confers on a person a significant ability to affect how voting power or investment power will be exercised").

large swap positions and purchases and sales by its swap counterparties of matching physical CSX shares.” (Rebuttal Expert Report of Marti G. Subrahmanyam ¶ 3.)⁴

Our disagreement with Professor Black on this point is not, however, the focus of this letter. We focus instead on what we perceive to be the primary concern of Judge Kaplan’s letter to the Commission: the evasion prong of the beneficial ownership test, Rule 13d-3(b). Nothing in Professor Black’s letter suggests that the evasion prong of the beneficial ownership test cannot be applied to a plan or scheme to evade the reporting requirement using cash-settled equity swaps. Treating cash-settled equity swaps as exempt from Rule 13d-3(b) would run contrary to the goal of the Williams Act (which Rule 13d-3(b) seeks to implement), would eviscerate Rule 13d-3(b), and would render compliance with Section 13(d) essentially voluntary.

III. Beneficial Ownership by Evasion

Rule 13d-3(b) deems a person to be the beneficial owner of a security if the person uses a contract, arrangement or device of some kind to prevent the vesting of beneficial ownership as part of a plan or scheme to evade the reporting requirements. Specifically, the rule states:

“Any person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement, or device with the purpose or effect of divesting such person of beneficial ownership of a security or preventing the vesting of such beneficial ownership as part of a plan or scheme to evade the reporting requirements of section 13(d) or (g) of the Act shall be deemed for purposes of such sections to be the beneficial owner of such security.”

To be sure, little has been said by the Commission about this prong of Rule 13d-3, which we call the evasion test, and little case law interprets it.⁵ Our analysis is thus based primarily upon the plain language of the Rule 13d-3(b) and the overall goal of Section 13(d) of the Exchange Act, which “is to alert the marketplace to every large, rapid aggregation or accumulation of securities. . . which might represent a potential shift in

⁴ Citations to the expert reports of Marti G. Subrahmanyam or Frank Partnoy are to the full title of the report. Citations to the Proposed Findings of Fact and Conclusions of Law of CSX Corporation Relating to Its Claims are of the form “PFF ¶ ___”. Citations to the trial transcript are of the form “Trial Tr. PAGE:LINE”. Citations to the letter sent by Professor Bernard Black are of the form “Black at ___”.

⁵ Of the few cases that even so much as mention Rule 13d-3(b), Levy ex rel Immunogen, Inc. v. Southbrook Int’l Invs., Ltd., No. 99-1480, 2000 U.S. Dist. LEXIS 6301 (S.D.N.Y. May 8, 2000), has the most in-depth discussion. It contains a single paragraph on the subject, in which the court denied plaintiff’s Rule 13d-3(b) claim for failure to plead and factually support affirmative acts of concealment and lack of disclosure. Id., at *16.

corporate control”. Treadway Cos. v. Care Corp., 638 F.2d 357, 380 (2d Cir. 1980) (internal citations omitted). We are mindful of the Commission’s guidance that beneficial ownership is “interpreted ... broadly” and includes the “ability to control or influence the voting or disposition of the securities”. Interpretive Release Applicable to Insider Reporting and Trading, Exchange Act Release No. 34-18114, 46 Fed. Reg. 48147-01 (Oct. 1, 1981) (emphasis added).

We do not undertake here to identify all of the circumstances under which a person might use cash-settled equity swaps to evade the reporting requirements. One can imagine any number of plans or schemes to that end. But, at a minimum, a person engages in a plan or scheme (and should thus be deemed a beneficial owner) when that person has:

1. Acquired a position in the derivative markets that, if held in the form of the registrant’s voting equity, would trigger a disclosure requirement (We emphasize that this factor constitutes a necessary but insufficient condition for a violation of Rule 13d-3(b)’s anti-evasion provision.);
2. Engaged in efforts to influence corporate management in a manner consistent with a course of conduct typical of activist shareholders having positions in excess of five percent of a registrant’s voting equity who are required to file pursuant to Section 13(d);
3. Engaged in efforts with the purpose or effect of influencing the voting position of counterparties who, by virtue of the foreseeable equity hedges held as a result of the equity swap positions at issue, own the registrant’s voting shares;
4. Caused a pre-positioning of the registrant’s voting shares in a manner that materially facilitates the rapid and low-cost acquisition of a reportable position upon the termination or other unwind of the derivative transactions at issue;
5. Caused the derivative positions at issue to be structured in a manner calculated to prevent counterparties from becoming subject to disclosure obligations under the Federal securities laws; and
6. Withheld from the market information regarding the person’s activities that is material (e.g., the person’s equity or derivative positions).

