

Update on Investment Only and Institutional Investor Exemptions to Premerger Filing under the HSR Act

I. Introduction

Four recent actions demonstrate the Federal Trade Commission (“FTC”) and the Antitrust Division of the Department of Justice (“DOJ”) (the “antitrust authorities”) are applying a narrow interpretation of the “investment only” and “institutional investor” exemptions to antitrust premerger filings. The investment only and institutional investor exemptions excuse passive investors acquiring certain minority holdings from premerger filing obligations. The antitrust authorities’ limiting of the scope of these exemptions will likely lead to more filings for minority acquisitions.

The Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (“HSR Act”),¹ requires persons contemplating mergers or acquisitions of voting securities or assets that satisfy the size-of transaction and size-of person thresholds² to notify the FTC and the DOJ and observe a waiting period before completing those transactions. Minority acquisitions of stock on the open market, for example, would be covered if they satisfy these thresholds, unless exempted. The HSR rules exempt acquisitions resulting in the buyer holding not more than 10% of outstanding voting securities of an issuer if they are made solely for the purpose of investment (“investment only exemption”).³ The federal antitrust authorities interpret this exemption narrowly and interpret “solely for the purpose of investment” to mean an acquisition when “the person holding or acquiring such voting securities has no intention of participating in the formation, determination, or direction of the basic business decisions of the issuer”⁴ and the issuer is not a competitor.

A similar but separate exemption exists for acquisitions resulting in defined institutional investors holding not more than 15% of outstanding voting securities of an issuer if the voting securities are acquired solely for the purpose of investment (“institutional investor exemption”).⁵ This exemption is not applicable, however, when the acquisition is of an institutional investor of the same type as any entity included within the acquiring person,⁶ an analog of the competitor carve-out of the investment only exemption.

II. Cases and Informal Interpretations

A. Third Point

In the summer of 2015, Third Point LLC and three of its affiliated hedge funds (collectively, “Third Point”) agreed to settle charges that they violated premerger notification laws due to improper reliance on the investment only exemption.⁷ Third Point failed to notify federal antitrust authorities prior to each of the three funds acquiring voting securities of Yahoo! Inc. (“Yahoo”) in excess of the statutory thresholds without making the required filings and observing the waiting period. The enforcement action against Third Point demonstrates

¹ 15 U.S.C. § 18a.

² The minimum size-of-transaction threshold is currently \$78.2 million (\$50 million, adjusted annually).

³ 16 C.F.R. § 802.9.

⁴ 16 C.F.R. § 801.1(i)(1).

⁵ 16 C.F.R. § 802.64.

⁶ 16 C.F.R. § 802.64(c)(1).

⁷ *United States v. Third Point Offshore Fund, Ltd., et al.*, Complaint for Injunctive Relief for Failure to Comply with the Premerger Reporting Requirements of the Hart-Scott-Rodino Act, 1:15-cv-01366 (D.D.C. Aug. 24, 2015).

the antitrust authorities' careful consideration of an investor's behavior that might manifest intent to acquire a company to influence and direct its business decisions. The FTC found that Third Point could not apply the investment only exemption to its acquisition of shares of Yahoo because of Third Point's correspondence to Yahoo announcing that Third Point was prepared to join Yahoo's board, Third Point's internal deliberation of a possible launch of a proxy battle for Yahoo directors, and public statements that Third Point was prepared to propose directors at Yahoo's next annual meeting.⁸ The settlement requires Third Point not to use the investment only exemption if it has contacted outside parties regarding a target company's board or has communicated with the company about new board membership.⁹

B. Leucadia National Corporation/KCG Holdings Inc.

Shortly after the Third Point settlement in September 2015, Leucadia National Corporation ("Leucadia") agreed to settle charges and pay \$240,000 in civil penalties to resolve allegations that it violated premerger laws based on its improper reliance on the institutional investor exemption for a conversion of its ownership in financial services company Knights Capital Group, Inc. that resulted in ownership of nearly 16.5 million voting shares of a new entity, KCG Holdings, Inc. ("KCG"), valued at approximately \$173 million.¹⁰ The complaint alleged that the company, after consultation with experienced HSR counsel, had erroneously concluded that it qualified for the institutional investor exemption because Jefferies (through whom Leucadia acquired shares of KCG voting securities) was a broker-dealer and Leucadia believed KCG was not a broker-dealer within the meaning of the HSR rules.¹¹ However, the antitrust authorities contended that KCG was a broker-dealer, and thus, the institutional investor exemption was not available for Leucadia¹² because KCG was effectively a competitor of Jefferies.¹³ The complaint noted that Leucadia had previously violated the HSR Act in 2007, which led to a corrective filing in 2008, though Leucadia was not penalized for that violation.¹⁴

