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International Information for International Business

VOLUME 21, NUMBER 10 >>> OCTOBER 2015

## U.S. FTC Settlement Narrowly Interprets Hart-Scott-Rodino Act's 'Investment-Only' Exemption from Reporting Requirements

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On Aug. 24, 2015, the U.S. Federal Trade Commission ("FTC") and the U.S. Department of Justice ("DOJ") filed a proposed settlement in federal court to settle charges that Third Point LLC and three of its affiliated funds ("Third Point Funds" and, together with Third Point LLC, "Third Point") violated the Hart-Scott-Rodino ("HSR") Act's pre-merger reporting requirements in connection with their 2011 acquisitions of stock in Yahoo! Inc.

The government's complaint alleges that Third Point improperly relied on the "investment-only" exemption to the HSR Act's filing and waiting requirements while acquiring Yahoo! voting securities in excess of the HSR Act's filing threshold. Third Point allegedly engaged in actions evidencing an "intent to acquire voting securities of Yahoo! other than solely for the purpose of investment," including reaching out to potential candi-

dates for Yahoo!'s board of directors and taking preliminary steps to launch a proxy contest for seats on Yahoo!'s board.

The settlement clarifies the FTC's view that the HSR Act's "investment-only" exemption applies only to purely passive acquisitions of voting securities. The exemption is not available if an acquiring person purchases voting securities with the intention of influencing basic business decisions or participating in the management of the issuer.

Most importantly, the FTC has clarified its position that efforts by an investor to so much as *prepare* to launch a proxy battle or propose a change in corporate policy can render the exemption unavailable.

Thus, prior to consummating a large acquisition, investors should seek advice of counsel regarding 1) whether the size of an acquisition triggers the HSR Act's filing requirement, and 2) whether any of their actions, statements or intentions could be character-

ized as inconsistent with an intent to invest “solely for the purpose of investment.”

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**Investors who are contemplating engaging in shareholder activism, even if they have not decided to proceed with an activist campaign, need to consider whether they must file a Hart-Scott-Rodino pre-merger notification form when acquiring stock in a target company.**

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### **The HSR Act’s Filing and Waiting Requirements and the Exemption for Investments Made ‘Solely for the Purpose of Investment’**

The HSR Act requires, in certain covered circumstances, acquiring persons and persons whose voting securities or assets are being acquired to file notifications with the federal antitrust agencies and to observe a waiting period before consummating acquisitions of voting securities or assets. The filing and waiting requirements are triggered when an acquisition would result in the acquiring person holding an aggregate total amount of the voting securities and assets of the acquired person that exceeds a certain annually adjusted threshold (currently \$76.3 million).<sup>1</sup> The filing and waiting requirements are intended to ensure that the federal antitrust authorities have an opportunity prior to closing to investigate whether a proposed transaction violates the antitrust laws. The government may seek injunctive relief and civil penalties for failure to comply with the HSR Act’s filing and waiting requirements, including a fine of up to \$16,000 for each day during which any applicable person is in violation of the HSR Act.

However, the HSR Act exempts acquisitions of voting securities from the filing and waiting requirements where the following conditions are met: 1) the acquisition is for less than 10 percent of the outstanding voting securities of the issuer, and 2) the investor is acquiring the securities “solely for the purpose of investment[.]”

The regulations promulgated under the HSR Act state that “[v]oting securities are held or acquired ‘solely for the purpose of investment’ if the person holding or acquiring such voting securities has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.”

The FTC has made clear that it interprets the “investment-only” exemption narrowly, and, in its view, the exemption will not apply where an acquiring person intends to influence or participate in the selection of an issuer’s board of directors.<sup>2</sup> Similarly, the DOJ has filed complaints against investors who merely “considered” taking certain actions that were inconsistent with an intent to act as a purely passive investor.<sup>3</sup>

### **Third Point’s Acquisition of Yahoo! Securities and the Resulting Government Action**

Between Aug. 8, 2011, and Sept. 8, 2011, three Third Point Funds each acquired more than \$66 million of Yahoo! voting securities on the open market, thus exceeding the applicable HSR Act’s filing threshold at the time. The Third Point Funds believed that the acquisitions were covered by the “investment-only” exemption. Thus, they did not file pre-merger notification forms with the FTC prior to making the acquisitions.

On Sept. 8, 2011, Third Point LLC filed a Schedule 13D with the Securities and Exchange Commission publicly disclosing the Third Point Funds’ holdings in Yahoo!. The Third Point Funds did not file the required HSR Act notification forms until Sept. 16, 2011, when Third Point formally decided to move forward with seeking to replace certain members of Yahoo!’s board of directors.

