

Fried Frank Antitrust & Competition Law



FTC Challenges Reliance on “Investment-Only” Exemption

This week, the Federal Trade Commission announced a settlement of charges that Third Point, a well-known activist investor, improperly relied on the “investment-only” exemption to the reporting obligations under the Hart-Scott-Rodino Act. This enforcement action is a harsh reminder of the FTC’s narrow interpretation of the exemption and provides additional insight on the types of conduct that the FTC deems inconsistent with passive investment intent. In a separate statement, the Director of the FTC’s Bureau of Competition emphasized that the test for the “investment-only” exemption is the acquirer’s intention, and merely “considering” or “expecting” to take certain actions may be sufficient to make the exemption inapplicable.¹

In general, the HSR Act requires an acquirer to file notification and observe a waiting period if, as a result of the transaction, the acquirer would hold voting securities of an issuer valued in excess of \$76.3 million.² The HSR Act provides an exemption for acquisitions of 10 percent or less of an issuer’s outstanding voting securities that are made “solely for the purpose of investment.”³ Under longstanding guidance, the FTC has delineated several actions as nearly always signaling a non-passive intent, including:

- nominating a candidate for the board of directors of the issuer;
- proposing corporate action requiring shareholder approval;
- soliciting proxies;
- serving as an officer or director of the issuer;
- being a competitor of the issuer; or
- doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer.⁴

¹ Deborah Feinstein, Ken Libby, and Jennifer Lee, “‘Investment-only’ means just that,” Aug. 24, 2015, available at <https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just>.

² This dollar threshold is adjusted annually to reflect changes to the U.S. gross national product. At the time of the acquisitions in question, the applicable threshold was \$66 million.

³ 15 U.S.C. § 18a(c)(9) and 16 C.F.R. § 802.9. The HSR rules provide that voting securities are held “solely for the purpose of investment” if the investor has “no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.” 16 C.F.R. § 801.1(i)(1).

⁴ 43 Fed. Reg. 33,450, 33,465 (1978).

As described below, the additional conduct prohibited in the FTC's settlement with Third Point, and follow-on statements of the Commission and its leadership, go beyond this well-known list.

Between August 8, 2011 and September 8, 2011, Third Point made a series of open market purchases of Yahoo voting securities through separate funds. The acquisitions resulted in three funds each holding Yahoo shares valued in excess of the HSR threshold. Third Point did not submit HSR notifications or observe the waiting period prior to crossing the filing thresholds, relying on the "investment-only" exemption. The FTC alleged that during this period, Third Point engaged in conduct inconsistent with passive investment intent, including: (i) contacting individuals to gauge their interest in becoming CEO or serving as a director of Yahoo; (ii) taking other steps to assemble an alternate slate of directors for the Yahoo board; (iii) preparing correspondence to Yahoo to announce that Third Point was prepared to join Yahoo's board; (iv) internally discussing the possible launch of a proxy battle; and (v) stating publicly that it was prepared to propose a slate of directors at Yahoo's next annual meeting.

The FTC's settlement prohibits Third Point from relying on the "investment-only" exemption if, in the four months prior to the acquisition, it has engaged in any of the conduct described in the FTC's previous guidance, or in the following additional conduct:⁵

- Inquiring of a third party as to his or her interest in being a candidate for the board or CEO of the issuer;
- Communicating with the issuer about potential candidates for the board or CEO; and
- Assembling a written list of possible candidates for the board or CEO.

The additional prohibitions demonstrate that the FTC will view preliminary steps in anticipation of potentially seeking to influence selection of directors or the CEO of an issuer as being inconsistent with passive investment intent. Indeed, the FTC took pains to emphasize that the "investment-only" exemption depends entirely on the acquirer's subjective intentions, and may not turn on any particular conduct. The FTC leadership's follow-on statement to the settlement cautioned that "if an acquiring person purchases voting securities with the intention of influencing the basic business decisions of the issuer . . . the exemption is not available," even if the investor has not yet acted on those intentions. As a result, the FTC may view internal discussions about possible shareholder advocacy strategies as sufficient to disqualify an investor from claiming the exemption. The FTC will, however, examine the totality of the circumstances to determine if the exemption was properly invoked.

The settlement also makes clear that the FTC will consider conduct that took place months prior to the acquisition in question as potentially disqualifying the investor from claiming the exemption, absent clear evidence that its efforts to influence the issuer were abandoned. Nevertheless, while the Third Point matter provides guidance to the business community on the FTC's interpretation of the "investment-only" exemption, absent a consent order, any enforcement efforts would still require the FTC to prove in court that a violation of the HSR Act has occurred.

⁵ While the FTC can seek civil penalties of up to \$16,000 for each day of a violation of the HSR Act and frequently has obtained significant monetary settlements, in this case the FTC decided not to seek monetary relief because Third Point was out of compliance for only a short period of time (the funds filed HSR notification forms several weeks after they crossed the thresholds) and this was Third Point's first violation of the HSR Act.

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