

Milbank

January 12, 2009

Corporate Governance Group

Client Alert

BEIJING FRANKFURT HONG KONG LONDON LOS ANGELES MUNICH NEW YORK SINGAPORE TOKYO WASHINGTON, DC

11TH CIRCUIT RULES THAT MEMBERSHIP IN A “GROUP” FOR PURPOSES OF SCHEDULE 13D REPORTING REQUIREMENTS REQUIRES OWNERSHIP OF COMPANY SHARES

On December 29, 2008, the U.S. Court of Appeals for the Eleventh Circuit ruled in *Hemispherx Biopharma Inc. v. Johannesburg Consolidated Investments*¹ that membership in a “group” for purposes of section 13(d) of the Securities Exchange Act of 1934 requires actual beneficial ownership of a company’s securities. According to the Court, “a determination of whether individuals or entities without a beneficial interest in a company’s securities can nonetheless become members of a ‘group’ within the meaning of section 13(d)(3) of the Exchange Act is a matter of first impression in this circuit. If the answer is yes, then the defendants should have made disclosures required under section 13(d)(1) of the Act. If the answer is no, they were not required to file the disclosures.” Concluding that “the answer is no,” the Court affirmed the lower court’s dismissal of the section 13(d)(1) claim, finding that the complaint failed to adequately allege beneficial ownership on the part of some of the alleged group members.²

¹ *Hemispherx Biopharma, Inc. v. Johannesburg Consolidated Investments*, 11th Cir., No. 05-14380 (12/29/08).

² The Court noted that there is an open question whether issuers are entitled to bring a private cause of action to enforce section 13(d). The Court stated that since section 13(d) does not expressly provide for a private cause of action, the four-part test set forth in the U.S. Supreme Court’s decision in *Cort v. Ash*, 422 U.S. 66 (1975), would be applied to discern congressional intent and establish whether an issuer may bring such a private cause of action. Since neither the lower court nor the parties presented this claim, the Court declined to opine on the issue. For discussion of the application of *Cort v. Ash* in the context of section 304 under the Sarbanes-Oxley Act of 2002, see our recent Client Alert entitled “Ninth Circuit Finds No Private Right of Action Under Section 304 of Sarbanes-Oxley,” January 5, 2009.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided herein.

In addition, if you would like copies of our other Client Alerts, please contact any of the attorneys listed. You can also obtain this and our other Client Alerts by visiting our website at <http://www.milbank.com> and choosing the “Client Alerts & Newsletters” link under “Newsroom/Events”.

This Client Alert is a source of general information for clients and friends of Milbank, Tweed, Hadley & McCloy LLP. Its content should not be construed as legal advice, and readers should not act upon the information in this Client Alert without consulting counsel. © 2009 Milbank, Tweed, Hadley & McCloy LLP. All rights reserved. Attorney Advertising, prior results do not guarantee a similar outcome.

www.milbank.com

Background

Hemispherx, a pharmaceutical research and development company specializing in nucleic acid technologies, brought this action against Bart Goemaere, the holder of a 30% interest in Hemispherx, and several South African individuals and entities (referred to as the “South African defendants”) relating to their discussions and other actions in connection with a potential hostile takeover attempt. Despite the fact that the South African defendants never purchased any Hemispherx shares and the hostile takeover did not come to fruition, Hemispherx alleged (among other claims) that the South African defendants acted as a group with Goemaere to “acquire, hold, vote and dispose” of Hemispherx shares and therefore violated section 13(d) by failing to make the disclosures required by that section on a Schedule 13D.

Section 13(d)(1) of the Exchange Act, together with the rules promulgated thereunder, require any person who acquires beneficial owner of more than five percent of any class of a voting equity security that is registered under the Exchange Act to disclose certain information on a Schedule 13D filed with the SEC. The required disclosures include (i) the background and identity of the investor, (ii) the source and amount of funds used to make the purchases, (iii) the purpose of the purchases and any plans or proposals with respect to the shares, (iv) the number of shares beneficially owned and the number of shares the person has a right to acquire and (v) information as to “any contracts, arrangements or understandings with any person” including “naming of the persons with whom such contracts, arrangements or understandings have been entered into and giving the details thereof.”

Section 13(d)(3) provides that “when two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a ‘person’ for the purposes of this subsection.” SEC Rule 13d-5 provides that once a group has been formed under section 13(d)(3), *each member* of that group shall be deemed to have acquired beneficial ownership of *all* securities owned by the group for purposes of the reporting requirements of section 13(d)(1).

Court’s Analysis

Hemispherx argued that since section 13(d)(3) and the related SEC rules do not explicitly mention “beneficial owner” or impose a beneficial ownership requirement for purposes of membership in a group, the South African defendants should be considered members of a “group” with Goemaere on the basis of their concerted activities with respect to Hemispherx and its securities. As a result, Hemispherx claimed that the South African defendants violated section 13(d)(1) and the related rules by failing to file a Schedule 13D.

