



## Scope of the Investment-Only Exemption

**October 10, 2018**

The Hart-Scott-Rodino Act (“HSR Act” or the “Act”) requires parties to certain acquisitions to notify the Federal Trade Commission (“FTC”) and the Antitrust Division of the Department of Justice (“DOJ”) (collectively, “the Agencies”), and to observe the applicable statutory waiting period before closing. The HSR Act’s applicability is limited both initially by the size of transaction and size of person thresholds, and subsequently by any statutory exemptions.

The investment-only exemption acts as one such limitation, providing that acquisitions meeting certain requirements are not subject to the Act’s filing and waiting period obligations. Over the past decade, the FTC and DOJ have increasingly narrowed their interpretation of the exemption. Companies contemplating an acquisition should take note, as improper reliance on the investment-only exemption is one of the most common reasons the Agencies bring enforcement actions for violating the HSR Act’s premerger notification requirements.

### Scope of the Exemption

The investment-only exemption provides that any person acquiring up to 10 percent of the outstanding voting securities of the acquired entity is exempt from the Act’s filing and waiting period requirements if the acquisition is “solely for the purpose of investment.” Official statements regarding application of the exemption are sparse. The Act itself defines the phrase “solely for the purpose of investment” as the absence of an “intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.” The Statement of Basis and Purpose (“SBP”), which accompanies the HSR Rules, offers some—though limited—insight into the types of conduct the FTC might consider inconsistent with a passive investment purpose, including the following non-exhaustive list of actions:

- [n]ominating 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; or
- engaging in the foregoing with respect to any entity directly or indirectly controlling the issuer.

### Agency Guidance and Enforcement

While the Agencies have issued very little additional guidance on the contours of the exemption, recent FTC informal interpretations and enforcement actions by both Agencies demonstrate an increasingly narrow interpretation of the exemption.

In 2016, the DOJ settled a complaint against ValueAct for failing to file notification and observe the HSR waiting period in connection with its acquisition of voting shares in Baker Hughes and Halliburton. The DOJ took issue with ValueAct’s communications with senior management for Halliburton and Baker Hughes that advised on business improvement, contemplated acquisitions, and other business matters. The DOJ explained that “[a]n investor who is considering influencing basic business decisions – such as merger and acquisition strategy, corporate re-structuring, and other competitively significant business strategies (e.g., relating to price, production capacity, or production output) – is not passive.” The DOJ also pointed to ValueAct’s reputation as a well-known activist investor and similar general statements from the company’s website as circumstantial evidence of non-passive intent.

The DOJ settlement imposed behavioral remedies and a fine of \$11 million on ValueAct, representing the highest fine ever imposed for an HSR Act violation. Notably, apart from a single instance of communication, all other relevant communications between ValueAct and the issuer took place within a few days to eleven months *after* ValueAct crossed the HSR filing thresholds. The case thus demonstrates the DOJ’s willingness to aggressively rely on *ex post facto* circumstantial evidence in finding non-passive intent, despite contrary guidance in the SBP.

*Continued on page 2...*

# Scope of the Investment-Only Exemption

Continued from page 1...

Between 2014-2018, the FTC released a series of Informal Interpretations regarding application of the investment-only exemption. Most recently, in January 2018, the FTC reiterated that the exemption is “highly fact-specific and focuses on whether intent is truly passive.”<sup>1</sup> The FTC further advised that in all instances involving acquisitions solely for the purpose of investment, the burden is on the investor to demonstrate that its intent is truly passive (e.g., that the investor has no intention of participating in the formulation, determination, or direction of the basic business decisions of the acquired issuer, including outsourcing such functions to a manager).<sup>2</sup>

## Consequences of Failing to Notify

Parties that fail to file or otherwise do not observe the waiting period under the HSR Act may be subject to large civil penalties (up to \$41,484 per day) and future reporting or other restrictions on conduct.<sup>3</sup> Significant civil penalties may be assessed as HSR Act penalties accrue from the date of closing until a corrective HSR Act filing is made and the transaction gains Agency approval. Further, as demonstrated in the *ValueAct* settlement, the Agencies appear willing to impose significant civil fines based on repeated violations of the HSR Act as well as other aggravating factors. Given the Agencies’ increasingly narrow interpretation of the exemption, investors should engage antitrust counsel before taking any actions that the Agencies may consider to be inconsistent with a passive investment purpose. Recent enforcement actions arising out of the investment-only exemption are noted in the Appendix that follows.

For more information on the investment-only exemption or the HSR Act in general, please contact any member of the firm’s [antitrust practice](#).

<sup>1</sup> In 2016, the agency withdrew a prior Informal Interpretation, issued in 2014, which was decided on the application of “bright-line” rules. The FTC stated only that “[t]his no longer represents the position of the PNO.” <https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1403011>.

<sup>2</sup> FTC Informal Interpretation 18010003 (Jan. 29, 2018), <https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/18010003>.