As we understand the facts in the pending litigation, these conditions are satisfied:

1. By December 6, 2006, TCI accumulated swaps referencing 5.20% of the CSX shares then outstanding, surpassing the 5% reporting threshold (applicable to voting equity) on that date. Before TCI ever began to convert its swaps into CSX shares, on March 30, 2007, TCI owned

- swaps referencing 14.07% of the CSX shares then outstanding. (PFF ¶ 45.);
2. TCI sought to influence and control CSX by replacing senior management, electing board members sympathetic to TCI, significantly reducing CSX workforce, and engaging in changes to the ownership structure of CSX, such as through a leveraged buy-out. (PFF ¶ 268.);
 3. Through its swap arrangements, TCI effectively and foreseeably put the matching shares, and their corresponding voting rights, in the hands of the counterparties, as opposed to the hands of whoever else would have otherwise held the shares. Counterparties have economic incentives to vote shares in favor of TCI as they compete for TCI's business, including the lucrative prime brokerage business. (Expert Report of Marti G. Subrahmanyam ¶¶ 160-62; Rebuttal Expert Report of Marti G. Subrahmanyam ¶¶ 43-44.) Moreover, TCI sought to influence at least one of its swap counterparties, Deutsche Bank (which is also a TCI prime broker), to vote in its favor in the proxy fight, based on TCI's connection to a hedge fund owned by Deutsche Bank known as Austin Friars. Anomalies in the ownership profile of CSX at the time of its initial record date suggest that TCI was successful in its efforts. (PFF ¶¶ 35-37, 221.);
 4. When TCI unwound its swaps, TCI's counterparties had no practical choice but to unwind their hedges by selling their matching physical shares. TCI determines when its swaps terminate, knows how many shares are involved, knows when its counterparty would likely sell, and knows how many shares it would likely sell. Investors with superior knowledge of the order flow in the market compared to other participants realize economic benefits from this information. Therefore, TCI is in a preferential position vis-à-vis other market participants and can purchase a large block of CSX shares at better prices on the open market than it would have otherwise been able to. In fact, TCI did purchase large blocks of CSX shares at prices that were very close to the prices obtained by its counterparties on sales of matching shares. (PFF ¶¶ 201-05; Expert Report of Marti G. Subrahmanyam ¶¶ 145-52; Rebuttal Expert Report of Marti G. Subrahmanyam ¶¶ 52-62.);
 5. TCI (a) divided its swaps among eight counterparties; (b) attempted to monitor their holdings to keep them from acquiring matching physical shares in excess of 5% (which would have required disclosure by the counterparties); and (c) after concentrating its swaps with two counterparties, kept token positions (1,000 swaps each) with the remaining six counterparties so as to hide its positions. (PFF ¶¶ 23-24, 39.); and

6. The information TCI withheld from disclosures, *e.g.*, that it held a significant stake in CSX and was seeking influence and control through swaps was plainly material. Mr. Hohn and Mr. Amin of TCI testified that TCI attempted to avoid disclosing its ownership and accumulation of CSX shares to other investors in order to prevent the stock price from increasing ahead of further accumulation of CSX shares by TCI. (Trial Tr. 189:3-189:8, 202:14-203:16, 204:15-205:23.) TCI's purported expert witness, Professor Frank Partnoy, finds that "[o]verall, returns to shareholders of companies that are targeted by activists have been very positive. That certainly has been the case for CSX, whose share price rose from \$35.99 on October 20, 2006, to \$64.03 as May 8, 2008, the date of Professor Subrahmanyam's report. Overall, CSX shares have increased in value relative to both market-weighted indices and competitor indices. The raw holding-period returns to an investor who purchased CSX on October 20, 2006, the date of TCI's first equity swap, and held through May 8, 2008, were 77.91%, whereas during the same period the raw returns for a competitor index and the S&P 500 index were 44.48% and 2.12%, respectively." (Rebuttal Expert Report of Frank Partnoy ¶ 109 (footnote excluded).)

If these are indeed the facts -- and we believe they are -- then we have little difficulty, reaching the conclusion that TCI was the beneficial owner of the shares referenced in its swaps.⁶

Professor Black in his letter states that a violation of 13d-3(b) cannot exist without beneficial ownership "either under the statute ... or under the remainder of Rule 13d-3". Without such a finding, "the investor's purpose for acquiring [the position] should be irrelevant". (Black at 5.) This argument misreads the rule. Rule 13d-3(b) provides an alternative method of finding beneficial ownership to voting or investment power under Rule 13d-3(a). Requiring Rule 13d-3(a) to be satisfied before Rule 13d-3(b) would render 13d-3(b) superfluous; one would not need to show beneficial ownership twice. Professor Black's interpretation is also in plain conflict with the language of the rule itself, which expressly provides that it applies when a person does not have beneficial ownership either because of divestiture or because beneficial ownership never vested in the first place.

