ALERTS

Activism and Passivity: HSR Act and Section 13(d) Developments for Investors

July 28, 2016

On July 12, 2016, the U.S. Department of Justice (the "DOJ") announced that investment firm ValueAct had entered into a consent decree in which it agreed to pay $11 million to settle charges that two of its affiliated funds acquired large stakes in Halliburton Company ("Halliburton") and Baker Hughes Incorporated ("Baker Hughes") in violation of the notification and waiting requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act"). The DOJ asserted that ValueAct was required to make an HSR Act filing, but ValueAct had asserted that no such filing was required due to the "investment-only" or so-called "passive investor" exemption. On the heels of such announcement, the Securities and Exchange Commission (the "SEC") provided clarification that it does not view the inability to utilize the "passive investor" exemption under the HSR Act as equivalent to an investor not being considered "passive" for purposes of Section 13(d) under the Securities Exchange Act of 1934 (the "Exchange Act").

ValueAct Settles with DOJ Over Alleged HSR Act Violations

The DOJ's case against ValueAct hinged on the applicability of the "investment-only" exemption from filing under the HSR Act, which 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."[1] As previously reported,[2] although ValueAct's holdings of Halliburton and Baker Hughes did not exceed 10 percent, the DOJ's complaint alleged that ValueAct's investment was not passive

because it "planned from the outset to take steps to influence the business decisions of both companies."[3] ValueAct has continued to refute the allegations made in the DOJ's complaint, which originally sought $19 million in penalties. However, in light of the recent announcement[4] that, starting on Aug. 1, 2016, penalties assessed for HSR Act violations (including violations that took place prior to Aug. 1, 2016) will increase by 150 percent from a maximum of $16,000 per day to $40,000 per day, ValueAct resolved the matter with the DOJ before the potential fine could be increased to approximately $47.5 million from the $19 million initially sought.

The settlement involves the largest monetary penalty that has been assessed for an HSR Act violation to date, and is nearly twice as large as the previous record fine ($5.67 million levied against Gemstar-TV Guide International Inc. and TV Guide Inc. in 2003). In addition to the monetary penalty, the proposed final judgment expressly enjoins ValueAct from relying on the "investment-only" exemption when ValueAct intends to, or ValueAct's investment strategy with respect to a particular issuer identifies circumstances in which ValueAct may, do any of the following:

- Propose to an officer or director of the issuer a merger, acquisition or sale of the issuer to another party;
- Propose to an officer or director of another company, in which ValueAct owns voting securities or an equity interest the potential terms on which that company might merge with, acquire or sell itself to the issuer;
- Propose to an officer or director of the issuer new or modified terms for, or an alternative transaction to, any publicly announced merger or acquisition to which the issuer is a party;
- Propose to an officer or director of the issuer changes to the issuer's corporate structure that require shareholder approval; or
- Propose to an officer or director of the issuer changes to the issuer's strategies regarding the pricing, production capacity, or production output.[5]

While the case was resolved before the court expressed its views on the scope of the "investment-only" exemption, the proposed judgment reflects the DOJ's position on its scope. Accordingly, investors should be aware that the current regulatory environment includes a narrow interpretation of the exemption. As we have previously noted,[6] the

ValueAct settlement highlights additional examples of behavior that the DOJ will view as inconsistent with an intent to acquire solely for the purpose of investment. The head of the DOJ's Antitrust Division stated that "ValueAct was not entitled to avoid the HSR requirements by claiming to be a passive investor, while at the same time injecting itself in [the proposed merger between Halliburton and Baker Hughes] … . Today's record penalty and important injunctive relief demonstrate our continued commitment to vigorous enforcement of these important notification and waiting period requirements."[7]

It should be assumed that any intention (even absent overt actions) to influence business decisions or participate in management renders the "investment-only" exemption unavailable. As we have previously written, even internal communications, communications with management of an issuer, and marketing or promotional statements can be used as evidence that an investor was not truly passive at the time an otherwise HSR Act-reportable acquisition[8] was made.

SEC Distinguishes Test for Filing on Schedule 13G from HSR Act "Investment-Only" Exemption

Two days after the ValueAct settlement, on July 14, 2016, the staff of the Division of Corporation Finance of the SEC published Compliance and Disclosure Interpretation ("CDI") #103.11 relating to Section 13(d) under the Exchange Act. The SEC staff made clear that it does not view the inability to utilize the "investment-only" exemption under the HSR Act as automatically disqualifying an investor from being considered "passive" for purposes of Section 13(d) of the Exchange Act and thereby being able to utilize the shorter form Schedule 13G (rather than Schedule 13D). While there is certainly overlap between the ability to utilize the HSR Act's "investment-only" exemption and the test for being able to file on Schedule 13G, the test for Schedule 13G generally depends on whether an investor has acquired or is holding its securities with the purpose or effect of changing or influencing control of the relevant issuer. In the SEC staff's view, discussions with management and the content and context of those discussions is relevant in determining whether an investor is "passive" for Section 13(d) purposes and, it noted in new CDI #103.11, that it has long been the view of the staff that engaging with management on executive compensation or social or public interest issues would not in and of itself

preclude an investor that was otherwise eligible to file on Schedule 13G from continuing to do so. Likewise, engagement on corporate governance topics as part of a broad effort to promote good corporate governance practices for all of its portfolio companies rather than to influence control of a particular portfolio company would not preclude an investor from utilizing Schedule 13G. However, engaging with management to call for a sale of the issuer, a sale of a significant amount of its assets or a restructuring would, as would engaging with management on a contested election of directors.

Accordingly, investors should continue to seek the advice of counsel regarding the HSR Act and SEC filing 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] 15 U.S.C. § 18a(c)(9).

[2] See our May 20, 2016 *Alert*, "Activist Investing Update: DOJ's HSR Action Against ValueAct Highlights Uncertainties Regarding the 'Investment-Only' Exemption."

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

[4] See our July 7, 2016 *Alert*, "HSR Act Update: 150-Percent Increase in Maximum Civil Penalties for Violations; Yearly Increases to Follow."

[5] [Proposed] Final Judgment, *United States v. VA Partners I, LLC*, No. 16-cv-01672 (N.D. Ca. Jul. 12, 2016).

[6] See our May 20, 2016 *Alert*, "Activist Investing Update: DOJ's HSR Action Against ValueAct Highlights Uncertainties Regarding the 'Investment-Only' Exemption."

[7] Press release, U.S. Dep't of Justice, Justice Department Obtains Record Fine and Injunctive Relief against Activist Investor for Violating Premerger Notification Requirements (July 12, 2016).

[8] Currently, the minimum threshold requiring a purchaser to make an HSR Act notification is $78.2 million. See our Jan. 21, 2016 *Alert*, "Increased HSR Act Thresholds Announced for 2016."

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