On Aug. 24, 2015, the FTC, by a 3-2 vote, recommended that the DOJ bring charges against Third Point, concluding that “the funds were not exempt from the HSR Act’s reporting obligations under the ‘investment-only’ exemption because Third Point took actions that belied an investment-only intent while making the purchases.”<sup>4</sup> That same day, the DOJ filed a complaint against Third Point and a proposed settlement in federal court for the District of Columbia, alleging that certain acts by Third Point were inconsistent with an intent to acquire securities “solely for the purpose of investment.”

Specifically, between Aug. 10 and Sept. 16, 2011, Third Point was alleged to have done the following:

- contacted certain individuals to gauge their interest and willingness to become the chief executive officer of Yahoo! or a potential board candidate of Yahoo!;
- took other steps to assemble an alternate slate of board of directors for Yahoo!;
- drafted correspondence to Yahoo! to announce that Third Point LLC was prepared to join the board of Yahoo!;
- internally deliberated the possible launch of a proxy battle for directors of Yahoo!; and
- made public statements that it was prepared to propose a slate of directors at Yahoo!’s next annual meeting.

The government did not seek civil penalties against Third Point, noting that Third Point ultimately complied with the filing requirement and that this was Third Point’s first violation of the HSR Act.<sup>5</sup> Instead, the proposed settlement, which requires approval and entry by a federal judge, enjoins Third Point from consummating an acquisition covered by the HSR Act without complying with the filing and waiting requirements, where Third Point has engaged in certain enumerated acts with respect to the issuer during the four months prior to the acquisition.

The enumerated acts include the following:

- nominating candidates for the issuer’s board of directors;
- proposing corporate action requiring shareholder approval;
- soliciting proxies;
- having, or being associated with an entity that has, a controlling shareholder, director, officer or employee who is simultaneously serving as an officer or director of the issuer;
- competing with the issuer; and
- inquiring with a third party regarding his or her interest in serving as a member of the issuer’s board of directors or management.<sup>6</sup>

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**Prior to consummating a large acquisition, investors should seek advice of counsel regarding 1) whether the size of an acquisition triggers the Hart-Scott-Rodino Act’s filing requirement, and 2) whether any of their actions, statements or intentions could be characterized as inconsistent with an intent to invest “solely for the purpose of investment.”**

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### Guidance for Investors

The takeaway from the Third Point settlement is that the “investment-only” exemption is narrowly applied by the federal antitrust regulators. In their view, its applicability depends on the acquirer’s intention, as well as its conduct. While certain overt acts, like reaching out to potential board candidates for an issuer or proposing changes to an issuer’s corporate policy, likely render the exemption inapplicable, investors merely contemplating such actions also may need to file a pre-merger notification form with the FTC and the Antitrust Division of the DOJ prior to acquiring shares in excess of the HSR Act’s filing threshold in such issuer. The agencies will review

a variety of factors, including the timing of such conduct or consideration, when determining if the “investment-only” exemption applies.

Accordingly, investors who are contemplating engaging in shareholder activism, even if they have not decided to proceed with an activist campaign, need to consider whether they must file an HSR pre-merger notification form when acquiring stock in a target company. When in doubt, investors should seek the advice of counsel with regard to any actions, statements or potential plans similar to Third Point’s that could result in the government concluding that the “investment-only” exemption does not apply.

### NOTES

<sup>1</sup> The HSR Act requires these thresholds to be adjusted and published annually “to reflect the percentage change in the gross national product for such fiscal year compared to the gross national product for the [prior year.]” 18 U.S.C. § 18a(a)(2).

<sup>2</sup> See Debbie Feinstein *et al.*, “‘Investment-only’ means just that,” Federal Trade Commission Blog, [https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just?utm\\_source=govdelivery](https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just?utm_source=govdelivery).

<sup>3</sup> See Complaint, *United States v. Manulife Fin. Corp.*, No. 04-722 RBW (D.D.C., May 3, 2004); Complaint, *United States v. Pennzoil Co.*, No. 1:94CV02077 (PLF) (D.D.C. Sept. 26, 1994).

<sup>4</sup> Statement of the Federal Trade Commission, *In the Matter of Third Point*, File No. 121-0019 (Aug. 24, 2015), available at [https://www.ftc.gov/system/files/documents/public\\_statements/777341/150824thirdpointcommstmt.pdf](https://www.ftc.gov/system/files/documents/public_statements/777341/150824thirdpointcommstmt.pdf).

<sup>5</sup> See Feinstein, *supra*, note 2.

<sup>6</sup> Proposed Final Judgment, *United States v. Third Point Offshore Fund, Ltd.*, No. 1:15-cv-01366, at 4-5 (Aug. 24, 2015).

*The text of the FTC’s proposed settlement is available at <https://www.ftc.gov/system/files/documents/cases/150824thirdpointstip.pdf>.*

*The text of the FTC’s press release on the proposed settlement is available at <https://www.ftc.gov/news-events/press-releases/2015/08/third-point-funds-agree-settle-ftc-charges-they-violated-us>.*

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