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While acquisitions of up to 10% of the voting interest in a target that are made "solely for the purpose of investment" are in many circumstances exempt from Hart-Scott-Rodino (HSR) reporting requirements, even when the value of the investment exceeds the $76.3 million HSR "size of transaction" threshold, federal antitrust authorities have long interpreted that "exemption" to be a narrow one.[1]

The Department of Justice this week sued three affiliated hedge funds and their New York-based management company for acquiring shares in Yahoo! in 2011, in excess of the then applicable HSR threshold, and simultaneously agreed to settle the action, prohibiting future violations, without obtaining any civil penalty. The suit sends a clear message to investors that taking actions other than voting shares likely takes an investment out of the exemption.

The Complaint, which was filed on behalf of a divided Federal Trade Commission, targets actions taken by Third Point LLC in connection with its acquisition of voting securities in Yahoo!. By late August 2011, three Third Point funds each had Yahoo! holdings exceeding the then applicable $66 million size-of-transaction threshold. On September 16, 2011, the three funds each filed a notification and report form under the HSR Act for the voting securities purchased, and the waiting period of those filings expired on October 17, 2011. Notwithstanding this filing, the DOJ alleged that the funds were in violation of the HSR Act from the point in August when they had each acquired shares putting their holdings above $66 million until the expiration of the waiting period in October 2011, given that they engaged in "various actions inconsistent with [qualifying for] an investment-only purpose" exemption.

Overview of the applicable laws and penalties

The HSR Act requires firms proposing to acquire voting securities in excess of the HSR thresholds to file a notification with the DOJ and FTC and to observe a waiting period before consummating the transaction. The HSR Act's notification and waiting requirements are intended to provide the federal antitrust agencies with advance notice of, and information about, proposed transactions, as well as an opportunity to investigate to determine whether such acquisitions may lessen competition and prevent potential anticompetitive effects. Civil penalties for failure to file can be significant, with maximum fines of up to $16,000 for each day until the violation is remedied.

The HSR Act and implementing rules provide certain exemptions from the notification and waiting period requirement, which include the acquisition of voting securities "solely for the purpose of investment," if, as a result of the acquisition, the securities held do not exceed 10 percent of the outstanding voting securities of the issuer and the "person holding or acquiring such voting securities has no intention of participating in the formulation, determination, or direction of the basic business decision of the issuer."[2]

Narrow definition for "solely for the purposes of investment" exemption

Since there was no dispute that the Third Point funds had acquired voting securities in excess of the HSR threshold and failed to timely file notification, in their publicly-issued statements and court documents, the agencies focused on whether Third Point had engaged in activities that were inconsistent with the historically narrowly defined "investment-only" exemption.

The agencies concluded the funds' actions took them outside the scope of the exemption, since their behavior demonstrated intent to "participate in the formulation of the basic business decisions of" Yahoo!, an intent that renders the exemption unavailable. The government highlighted the following actions:

- communicating with third parties to determine their interest in becoming the CEO of Yahoo! or a potential candidate for Yahoo!'s board of directors.

- taking steps to assemble an alternate slate of board of directors for Yahoo!.
- drafting correspondence to Yahoo! to announce that Third Point LLC was prepared to join its board.
- internally deliberating the possible initiation of a proxy battle for directors of Yahoo!.
- making public statements regarding proposing a slate of directors at Yahoo!'s next annual meeting.

The agencies viewed the actions by Third Point as disqualifying it and its funds from claiming the exemption. While the government has regularly challenged acquisitions as inconsistent with the "solely for the purpose of investment" exemption, this suit is noteworthy, since the identified conduct did not fall neatly within the list of conduct identified by the FTC as contrary to the exemption as provided in the agency's Statement of Basis and Purpose (SBP), which accompanied the issuance of the HSR rules in 1978. That list of things deemed to be inconsistent with an investment-only purpose includes:

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

A strong dissent and request for re-evaluation

While a majority of the FTC Commissioners supported the charges brought against Third Point, the two Republican Commissioners questioned whether the public interest supported referral of the matter for enforcement. Commissioners Ohlhausen and Wright argued that a narrow interpretation of the investment-only exemption is likely to "chill valuable shareholder advocacy while subjecting transactions that are highly unlikely to raise substantive antitrust concerns to the notice and waiting requirements of the HSR Act."

The dissenters argued not to focus on whether there had been a technical violation of the HSR Act but instead to look beyond the violation and examine the lack of competitive harm in the specific case and the likelihood that similar transactions would likewise not present competitive harm as weighed against the potential benefits to the market that could come from adopting a more lenient and broader interpretation of the exemption that would allow for shareholder advocacy.

The dissenting Commissioners also advocated that the HSR Act and premerger notification system should adapt to "allow antitrust agencies to focus on the proposed transactions that are most likely to result in a substantial lessening of competition." The Commissioners called for a revaluation of the scope of the investment-only exemption to take into consideration changes to the HSR framework that have taken place since 1978.

Staying on the right side of the line

While the dissenting Commissioners' statements might spark a reexamination of the scope of the "investment-only" exemption, the message for those looking to the current scope of the exemption is clear. The exemption remains a narrow one, and the FTC continues to actively enforce violations of the HSR Act even where there is no apparent competitive harm from an alleged violation.

Notes

1. The HSR size-of-transaction test is adjusted annually based on inflation.
2. Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33,450, 33,465 (July 31, 1978) (codified at 16 C.F.R. § 801.1(i)(1)).

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