ALERTS

Activist Investing Update: DOJ's HSR Action Against ValueAct Highlights Uncertainties Regarding the 'Investment-Only' Exemption

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Last month, the U.S. Department of Justice (the "DOJ") filed a complaint in federal court against two ValueAct investment funds and their shared general partner (together, "ValueAct") for failing to comply with the notification and waiting requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act"). According to the complaint, ValueAct acquired over $2.5 billion of voting securities of two oil industry service companies, Halliburton Company ("Halliburton") and Baker Hughes Incorporated ("Baker Hughes"), after the two companies announced a possible merger on Nov. 17, 2014, which has since been abandoned.[1] The complaint alleges that ValueAct became "one of the largest shareholders of both Halliburton and Baker Hughes, without providing the government its statutory right to notice and prior review of the stock purchases."[2]

The HSR Act requires purchasers of voting stock to file notifications with the DOJ and the Federal Trade Commission (the "FTC") and to wait to acquire the stock when the purchaser's holdings would exceed a minimum threshold of aggregate voting stock that is adjusted and published annually.[3] The "investment-only" or so-called "passive investor" exemption allows a purchaser to acquire stock without observing the notification and waiting requirements. The exemption requires that the purchaser's holdings cannot exceed 10 percent of the company's voting securities and that the purchase must be "solely for the purpose of investment."[4] The DOJ (and the FTC) narrowly interpret this

HSR Act provision to allow an investor to rely on the exemption only when acquiring voting stock with the intention of being a truly passive investor.[5] In their view, if there is an intention to influence business decisions or participate in management, the exemption becomes unavailable.

The DOJ alleges that, from the time ValueAct began acquiring shares in Halliburton and Baker Hughes, its executives were planning to use ValueAct's position as a significant shareholder in both companies to increase the chances that the merger would be implemented. The complaint cites memoranda to investors stating that the purchase of Halliburton and Baker Hughes securities would allow ValueAct to "be a strong advocate for the deal to close" and "[i]ncrease [the] probability of [the] deal happening," as well as statements regarding ValueAct's intent to help restructure the merger transaction if it encountered regulatory or other hurdles, including a "back-up plan" to sell components of Baker Hughes' business if the merger failed. In addition, the DOJ alleges that ValueAct intended to influence management at both Halliburton and Baker Hughes through frequent direct communications regarding their operations, including multiple meetings with the companies' respective CEOs. Specifically, the complaint mentions statements made by ValueAct to Halliburton regarding contacting other shareholders about ValueAct's view on the merger prior to a shareholder vote, recommending a firm that could assist the companies with post-merger real estate integration services, and proposing changes to Halliburton's executive compensation plan. The complaint seeks, at a minimum, a civil penalty of $19 million as well as an injunction against future violations of the HSR Act.[6]

Implications for Investors of the *ValueAct* Complaint

The DOJ's complaint represents an extension of its position that proxy-related activity (such as nominating board candidates or making shareholder proposals), board representation or being a competitor of the issuer renders the "investment-only" exemption inapplicable. Significantly, the DOJ seemed to place heavy emphasis on the fact that ValueAct is an activist investor. The following are key takeaways from the complaint:

- *Communications with an issuer outside the types of conduct enumerated in the exemption's Statement of Basis and Purpose may amount to intent to "influence management."* While some amount of

communication between shareholders and issuers is expected, the government has taken the position that there is a point at which having discussions with and making recommendations to the management of an issuer renders the exemption inapplicable. Unlike prior enforcement actions, the complaint here does not allege that ValueAct took any steps during the relevant time periods toward engaging in any of the enumerated[7] actions that typically render the exemption unavailable or took action to change the composition of the board of directors.[8] In contrast, the facts emphasized in the complaint indicate that communications with the management of the issuer about the running of the business could be evidence that the investor improperly availed itself of the exemption.

- *Internal or promotional statements may be viewed by regulators as evidence of intent, even in the absence of traditionally "activist" steps.* The government seems to presume that ValueAct's investments were not passive because ValueAct is "well known as an activist investor" that promotes itself as such.[9] The complaint alleges that internal communications and marketing statements referring to ValueAct's general activist strategy are proof that ValueAct did not purchase the voting securities "solely for the purpose of investment." Thus, the way investors market themselves and/or typically conduct business may play a role in how future investments are perceived by government agencies — causing those agencies to look at such investors' acquisitions with a more critical eye — as the DOJ did here.

    - Internal communications and drafts, which can be obtained by the government during the course of an HSR-related investigation;

    - The investor's own marketing materials or communications —all things being equal, an investor that generally holds itself out to be an activist or as pursuing activist strategies may have more difficulty availaing itself of the exemption;

    - Statements that an investor may seek to take on an active role in the issuer, depending on future events (e.g., regulatory roadblocks or the failure of an underlying merger to be consummated); and

    - A Schedule 13D filing with the SEC, even if the stated purpose is "investment purposes," particularly if the investor discloses plans to discuss business matters with management.[10]

- In addition, the complaint indicates that any of the following could be viewed after the fact by the government as evidence that the investor's intent was not "solely for the purpose of investment" at the time an otherwise reportable transaction was made:

- *Be cautious when investing in competitors.* It is generally understood that multiple investments in competing issuers may be subject to heightened scrutiny. The FTC has stated informally[11] that investments of 10 percent or more in a competitor to an issuer may create the presumption that an investment in the issuer is not passive. Here, the government does not dispute that ValueAct held less than 10 percent of both companies at all relevant times. Notwithstanding that, the DOJ asserts that the "investment-only" exemption does not apply, highlighting the fact that the 10 percent test should not be viewed as a safe harbor. Accordingly, investments of less than 10 percent in competitors that are also parties to a potential merger can expect to receive an even greater level of scrutiny, particularly where the investor engages with management personnel at either of the merging parties.