We understand that TCI and 3G have argued that they have not used their swap arrangements to evade the reporting requirements because, among other things, they did not act in bad faith for the sole or dominant purpose of evading the reporting requirements. While TCI's and 3G's state of mind is not for us to decide, their argument

⁶ We believe that Defendants' activities can be analogized to "stock parking", an alternative method for demonstrating beneficial ownership. *See, e.g., SEC v. First City Financial Corp., Ltd.*, 688 F. Supp. 705 (D.D.C. 1988) (discussing stock parking), *aff'd* 890 F.2d 1215 (D.C. Cir. 1989).

mischaracterizes Rule 13d-3(b). The text of the rule says nothing about scienter or bad faith. The law is, instead, that scienter is not an element of a Section 13(d) violation, see, e.g., SEC v. Savoy Indus., 587 F.2d 1149, 1167 (D.C. Cir. 1978), and we are aware of no case requiring a showing of bad faith. Defendants also cannot cite to any such precedent.

Rule 13d-3(b) also does not require that a person have a motive to evade, much less that evasion be a person's sole, or even dominant, motive. The text of the rule is clear: it applies where an arrangement is used for the purpose or with the effect of evading the reporting requirements. An effect arises independent of any purpose, and "purpose" therefore cannot constitute an essential element of beneficial ownership under Rule 13d-3(b) without rendering the term "effect" a nullity. Thus, it comes as little surprise that Defendants are unable to cite to any precedent establishing that Rule 13d-3(b) is satisfied only upon a showing that a person's motive was to violate the law.

Professor Black does not address what state of mind is required for a 13(d) violation in his letter. However, we are aware of the position set forth by TCI and 3G, in their filings before Judge Kaplan, and it appears to be based upon an erroneous reading of an SEC Release from 1977. The Release provides:

"In order to acquire a substantial position in the voting securities of Z Corporation prior to the election of directors which will take place in the near future, X causes ten institutions to each acquire three percent of the outstanding shares of Z Corporation. None of the institutions are aware of the purchases by the other institutions or of X's control objective. As an attempted means of avoiding disclosure of his beneficial ownership of the Z shares until a short time before the election, X, simultaneously with the purchase of the Z shares, gives an irrevocable proxy to A; which proxy will lapse according to its terms...As indicated in Rule 13d-3(b), X is also deemed a beneficial owner of the same Z shares for the period of the proxy as well as thereafter, and therefore must file a Schedule 13D." Exchange Act Release No. 13291, § IV, Example 8 (Feb. 24, 1977).

Rather than support TCI's and 3G's position, we believe that the SEC's guidance undermines it. The Release says nothing about bad faith or predominance of an evasion motive. Nor can either supposed requirement fairly be inferred from the fact pattern described in the SEC's commentary. The Commission has explicitly stated, moreover, that in the context of Rule 144A, a determination of the existence of a plan or scheme to evade "*does not turn on the security offeror's motive*". November 28, 2006 SEC Amicus Letter to Judge Karon O. Bowdre in In re HealthSouth Sec. Litig., No. 03-1500 (N.D. Ala.) (available at <http://www.sec.gov/litigation/briefs/2006/healthsouthbrief.pdf>) (emphasis added) (The SEC continues: "the safe harbor is unavailable . . . if an offeror's technical compliance with Rule 144A is an attempt to evade registration . . .").

IV. Flaws in Professor Black's Analysis

In his letter, Professor Black asserts a variety of positions that are contrary to our understanding of the law, market practice, and the facts developed in the pending

litigation. An exhaustive list of our disagreements is beyond the scope of this letter, but several points deserve mention:

1. Professor Black assumes the non-existence of elements that bear upon the determination of beneficial ownership. For example, he assumes that swaps are “often” hedged with matching shares, but “not always”, and does not credit the evidence that on the facts of this case the match is essentially perfect, on a one-for-one basis. (Black at 7; PFF ¶ 202.) He also states that he is “not aware of a market practice” regarding swap counterparties contacting dealers to attempt to persuade them to vote in any particular matter. He goes on to baldly assert that this “did not occur in this case” when there is evidence that TCI did just that with Austin Friars. (Black at 8; PFF ¶¶ 35-38.)