C. ValueAct

On July 12, 2016, the DOJ announced that ValueAct Capital investors ("ValueAct") agreed to pay \$11 million to settle charges that it violated premerger reporting requirements¹⁵ when ValueAct bought over \$2.5 billion of stock in Halliburton Co. ("Halliburton") and Baker Hughes Inc. ("Baker Hughes") with the intention of influencing the business activities and strategies of the companies.¹⁶ While ValueAct relied on the investment

⁸ *Id.*

⁹ *United States v. Third Point Offshore Fund, Ltd., et al.*, Final Judgment, 1:15-cv-01366 (D.D.C. Aug. 24, 2015).

¹⁰ *United States v. Leucadia National Corp.*, Complaint for Civil Penalties for Failure to Comply with the Premerger Reporting Requirements of the Hart-Scott-Rodino Act, 1:15-cv-01547 (D.D.C. Sept. 22, 2015).

¹¹ *Id.*

¹² *Id.*

¹³ The complaint further alleged that Leucadia was in continuous violation of the HSR Act from July 1, 2013 when it acquired the KCG voting securities that resulted in it holding more than 10% of the outstanding KCG voting securities valued in excess of the HSR Act's filing threshold through October 14, 2014, after it filed notification under the HSR Act with the federal antitrust authorities to acquire the voting securities of KCG and the waiting period expired. *Id.*

¹⁴ *Id.*

¹⁵ Press Release, Department of Justice, *Justice Department Obtains Record Fine and Injunctive Relief against Activist Investor for Violating Premerger Notification Requirements* (July 12, 2016), <https://www.justice.gov/opa/pr/justice-department-obtains-record-fine-and-injunctive-relief-against-activist-investor>; see also Complaint, *United States v. VA Partners I, LLC, et al.*, 3:16-cv-1672 (N.D. Cal. Apr. 4, 2016) (Dkt. No. 1).

¹⁶ The prospective \$28 billion merger between Halliburton and Baker Hughes that the DOJ alleged ValueAct had the intention to influence was abandoned due to the DOJ's antitrust challenge to its consummation. Mike Stone, *Halliburton*

only exemption in its decision not to make an HSR filing for its purchase of Halliburton and Baker Hughes voting shares, the DOJ alleged ValueAct's behavior prohibited the application of this exemption.¹⁷ The complaint against ValueAct alleged that it used its access to executives of Halliburton and Baker Hughes to formulate merger and other business strategies with the companies.¹⁸ The complaint highlighted language from ValueAct's website, which stated that the company's business model includes involvement in the management in the companies in which it invests.¹⁹ The complaint concluded that because ValueAct purchased voting shares in Halliburton and Baker Hughes with the intent of influencing executives, ValueAct could not rely on the investment only exemption.²⁰ Additionally, the complaint noted that ValueAct filed a corrective notification for three prior acquisitions of voting shares in 2003,²¹ and had a violation for failure to make required filings for three acquisitions in 2005, which resulted in a \$1.1 million civil penalty.²² ValueAct has agreed to pay a record \$11 million penalty, the largest since the previously highest fine for an HSR violation of \$5.67 million.²³

D. Sarofim

Most recently in October 2016, the FTC announced a \$720,000 settlement with investment firm founder Fayez Sarofim to settle allegations that Mr. Sarofim improperly used the investment only exemption and violated the HSR Act multiple times over the past eleven years.²⁴ The FTC asserted that Mr. Sarofim relied on the investment only exemption as the reason not to file for three acquisitions of voting securities of Kinder Morgan, Inc. ("KMI") in 2001, 2006, and 2012 and numerous acquisitions of voting securities of the company Unitrin Inc. ("Unitrin"), now known as Kemper Corporation ("Kemper") in 2007-2008.²⁵ During the acquisition of voting securities of KMI, Mr. Sarofim was "a member of the KMI board, a position that necessarily caused him to participate in the formulation, determination, or direction of the basic business decisions of KMI[,]"²⁶ and during the acquisitions of voting securities at issue of Unitrin, Mr. Sarofim was also a board member of the company—