<sup>3</sup> FTC, *FTC Publishes Inflation-Adjusted Civil Penalty Amounts* (Jan. 23, 2018), <https://www.ftc.gov/news-events/press-releases/2018/01/ftc-publishes-inflation-adjusted-civil-penalty-amounts>.

## HSR Act Enforcement: Investment-Only Exemption

Case	Fine	Conduct	Complaint
<i>United States v. William F. Farley</i> , 1995 No. 1:92-cv-1071 (N.D. Ill., 1995)	\$425,000	The DOJ alleged that Farley did not have a passive intent with respect to his 1998 acquisitions of West Point voting stock. DOJ cited the following as evidence: the stock was bought using funds borrowed for the purpose of investment in possible acquisition candidates; board meeting minutes of one of Farley’s companies indicated West Point had once been contemplated as an acquisition target; Farley previously discussed the possibility of acquiring West Point with an investment bank; an internal memo analyzed the effect of acquiring West Point on Farley’s other companies; and Farley had a business that competed with West Point.	<a href="https://www.ftc.gov/enforcement/cases-proceedings/891-0036/farley-william-f-united-states-america-ftc">https://www.ftc.gov/enforcement/cases-proceedings/891-0036/farley-william-f-united-states-america-ftc</a>

Continued on page 3...

# Scope of the Investment-Only Exemption

Continued from page 2...

## HSR Act Enforcement: Investment-Only Exemption (Continued)

Case	Fine	Conduct	Complaint
<i>United States v. William H. Gates</i> , No. 1:04-cv-00721-CKK (D.D.C. 2004)	\$800,000	The FTC determined Gates did not qualify for the investment-only exemption in connection with his May 9, 2002 acquisition of voting securities of ICOS, (made through his investment entity, Cascade) because he intended to participate in the formulation, determination, or direction of the basic business decisions of ICOS through, among other things, his membership on the board of directors of ICOS. The FTC noted this was Gates' second HSR violation in a six month period, which factored into the Agency's decision to pursue this enforcement action.	<a href="https://www.ftc.gov/sites/default/files/documents/cases/2004/05/040503gatespremrgrcmplt.pdf">https://www.ftc.gov/sites/default/files/documents/cases/2004/05/040503gatespremrgrcmplt.pdf</a>
<i>United States v. Manulife Fin. Corp.</i> , No. 1:04-cv-0722-RBW (D.D.C. 2004)	\$1,000,000	The DOJ alleged Manulife intended to merge with the target at the time it acquired the target's stock, citing the following evidence: the companies were competitors; the companies discussed the possibility of a merger within the last year; after the stock was acquired, Manulife's CEO contacted the target's CEO to discuss a possible merger; and the companies announced that they had agreed to merge after the stock acquisition.	<a href="https://www.justice.gov/atr/case/us-v-manulife-financial-corp">https://www.justice.gov/atr/case/us-v-manulife-financial-corp</a>
<i>United States v. James D. Dondero</i> , No. 1:07-cv-00931-ESH (D.D.C. 2007)	\$250,000	The FTC determined that Dondero could not rely on the investment only exemption when he exercised an option to acquire 10,000 shares of Motient Corp., without making an HSR filing. Dondero was the ultimate parent entity of a hedge fund, Highland Management, which already held Motient stock that had appreciated significantly, resulting in Dondero holding over \$90M in Motient voting securities. A corrective filing was made, but the Commission brought an enforcement action against Dondero, noting that this violation took place less than one year after Highland Management made a corrective filing and outlined steps to avoid future violations following an unrelated previous transaction.	<a href="https://www.ftc.gov/enforcement/cases-proceedings/0510184/dondero-james-d-co-highland-capital-management-lp-united">https://www.ftc.gov/enforcement/cases-proceedings/0510184/dondero-james-d-co-highland-capital-management-lp-united</a>
<i>United States v. ESL Partners, L.P and ZAM Holdings, L.P.</i> , No. 1:08-cv-02175-JDB (D.D.C. 2008)	\$800,000	The FTC brought an enforcement action against Defendant who improperly relied on the investment-only exemption. Defendant-investor acquired AutoZone Inc. shares through an investment fund without making an HSR filing. However, the investment fund's advisor was managed and directed by an individual who also had representation on the target's board of directors. The FTC determined the exemption was not applicable under these circumstances.	<a href="https://www.ftc.gov/enforcement/cases-proceedings/0510091/esl-partners-lp-zam-holdings-lp-united-states-america-federal">https://www.ftc.gov/enforcement/cases-proceedings/0510091/esl-partners-lp-zam-holdings-lp-united-states-america-federal</a>

Continued on page 4...

# Scope of the Investment-Only Exemption

Continued from page 3...