2. Professor Black assumes (almost always, if not always, in favor of TCI) facts that are disputed, contrary to the undisputed evidence, or without support. For example, at the outset, he assumes that TCI had “no formal or informal agreement, understanding, arrangement, or relationship” with its swap counterparties beyond the swap agreements and that it had no communications of any kind regarding how the shares underlying the swaps would be voted, all of which go directly to the ultimate issue of beneficial ownership. (Black at 6.) He also ignores evidence that TCI and 3G formed a group before December 12, 2007, and assumes they formed a group no earlier than the date on which they executed a formal group agreement on December 12, 2007. (Black at 1; PFF ¶¶ 44-110.) He also states that “since announcing their group formation in December, TCI and 3G have fully disclosed their holdings of both shares and equity swaps”, without mention of the evidence offered by CSX to the contrary. (Black at 5 n.9; PFF ¶¶ 44-110, 263-279.)

3. Professor Black acknowledges major differences between futures and swaps such as different treatment of dividends, different regulatory structure, different margin requirements, different contracting, and different informational environments. Professor Black, however, states that “[a] single stock future is basically a publicly traded version of an equity swap.” This statement is incorrect. (PFF ¶¶ 241-47.) In addition to the reasons that Professor Black does acknowledge (which alone defeat his conclusion), traders face fundamental differences in counterparty credit risk related to the two types of instruments. Swaps contracts expose both parties to the risk of the other party’s ability to perform under the contract whereas futures have the safety net of the clearing corporation, which provides for a multilateral offset on all future trades. Additionally, the market for single stock futures is too small or illiquid to allow for hedging swaps approaching 5% of the value of a company the size of CSX. And Professor Black’s other suggested hedging alternatives are too poor a fit or too expensive for the low-margin swap business. Finally, Professor Black offers no evidence of any situation in which equity swaps positions comparable to those here at issue were hedged through any means that did not involve the acquisition of large numbers of the registrant’s shares, and there is no such information of record in these proceedings. Professor Black’s assertions in this regard are thus entirely speculative.

V. The Benefits of this Approach

Contrary to Professor Black's suggestion, considering TCI's conduct as a plan or scheme to evade the reporting requirements would neither stretch the text of Rule 13d-3(b) nor create dislocations in the marketplace. It would impose little cost and would be of great benefit to shareholders and investors.

Applying Rule 13d-3(b) as we describe would affect relatively few market participants. Disclosure would be required only where a person attains a greater than 5% economic interest for the purpose exerting influence or control of the issuer and simultaneously seeks actually to influence or control the issuer and the voting of physical shares by swap counterparties. In addition, in our analysis, the hedged equity shares would have to be pre-positioned, the swaps would have to be structured in a manner calculated to reduce counterparty disclosure obligations, and the information withheld from the market would have to be material. This is undoubtedly an infrequent occurrence. Moreover, disclosure by a holder of a 5% economic interest through swaps acquired under circumstances consistent with our proposed analysis is entirely in line with the Williams Act's goal that the public be on notice of the large position that the shareholder has in a company with an intent to influence control.

We believe strongly in the case for requiring symmetric disclosure of cash-settled equity swaps positions. Indeed, Professors Hu and Black recently summarized the policy considerations for more disclosure as follows (Hu & Black, 2008, at pages 683-84):

“We discuss the policy factors bearing on the optimal level of shareholder disclosure in [Hu & Black (2006)], and do not repeat that analysis here. These requirements are rooted in the belief that investors, as well as society at large, should know who a company's major shareholders are. Investors should also know whether those shareholders are buying and selling and should have an opportunity to respond. From an economic standpoint, share pricing will be more efficient if investors know what major investors are doing and have advance notice of possible changes of control. The integrity of, and confidence in, the stock market will be enhanced. We also identified reasons more directly related to equity decoupling. Disclosure can provide information on the frequency of empty voting and hidden (morphable) ownership. Disclosure may also deter some new vote buying; not everyone will do in the sunshine what they will do in the dark. Moreover, some empty voting strategies may be less effective if disclosed.”

In the context of this case, the integrity of the market for CSX stock was undermined. By disclosing their positions only selectively, TCI and 3G and their hedge fund friends were aware of, and traded on, information not available to the public and not reflected in the share price. The integrity of the stock market was undermined and an uneven playing field was created.

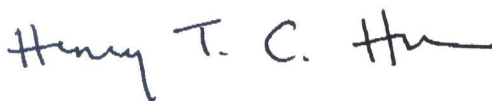
VI. Conclusion

We conclude that Defendants, in clear violation of Rule 13d-3(b), engaged in a “scheme to evade the reporting requirements of section 13(d) or (g) of the Act”. We urge the Commission to interpret the language of Rule 13(d) in accordance with its terms and to reflect this fact.

Respectfully,



Joseph A. Grundfest



Henry T. C. Hu



Marti G. Subrahmanyam