and Baker Hughes scraps \$28 billion merger, REUTERS, (May 2, 2016), <http://www.reuters.com/article/us-bakerhughes-m-a-halliburton-idUSKCN0XS1KW>. Both the DOJ and European Commission had expressed concerns regarding the proposed merger's impact on competition. Press Release, Department of Justice, *Halliburton and Baker Hughes Abandon Merger After Department of Justice Sued to Block Deal* (May 1, 2016), <https://www.justice.gov/opa/pr/halliburton-and-baker-hughes-abandon-merger-after-department-justice-sued-block-deal>; Press Release, European Commission, *Mergers: Commission opens in-depth investigation into acquisition of oilfield service provider Baker Hughes by Halliburton* (Jan. 12, 2016), http://europa.eu/rapid/press-release_IP-16-48_en.htm.

¹⁷ See supra n. 15.

¹⁸ Complaint, *United States v. VA Partners I, LLC, et al.*, 3:16-cv-1672 (N.D. Cal. Apr. 4, 2016) (Dkt. No. 1).

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.* No enforcement action was taken for the ValueAct's 2003 HSR Act violation. *Id.*

²² *Id.*

²³ Press Release, Department of Justice, *Justice Department Obtains Record Fine and Injunctive Relief against Activist Investor for Violating Premerger Notification Requirements* (July 12, 2016), <https://www.justice.gov/opa/pr/justice-department-obtains-record-fine-and-injunctive-relief-against-activist-investor>.

²⁴ Press Release, Federal Trade Commission, *Investment Firm Founder Fayez Sarofim to Pay \$720,000 to Settle FTC Charges for Violation of U.S. Premerger Notification Requirements*, https://www.ftc.gov/news-events/press-releases/2016/10/investment-firm-founder-fayez-sarofim-pay-720000-settle-ftc?utm_source=govdelivery.

²⁵ *United States v. Fayez Sarofim*, Competitive Impact Statement, 1:16-cv-02156 (D.D.C. Oct. 27, 2016).

²⁶ *Id.*

which was renamed Kemper in 2011—thus the complaint alleged that the investment only exemption did not apply to Mr. Sarofim’s acquisitions of KMI and Kemper.²⁷

E. Informal Interpretations

The FTC recently invalidated three informal interpretations of the HSR Act and rules, further limiting the application of the investment only exemption.²⁸ The FTC has pointedly stated that they “have long made clear that the investment only exemption is a narrow exemption”²⁹ and has indicated that additional guidance on the narrowing of the investment only exemption will be forthcoming.

III. Implications

Investors should exercise caution when relying on the investment only and institutional investor exemptions. Antitrust authorities maintain a narrow interpretation of these exemptions. Investors considering invoking these exemptions should expect antitrust authorities to closely examine their underlying behavior to determine whether the investors intended to influence the business decisions of the acquired entity.

Additionally, as indicated by the discussion of prior HSR violations in the complaints against ValueAct and Leucadia, antitrust authorities are more likely to bring charges against entities that have prior violations than first-time offenders. The HSR Act and rules, including exemptions to filing requirements, should be carefully reviewed whenever equity transactions are contemplated.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Elai Katz at 212.701.3039 or ekatz@cahill.com; or Lauren Rackow at 212.701.3725 or lrackow@cahill.com.

²⁷ *United States v. Faye Sarofim*, Complaint for Civil Penalties for Failure to Comply with the Premerger Reporting and Waiting Requirements of the Hart-Scott-Rodino Act, 1:16-cv-02156 (D.D.C. Oct. 27, 2016).

²⁸ HSR Informal Interpretation #1202014 (Feb. 27, 2012), <https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1202014> (competitors outside of the U.S., but not inside the U.S., no longer qualify for the investment only exemption); HSR Informal Interpretation #1308003 (Sept. 4, 2013), <https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1308003> (circumstances where the manager of the investment is not-passive, but the investor is passive, no longer qualify for the investment only exemption); HSR Informal Interpretation #1403011 (Mar. 20, 2014), <https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1403011> (owning less than 10% of a company and then acquiring less than 10% of a competitor may not qualify for the investment only exemption).

²⁹ Debbie Feinstein, Ken Libby, and Jennifer Lee, “*Investment-only*” means just that, Bureau of Competition (Aug. 24, 2015 5:25 pm), <https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just>.