Investment Fund Violates “Investment-Only” HSR Exemption

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At the request of the Federal Trade Commission ("FTC" or "Commission"), the Department of Justice ("DOJ") filed this week in federal court a proposed settlement to charges that an investment fund violated the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a ("HSR Act" or "Act") by improperly relying on the "investment-only" exemption. In the Matter of Third Point, FTC File No. 121-0019 (August 24, 2015). The matter arises out of the purchase through several transactions on the open market of voting securities of Yahoo! Inc. by several funds managed by Third Point LLC financial investment firm in 2011. The FTC voted 3-2 to refer the matter for enforcement. The settlement provides an extended list of actions that preclude the use of the exemption, and reinforces the Commission’s stance that the likely-competitive impact of a transaction is irrelevant to whether the HSR Act requirements are applicable.

This matter provides concrete and expanded guidance regarding conduct the FTC has deemed inconsistent with the investment-only exemption to the HSR Act’s reporting requirements. While the FTC has long made clear that the exemption applies only to passive investors for holdings up to 10%, the settlement here further develops the list of specific examples that make the exemption unavailable. This matter also serves as a general reminder to investment firms that a strong HSR compliance program is critical to avoiding violations. Not only is such a program relevant to the correct application of the investment-only exemption, but it can also be essential to avoiding HSR violations that occur when the aggregate holdings of an entity cross the 10% threshold (when investment intent becomes irrelevant).

HSR Act

The HSR Act requires parties engaged in certain transactions to file a notification with the FTC and the Antitrust Division of the DOJ, and to observe a statutorily prescribed waiting period (usually 30 days) prior to closing, if the jurisdictional size thresholds are met. Transactions potentially covered by the HSR Act include mergers, acquisitions, joint ventures, exclusive license deals, and minority investments. The purpose of the HSR Act is to maintain the competitive status quo during the waiting period while the federal antitrust agencies investigate whether the proposed transaction may substantially lessen competition in any relevant market in violation of the antitrust laws.

Because the HSR Act is a procedural requirement that applies regardless of the likely competitive impact of a transaction, exemptions to the Act are designed to eliminate the filing and waiting period requirement for those types of transactions that are most unlikely to have competitive significance. One such exemption is the so-called "investment only" exemption. The HSR Act exempts acquisitions of voting securities if made "solely for the purpose of investment." The HSR rules state that acquisitions of less than 10% are exempt if the investor has "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer." The Statement of Basis and Purpose ("SBP") issued at the time the Commission promulgated the HSR rules provides the following examples of conduct inconsistent with an investment-only intent:

- nominating a candidate for the board of directors;
- holding a board seat or being an officer;
- proposing corporate action that requires shareholder approval;
- soliciting proxies; or
- being a competitor of the issuer.

Third Point’s Violation

The FTC brought this action against Third Point LLC and three funds it manages (Third Point Offshore Fund, Ltd., Third Point Ultra, Ltd., and Third Point Partners Qualified L.P., each their own "ultimate parent entity" for HSR purposes) (collectively "Third Point"). Through multiple transactions in August 2011, the Third Point funds acquired on the open market voting securities of Yahoo! Inc. that in aggregate for each fund exceeded $66 million in value (the relevant jurisdictional threshold at the time). In reliance on the investment-only exemption, Third Point made the acquisitions without filing the required notifications under the HSR Act or observing the waiting period. In September 2011, after the acquisitions had already been consummated, Third Point corrected its investment-only exemption, noting that in aggregate for each fund exceeded $66 million in value. The FTC voted 3-2 to refer the matter for enforcement.

Arguing that the acquisitions did not qualify for the investment-only exemption, the FTC alleged that the entities were each in violation of the Act for the period from September to October. Specifically, the FTC argued that the following actions taken by Third Point at the time of the acquisitions belied an investment-only intention:

- contacting certain individuals to gauge their interest and willingness to become the CEO of Yahoo or a potential board candidate of Yahoo;
- assembling an alternate slate for the Yahoo Board;
documents from the time of and shortly prior to the acquisition. Would be very fact specific, and an investigation into the use of the exemption would involve a review of the investor’s business. Such a determination conceivable that an investor may be passive at the time of the acquisition (and thus appropriately use the exemption), but later become an active investor (and thus no longer able to use the exemption for subsequent acquisitions). Such a determination would be very fact specific, and an investigation into the use of the exemption would involve a review of the investor’s business documents from the time of and shortly prior to the acquisition.