## HSR Act Enforcement: Investment-Only Exemption (Continued)

Case	Fine	Conduct	Complaint
<i>United States v. Biglari Holdings, Inc.</i> , No. 1:12-cv-01586-RJL (D.D.C. 2012)	\$850,000	The FTC alleged that at the time of acquiring a stake in Cracker Barrel, Biglari intended to actively participate in the management of the target company including seeking a seat on the company's board of directors. Note: Biglari only requested representation on the board of directors of Cracker Barrel.	<a href="https://www.ftc.gov/enforcement/cases-proceedings/1110224/biglari-holdings-inc">https://www.ftc.gov/enforcement/cases-proceedings/1110224/biglari-holdings-inc</a>
<i>United States v. Barry Diller, No.</i> 1:13-cv-01002-GK (D.D.C. 2013)	\$480,000	The FTC brought this action against Diller alleging he did not have a passive intent at the time of the acquisitions in question. Between 2010 and 2012, Diller made a series of unreported acquisitions of Coca Cola shares resulting in his holding voting securities exceeding the reporting threshold. Diller did not qualify for the passive investment exemption because he intended to participate in the formulation, determination, or direction of the basic business decisions of Coke through his membership on the company's board of directors. Diller subsequently made corrective filings, but the Commission sought penalties because Diller had previously made a corrective filing in connection with an unrelated 1998 acquisition of voting securities in a different company.	<a href="https://www.ftc.gov/enforcement/cases-proceedings/121-0179/diller-barry-us">https://www.ftc.gov/enforcement/cases-proceedings/121-0179/diller-barry-us</a>
<i>United States v. Third Point Offshore Fund, LTD</i> , No. 1:15-cv-01366-KBJ (D.D.C. 2015)	\$0 The agencies determined not to seek civil penalties based on several factors, including that the violation was inadvertent and short-lived, and this was the defendants' first violation of the HSR Act. The agencies imposed behavioral remedies prohibiting defendants from relying on the investment-only exemption when certain factors are met.	The FTC brought an enforcement action alleging that defendants' intent was inconsistent with passive investment. At the time of defendants' purchases of Yahoo stock, defendant Third Point LLC, which made investment decisions on behalf of the other defendant investment funds, was taking actions inconsistent with an investment-only intent: defendants contacted certain individuals to gauge their interest in becoming CEO or potential board candidate of Yahoo; took other steps to assemble an alternate slate of board of directors for Yahoo; internally deliberated the possible launch of a proxy battle for directors of Yahoo; and made public statements that they were prepared to propose a slate of directors at Yahoo's next annual meeting.	<a href="https://www.ftc.gov/enforcement/cases-proceedings/121-0019/third-point-llc">https://www.ftc.gov/enforcement/cases-proceedings/121-0019/third-point-llc</a>

Continued on page 5...

# Scope of the Investment-Only Exemption

Continued from page 4...

## HSR Act Enforcement: Investment-Only Exemption (Continued)

Case	Fine	Conduct	Complaint
<i>United States v. VA Partners I, LLC</i> , No. 3:16-cv-01672-WHA (N.D. Cal. 2016)	\$11,000,000  ValueAct is also enjoined from relying on the “investment-only” exemption when it intends to influence, or is considering influencing, certain basic business decisions, including those relating to merger and acquisition strategy, corporate restructuring, and the company’s pricing, production capacity, or production output.	The DOJ alleged that ValueAct purchased shares of Halliburton and Baker Hughes with the intent to influence the companies’ business decisions, including decisions related to a merger of the two companies that was then under Agency investigation.	<a href="https://www.justice.gov/atr/case/us-v-va-partners-i-llc-et-al">https://www.justice.gov/atr/case/us-v-va-partners-i-llc-et-al</a>
<i>United States v. Fayez Sarofim</i> , No. 1:16-cv-02156-RC (D.D.C. 2017)	\$720,000	The FTC determined that Defendant could not rely on the investment-only exemption for unreported acquisitions during the time he was a member of each target company’s board. A board position necessarily caused him to participate in the formulation, determination, or direction of the basic business decisions of that company.	<a href="https://www.ftc.gov/enforcement/cases-proceedings/151-0064/united-states-federal-trade-commission-v-fayez-sarofim">https://www.ftc.gov/enforcement/cases-proceedings/151-0064/united-states-federal-trade-commission-v-fayez-sarofim</a>



This WSGR Alert was sent to our clients and interested parties via email on October 10, 2018.  
To receive future WSGR Alerts and newsletters via email, please contact Marketing at [wsgr\\_resource@wsgr.com](mailto:wsgr_resource@wsgr.com) and ask to be added to our mailing list.  
This communication is provided as a service to our clients and friends and is for informational purposes only. It is not intended to create an attorney-client relationship or constitute an advertisement, a solicitation, or professional advice as to any particular situation.

650 Page Mill Road | Palo Alto, CA 94304-1050 | Tel: (650) 493-9300 | Fax: (650) 493-6811 | email: [wsgr\\_resource@wsgr.com](mailto:wsgr_resource@wsgr.com) | [www.wsgr.com](http://www.wsgr.com)

© 2018 Wilson Sonsini Goodrich & Rosati, Professional Corporation  
All rights reserved.