The Court, however, determined that because the “plain language” of the statute and rules left open the question whether beneficial ownership of stock is required for group membership, it turned to congressional intent and the purpose of the statute for guidance. According to the Court, the reporting requirements of section 13(d) are intended to ensure that “an issuer receives notice that a significant amount of its shares is being accumulated” and “to prevent persons who already have attained beneficial ownership of some amount of an

issuer's securities from combining to control over five percent of a class of securities, yet ducking the reporting requirements in section 13(d)(1). That is what section 13(d)(3) is all about." The Court concluded that in order to fulfill this purpose, *each* member of a "group" must have shares to "pool."³ Based on Goemaere's filings, Hemispherx was well aware of his accumulation of shares.

The Court also noted that the purpose of section 13(d) would not be eroded by failing to require those without beneficial ownership to file: "if the total beneficial ownership of all members exceeds the threshold amount of five percent, a Schedule 13D must be filed disclosing, among other details, 'information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer.'" Thus, any person subject to the reporting requirements, such as Goemaere, is required "to disclose the identify of everyone, including those who are not beneficial owners, who possesses some form of present or future interest in the securities, along with details of the arrangements or understandings with those non-beneficial owners." According to the Court, although the South African defendants were not required to make their own filing, Goemaere, as holder of 30% of the Hemispherx stock, was obligated to disclose on his Schedule 13D the South African defendants' identities and to provide details of any arrangements that he had with them regarding the stock of Hemispherx.

The Court also rejected Hemispherx's interpretation of the statute on the basis of practical considerations. Without a requirement of beneficial ownership for a person to be deemed part of a section 13(d)(3) group, the Court noted that any number of persons assisting with the purchase of a corporation's securities, including financial advisors, attorneys, bankers and accountants, could be deemed part of a group acting for the "purpose of acquiring, holding or disposing of securities." Because the Court was doubtful that Congress intended such persons to be subject to the section 13(d)(1) reporting requirements, the Court concluded that beneficial ownership was a prerequisite for any person or entity to be a member of a section 13(d)(3) group.

Implications for Future Section 13(d) Disclosures

The *Hemispherx* decision provides limited guidance for shareholders required to make Schedule 13D disclosures. Although the Court ruled that the South African defendants were not required to file a Schedule 13D, it nevertheless indicated that Goemaere's arrangements with the South African defendants constituted "contracts, arrangements, or understandings with any person with respect to any securities" requiring disclosure. However, the Court did not dictate the extent of the disclosure or the level of detail required with respect to the South African defendants' activities. Rather than following guidance from the Court, future disclosures about arrangements or understandings among actual investors and others regarding their mutual intentions with respect to SEC-registered securities will be left to the judgment of the shareholders making the disclosures.

³ In support of this holding, the Court cited *Rosenberg v. XM Ventures*, 274 F.3d 137 (3d Cir. 2001), where the Court of Appeals for the Third Circuit held that "each member of a section 13(d) group must hold beneficial ownership of the equity securities of the issuing entity prior to its entry into such a group."

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

Beijing

Units 05-06, 15th Floor, Tower 2
China Central Place, 79 Jianguo Road, Chaoyang District
Beijing 100025, China

Anthony Root +86-10-5969-2777 aroot@milbank.com
Edward Sun +86-10-5969-2772 esun@milbank.com

Frankfurt

Taunusanlage 15
60325 Frankfurt am Main, Germany

Norbert Rieger +49-69-71914-3453 nrieger@milbank.com

Hong Kong

3007 Alexandra House, 18 Chater Road
Central, Hong Kong

Anthony Root +852-2971-4842 aroot@milbank.com
Joshua Zimmerman +852-2971-4811 jzimmerman@milbank.com

London

10 Gresham Street
London EC2V 7JD, England

Stuart Harray +44-20-7615-3083 sharray@milbank.com
Thomas Siebens +44-20-7615-3034 tsiebens@milbank.com

Los Angeles

601 South Figueroa Street
Los Angeles, CA 90017

Ken Baronsky +1-213-892-4333 kbaronsky@milbank.com
Neil Wertlieb +1-213-892-4410 nwertlieb@milbank.com

Munich

Maximilianstrasse 15 (Maximilianhoefer)
80539 Munich, Germany

Peter Nussbaum +49-89-25559-3636 pnussbaum@milbank.com

New York

One Chase Manhattan Plaza
New York, NY 10005

Scott Edelman +1-212-530-5149 sedelman@milbank.com
Roland Hlawaty +1-212-530-5735 rhlawaty@milbank.com
Thomas Janson +1-212-530-5921 tjanson@milbank.com
Robert Reder +1-212-530-5680 rreder@milbank.com
Alan Stone +1-212-530-5285 astone@milbank.com
Douglas Tanner +1-212-530-5505 dtanner@milbank.com

Singapore

30 Raffles Place, #14-00 Chevron House
Singapore 048622

David Zemans +65-6428-2555 dzemans@milbank.com
Naomi Ishikawa +65-6428-2525 nishikawa@milbank.com

Tokyo

21F Midtown Tower, 9-7-1 Akasaka, Minato-ku
Tokyo 107-6221 Japan

Darrel Holstein +813-5410-2841 dholstein@milbank.com
Bradley Edmister +813-5410-2843 edmister@milbank.com

Washington, DC

International Square Building, 1850 K Street
Washington, DC 20006

Glenn Gerstell +202-835-7585 gerstell@milbank.com