

Client Alert

August 31, 2015

Recent FTC Action Underscores Narrow Interpretation of HSR “Investment-Only” Exemption

By Jeffrey A. Jaeckel and Lauren A. Navarro

On August 24, 2015, the Federal Trade Commission (“FTC” or the “Commission”) filed a proposed settlement in federal court regarding alleged violations by Third Point LLC (“Third Point”) of the premerger reporting laws related to Third Point’s 2011 open market acquisition of stock in Yahoo! Inc. (“Yahoo”). In its complaint, the FTC alleged that Third Point’s conduct—including assembling an alternate slate for the Yahoo Board and publicly stating that it was prepared to propose a slate of directors at Yahoo’s next annual meeting—established that its open market acquisitions of stock were not exempt from the law’s reporting requirements on the ground that they were “solely for the purpose of investment.”

THE HSR “INVESTMENT-ONLY” EXEMPTION

The Hart-Scott-Rodino Act (“HSR Act”) requires that companies and individuals notify the FTC and the Department of Justice (“DOJ”) of most large transactions that affect commerce in the United States and satisfy the HSR Act reporting thresholds. Those acquirers must then observe a waiting period before closing their transaction, while one of the two agencies determines whether the transaction may result in a substantial lessening of competition.

The HSR Act exempts acquisitions of up to ten percent of an issuer’s voting securities if the acquisition is made solely for the purpose of investment.¹ The HSR Rules state that this “investment-only” exemption applies if the investor acquires less than ten percent of the issuer’s shares and has “no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.”²

The FTC’s Statement of Basics and Purpose promulgating the final HSR rules in 1978 describe certain types of conduct that will be viewed as evidence of intent inconsistent with investment purpose, including but not limited to: (1) nominating a candidate for the board of directors of the issuer; (2) proposing corporate action requiring shareholder approval; (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.³

¹ 15 U.S.C. §18a(c)(9).

² Rule 801.1(i)(1).

³ 43 Federal Register 33450, 33465 (July 31, 1978); available at https://www.ftc.gov/sites/default/files/documents/hsr_statements/43-fr-33450/780731fr43fr33450.pdf.

Client Alert

THE “INVESTMENT-ONLY” EXEMPTION IS NARROW

According to the FTC, the interpretation and application of the exemption has long been a narrow one. Specifically:

- In 1982, former Competition Director Thomas J. Campbell wrote that “[t]he Bureau construes the term ‘solely for the purpose of investment,’ as used in the Act and in the premerger rules, to apply only to purchasers who intend to hold the voting securities as passive investors. If an acquiring person purchases voting securities with the intention of influencing the basic business decisions of the issuer, or with the intention of participating in the management of the issuer, the exemption is not available.”⁴
- In 1988, James Mullenix, then Associate Director of the FTC’s Bureau of Competition, stated that “[i]f any company is seriously considering a takeover attempt, but has not yet made a final decision, it is not buying stock solely for the purpose of investment. If it expects to nominate someone for a seat on the board of directors, it is not buying stock solely for the purpose of investment.”⁵
- In 2002, Marian Bruno, then Assistant Director of the FTC’s Premerger Notification Office, warned institutional investors that the investment-only exemption is unavailable if the acquirer attempts to influence the management decisions of the issuer.⁶

The FTC’s settlement with Third Point continues this trend.

THE AVAILABILITY OF THE “INVESTMENT-ONLY” EXEMPTION TO THIRD POINT’S ACQUISITIONS

Third Point is a New York-based financial investment firm responsible for managing approximately \$16 billion through a variety of funds, including three affiliated hedge fund companies: Third Point Partners Qualified L.P., Third Point Ultra, LTD, and Third Point Offshore Fund, LTD (collectively, the “Funds”). In the transactions at issue, the Funds made multiple open market acquisitions of Yahoo voting securities between August 8, 2011 and September 8, 2011.⁷ These acquisitions resulted in each of the funds holding in excess of \$66 million, which was the applicable HSR filing threshold at the time.⁸

Third Point did not submit HSR premerger notification forms or observe the applicable waiting periods prior to making the acquisitions of Yahoo shares. Instead, the three Funds claimed they were “exempt” from the HSR reporting requirements because the purchases were made “solely for the purpose of investment” and each held less than ten percent of Yahoo’s outstanding securities.⁹

The FTC concluded, however, that Third Point was engaged in conduct that was inconsistent with an “investment-

⁴ https://www.ftc.gov/sites/default/files/documents/reports_annual/6th-report-fy-1982/6annrpt1982_0.pdf.