Proposed Settlement

The Stipulated Order, which requires approval and entry by a federal judge pursuant to the Tunney Act, prohibits Third Point from making acquisitions in reliance on the investment-only exemption if Third Point has engaged in certain enumerated conduct at the time of the acquisition or in the four months prior:

- nominating a candidate for the board of directors of the issuer;
- proposing corporate action requiring shareholder approval;
- soliciting proxies with respect to such issuer;
- having a representative serve as an officer or director of the issuer;
- being a competitor of the issuer;
- doing any of the above activities with regard to an entity controlled by the issuer;
- asking third parties about interest in being a candidate for the board or CEO of the issuer, and not abandoning such efforts;
- communicating with the issuer about potential candidates for the board or CEO of the issuer, and not abandoning such efforts; or
- assembling a list of possible candidates for the board or CEO of the issuer, if done with the knowledge of the CEO.

The settlement also requires Third Point to maintain a compliance program to ensure adherence to the terms of the settlement.

The HSR Act, at the discretion of the antitrust agencies, allows for civil penalties of up to $16,000 for each day of violation. Here, the Commission, in consultation with the DOJ, decided to seek only injunctive relief. The FTC’s decision to exercise its discretion not to levy a monetary penalty was based on the relatively short period of the violation, Third Point’s observance of the Act’s filing and waiting period requirements for subsequent purchases of Yahoo voting securities, and the fact that this was Third Point’s first HSR violation.

Dissent

FTC Commissioners Maureen K. Ohlhausen and Joshua D. Wright dissented. They did not dispute the Commission’s conclusion that Third Point violated the HSR Act. Rather, the dissent argued that the public interest did not support a referral of the matter for enforcement, and thus they would have exercised prosecutorial discretion not to take any action against Third Point. The dissent argued that the Commission’s position is a “narrow interpretation” of the exemption that is “likely to chill valuable shareholder advocacy while subjecting transactions that are highly unlikely to raise substantive antitrust concerns” to the HSR Act notification requirements. They further argued that the HSR Act “must adapt to allow antitrust agencies to focus on those proposed transactions that are most likely to result in a substantial lessening of competition.”

Advocating for renewed efforts to modify the investment-only exemption and to reevaluate its proper scope, the dissent proposed two possible changes: i) amending the rules to create an exemption for all acquisitions that do not result in the holding of more than 10% of the issuer’s outstanding voting securities (regardless of intent); or ii) interpreting the investment-only exemption to exclude only the specific types of conduct described in the SBP (rather than the expanded list created in this settlement).

In the Competitive Impact Statement filed with the settlement, the Commission emphasized that the HSR Act “is critical to the federal antitrust agencies’ ability to investigate large acquisitions before they are consummated, prevent acquisitions determined to be unlawful under Section 7 of the Clayton Act [], and design effective divestiture relief when appropriate.” In response to the dissent, the Commission explained that enforcement in this matter is in the public interest because it instills respect for the HSR Act, deters violations, and provides a clear, consistent, and transparent interpretation of the exemption. The Commission noted that whether the transaction was likely to produce any competitive harm is not relevant to the public interest question because the Act is procedural and thus it is expected that the vast majority of the reported transactions will not result in challenges by the antitrust agencies.

Clear Guidance

The FTC emphasized that “since 1978, the Commission has consistently and narrowly defined the phrase ‘solely for the purpose of investment’ to mean that an acquiring person must not intend to participate in the formulation of the basic business decisions of an issuer.” The expanded list of investor actions contained in the proposed settlement provides clear guidance for interpreting that definition and creates a compliance roadmap for any party contemplating the use of the HSR investment-only exemption.

Importantly, it is also worth highlighting the phrase “at the time of the acquisition.” The investment intent relevant to the applicability of the exemption is the intent of the purchaser at the time of the acquisition. The FTC on other occasions has made clear that it is conceivable that an investor may be passive at the time of the acquisition (and thus appropriately use the exemption), but later become an active investor (and thus no longer able to use the exemption for subsequent acquisitions). Such a determination would be very fact specific, and an investigation into the use of the exemption would involve a review of the investor’s business documents from the time of and shortly prior to the acquisition.