- *Hindsight can cause a regulator to assume that an investor intended to influence management beginning with its initial acquisition.* It has long been understood that a purported change of intent that is close in time to an otherwise reportable transaction may be viewed skeptically by the agencies. The *ValueAct* complaint alleges that ValueAct was ineligible for the exemption because it "planned from the outset to take steps to influence the business decisions of both companies, and met frequently with executives of both companies to execute those plans," precluding the possibility that the stock purchases were made "solely for the purpose of investment."[12] Although many of the specific events cited in the complaint took place after ValueAct had ceased to acquire additional shares,[13] the government has attempted to use prior statements made by ValueAct personnel about their plans for the merging parties as evidence of ValueAct's purported intent at the time of the acquisition.

The court in this matter could shed light on how narrowly the exemption should be interpreted. Whether government agencies are correctly interpreting the scope of the "investment-only" exemption is far from settled law. Indeed, there are conflicting opinions on this issue that have not been addressed because prior enforcement actions involving the exemption have been settled out of court. For instance, the FTC

Commissioners involved in the recent *Third Point* action did not unanimously agree on the interpretation of the "investment-only" exemption. The dissenters stated: "[T]he Commission's narrow interpretation of the 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."[14] Some members of the premerger bar also have advocated for a simpler, bright-line test for the use of the investment-only exemption, or at least for a clearer set of examples of permissible conduct while still claiming the exemption.

A decision by the court in *ValueAct*, either in connection with motions or following a trial, hopefully will clarify the scope of the "investment-only" exemption. In the meantime, investors should be aware that internal communications, communications with management of an issuer, and marketing or promotional statements can be used against them should the government choose to bring an enforcement action. Investors should continue to seek the advice of counsel regarding the HSR implications of their potential investments.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] The Halliburton-Baker Hughes merger was challenged by the DOJ. *See* Press Release, U.S. Dep't of Justice, Justice Department Sues to Block Halliburton's Acquisition of Baker Hughes (Apr. 6, 2016). On May 1, 2016, the parties announced that they would be terminating their merger agreement.

[2] Complaint at ¶ 5, *United States v. VA Partners I, LLC*, No. 16-cv-01672 (N.D. Ca. Apr. 4, 2016).

[3] The minimum threshold for reportability under the HSR Act is currently $78.2 million.

[4] 15 U.S.C. § 18a(c)(9).

[5] For the more about the "investment-only" exemption and the implications of another recent enforcement action, see our previous *Alert*,

"Hart-Scott-Rodino Filing Update: Recent Settlement Interprets 'Investment-Only' Exemption Narrowly" (Sept. 3, 2015).

[6] ValueAct entities previously violated the HSR Act by failing to make required filings. The first time, no enforcement action was brought against the company. The second time, ValueAct settled the enforcement action and paid a civil penalty of $1.1 million in connection with the settlement.

[7] According to the Statement of Basis and Purpose underlying the exemption, conduct that is viewed as inconsistent with an acquisition that was purportedly solely for the purpose of investment includes: (1) nominating a candidate to the board of the directors of the issuer; (2) proposing corporate action requiring shareholder approval (although the mere voting of stock is not inconsistent with an investment intent); (3) soliciting proxies; (4) having a controlling shareholder, director, officer or employee simultaneously serving as an officer or director of the issuer; (5) being a competitor of the issuer; or (6) doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer. 43 Fed. Reg. 33,450, 33,465 (July 31, 1978).

[8] In the 2012 enforcement action against Biglari Holdings Inc., the investor allegedly reached out to the issuer requesting board seats, in addition to other actions. More recently, the government alleged that Third Point LLC and three of its affiliated funds took various steps in preparation of a proposal for an alternate slate of directors for the issuer in question, Yahoo! Inc.

[9] Complaint at ¶¶ 12-13; *see also* Complaint at ¶ 2.

[10] According to the complaint, ValueAct filed a Beneficial Ownership Report (Schedule 13D) with the Securities and Exchange Commission ("SEC") that said ValueAct "might 'propos[e] changes in [Baker Hughes's] operations.'"

[11] HSR Informal Interpretation Letters, #1403011 (March 20, 2014).

[12] Complaint ¶ 4.

[13] According to the complaint, ValueAct's purchases, through one of its funds, of Baker Hughes voting securities continued through Jan. 15, 2015, one day prior to the filing of the Schedule 13D. ValueAct's purchases, through two of its funds, of Halliburton voting securities continued through June 30, 2015 and March, 12, 2015, respectively — prior to July 2015 and

September 2015 meetings with Halliburton's CEO in which ValueAct presented: (1) proposed changes to Halliburton's executive compensation plan; and (2) a potential restructuring plan to selectively acquire parts of Baker Hughes' business.

[14] Dissenting Statement of Commissioners Maureen K. Ohlhausen and Joshua D. Wright, *In the Matter of Third Point*, File No. 121-0019 (Aug. 24, 2015).

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