⁵ 57 Antitrust Law Journal 125, 128 (1988).

⁶ <https://www.ftc.gov/public-statements/2002/06/hart-scott-rodino-25>.

⁷ The FTC’s Complaint alleges that each Fund was its own “ultimate parent entity” and each met the size of person test under the HSR Act.

⁸ The HSR Act thresholds are adjusted annually to track changes in the U.S. gross national product. See our client alert, [New HSR Filing Thresholds for 2015](#)

⁹ See the FTC’s Complaint available at <https://www.ftc.gov/system/files/documents/cases/150824thirdpointcmpt.pdf>.

Client Alert

only” intent at the time the Funds were acquiring the Yahoo shares. Specifically, the complaint alleges that Third Point was communicating with third parties to determine their interest in becoming the CEO or a board candidate of Yahoo. In addition, between August 10 and September 16, when the Funds ultimately made HSR filings, Third Point allegedly took the following steps:

- assembled an alternate slate for the Yahoo Board;
- drafted correspondence to Yahoo announcing that Third Point was prepared to join the Yahoo Board;
- internally discussed the possible launch of a proxy battle for directors of Yahoo; and
- stated publicly that it was prepared to propose a slate of directors at Yahoo’s next annual meeting.¹⁰

Because, in the FTC’s view, “Third Point’s conduct demonstrated that it intended to have more than a passive interest in Yahoo,” the agency concluded that that Third Point’s reliance on the investment-only exemption was misplaced.¹¹ The FTC sought only injunctive relief for the alleged HSR violation—not civil monetary penalties—in part because this was Third Point’s first violation of the HSR Act, and in part because Third Point quickly filed the required forms and thus was out of compliance for only a short period of time.¹² Third Point also made filings and observed the required waiting periods for subsequent purchases of Yahoo shares. Under the terms of the settlement, Third Point commits to make all appropriate HSR filings for the next five years.

KEY TAKEAWAYS

- **Investor Intent is Critical.** The Third Point settlement is a reminder that investor intent is critical to the application of the investment-only exemption. Although Third Point’s settlement gives investors, CEOs, and board members some indication of what the FTC regards as evidence of non-passive intent, the agency has made it clear that other (yet to be determined) conduct may also provide evidence of non-passive intent.
- **No Factor is Dispositive.** The FTC has explained it will assess a variety of factors in determining whether the exemption has been properly invoked; no single factor is dispositive.
- **Proceed With Caution.** Any investor acquiring shares in a company in reliance on the HSR Act investment-only exemption should proceed with caution if engaged in activities that may be deemed as affecting the business decisions of the investee company. The Third Point settlement underscores the FTC’s continued focus on narrowly interpreting that exemption. Although the FTC did not seek civil penalties from Third Point, the agency makes such decisions on a case-by-case basis and therefore may seek civil penalties in similar cases in the future.

¹⁰ *Id.* at Paragraph 30, available at <https://www.ftc.gov/system/files/documents/cases/150824thirdpointcmpt.pdf>.

¹¹ https://www.ftc.gov/news-events/press-releases/2015/08/third-point-funds-agree-settle-ftc-charges-they-violated-us?utm_source=govdelivery.

¹² Under the HSR Act, the penalty for failure to make a required HSR Act filing and observe the waiting period is

\$16,000 per day for each day of non-compliance, that is, from the HSR Act reportable acquisition date to the satisfaction of the HSR waiting period.

Client Alert

Contact:

Jeffrey A. Jaeckel

(202) 778-1440

jjaeckel@mofo.com

Lauren A. Navarro

(202) 778-1667

lnavarro@mofo.com

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer's* A-List for 12 straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.