



# THE THRESHOLD

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The Mergers &  
Acquisitions Committee

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## FROM THE CHAIR

To All Committee Members:

Welcome to the Fall 2014 edition of The Threshold! We have six interesting articles that merger practitioners should find both useful and timely.

We lead off with a piece by David Gelfand, Deputy Assistant Attorney General for Litigation at the Antitrust Division, "Reflections on the Past Year at the Antitrust Division." This is a valuable speech, deserving of wider circulation, that was delivered earlier this year. It provides an excellent review of how the Division approaches merger analysis today, highlighting customer testimony, internal company documents, economic evidence, remedies, and two recent matters where consent decrees were entered into quickly, permitting mergers to close within 60 days of the HSR filing. Next, Howard Morse, Megan Browdie, and Sarah Swain discuss

the pros and cons of potential Congressional action to correct the “perceived discrepancy” between the FTC and DOJ merger review processes. A House committee approved a bill in September that would both eliminate the FTC’s authority to proceed administratively against mergers and impose the identical standards of proof on the FTC and DOJ for merger cases brought in federal court. The recent election increases the chances that a Senate committee will take this matter up as well.

In “Rethinking the Investment-Only Exception,” Scott Sher and Chris Williams explore in depth the current uncertainties regarding the meaning of the Hart-Scott-Rodino “solely for the purpose of investment” filing exemption, concluding that the exemption is too narrow. The authors support an interpretation of the exemption that would harmonize it with the substantive “companion exemption” in §7 of the Clayton Act; they also argue that the FTC should clarify that “investor speech” is not inconsistent with passive investment intent. In “A Summary of Economic Analysis in MOFCOM’s Merger Reviews,” Elizabeth Xiao-Ru Wang examines the published merger decisions in which MOFCOM, China’s merger enforcement agency, has imposed remedies. The author provides a very helpful discussion of how MOFCOM has used economic analysis both in dealing with each of the elements of a “standard competitive analysis” and in crafting remedies. Comprehensive tables are provided showing types of remedies imposed in all MOFCOM mergers for the period 2008 – 2014. Next, Anna Aryankalayil provides a very useful summary of a recent M&A Committee teleconference program, “Merger Efficiencies – Hot Documents and Hot Data,” concluding with tips to practitioners for how to take efficiencies to the finish line. Finally, David Dueck and Clotilde Caupin discuss a number of interesting, and in some cases “ground-breaking,” merger decisions by competition authorities around the world over the past several months: France required an internet operator to provide rivals with access to its cable and infrastructure network as a condition to approving a merger; Germany provided important guidance on the failing company defense in two mergers, one where the defense was accepted and the other where it was not; and there were also important developments in South Africa, COMESA, Brazil, and Ireland.

The committee continues to be hard at work on publications -- not only this issue of *The Threshold*, but also on new editions of two key books, the “Premerger Notification Practice Manual” and “Mergers & Acquisitions: Understanding the Antitrust Issues.” We expect both

books to be available at or before the time of the 2015 Spring Meeting. In addition, we have started working on a new edition of the Gun Jumping book that should be out by the 2016 Spring Meeting. We also expect to announce by year end our new Committee website resource containing a searchable database of antitrust-related clauses in merger agreements.

The next Threshold will be out just before the 2015 Spring Meeting. As always, we would be delighted to publish letters to the editor commenting on any past articles, and we would be doubly delighted to hear from you about any articles you would like to write yourself. Are there any “inside baseball” stories you could tell that would be of interest to our ever growing committee membership?

Enjoy the newsletter!

--Paul B. Hewitt

## RETHINKING THE INVESTMENT-ONLY EXEMPTION

Scott A. Sher and Christopher A. Williams\*

Improper reliance on the “investment-only” exemption is the most common reason the Federal Trade Commission (“Commission” or “FTC”) brings a civil enforcement action for violating the premerger notification requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976<sup>1</sup> (“HSR Act”).<sup>2</sup> The “investment only” exemption requires that the acquisition be made “solely for the purpose of investment.”<sup>3</sup> But the Commission, which enforces the HSR Act and the rules promulgated thereunder<sup>4</sup> (“HSR Rules”), has yet to provide consistent guidance about what “solely for the purpose of investment” means. At times, the Commission’s staff has asserted the exemption is narrow<sup>5</sup> and available only to “purely passive” investors.<sup>6</sup> However, the Commission has never provided

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<sup>1</sup> 15 U.S.C. § 18a.

<sup>2</sup> There have been fifty-two civil enforcement actions since the HSR Act became effective in 1978: fifteen for not qualifying for an exemption because the transaction was not found to be solely for the purpose of investment; thirteen for failing to file for other reasons; nine for structuring transactions to avoid notification (i.e., devices for avoidance); eight for exercising of beneficial ownership of the seller by the buyer prior to closing (i.e., gun-jumping); five for failing to submit documents responsive to Item 4(c); and two for non-compliance with a request for additional information or documentary material (i.e., Second Request).

<sup>3</sup> 15 U.S.C. § 18a (investment-only exemption); 16 C.F.R. §§ 802.9 (incorporating the statutory exemption) and 802.64 (exemption for acquisitions of voting securities by certain institutional investors).

<sup>4</sup> 16 C.F.R. pts. 801-803.

<sup>5</sup> See Press Release, Fed. Trade Comm’n, Biglari Holdings, Inc., to Pay \$850,000 Penalty to Resolve FTC Allegations That it Violated U.S. Premerger Notification Requirements (Sept. 25, 2012), available at <http://www.ftc.gov/news-events/press-releases/2012/09/biglari-holdings-inc-pay-850000-penalty-resolve-ftc-allegations> (“The passive investment exemption is a narrow one . . .”).

<sup>6</sup> See Plaintiff’s Statement of Legal Theory at 6, *United States v. Farley*, No. 1:92-cv-01071 (N.D. Ill. June 8, 1994) [hereinafter Plaintiff’s Statement of Legal Theory] (“The exemption applies only to purchasers who intend to hold voting securities as purely passive investors.”); see also FTC Premerger Notification Office (PNO), Informal Interpretation No. 1304004 (Apr. 10, 2013), available at <http://www.ftc.gov/enforcement/premerger-notification-program/informal->

formal guidance regarding its interpretation of the term, leaving investors who want to articulate their views to the management of an issuer uncertain as to whether the Commission will conclude that such expression to lose the benefit of the exemption.

This lack of guidance is becoming more problematic as institutional investors who wish to vocalize their concerns to management face an increased likelihood of Commission scrutiny.<sup>7</sup> Ten years ago, one FTC official (in her individual, *not* Commission, capacity) expressed concern that institutional investors are increasingly and improperly relying upon the investment-only exemption when they engage in “shareholder activism,” but that is all we have heard from the Commission on the topic.<sup>8</sup> Shareholder activism encompasses a continuum of actions that shareholders may utilize to communicate their views to management, and discerning when a shareholder’s intent transitions from mere investment to controlling or influencing management is a tricky issue. For example, an investor who perceives that management is engaging in harmful actions may initially be attempting merely to enhance his investments by expressing his concern (and thus acting in accordance with an investment-only intent). But, if management persists in the harmful action, he may develop an intent to actively stop those actions by exerting control over management. This distinction between “considering” the actions of an issuer’s management and “intending” to influence these actions is crucial, but relatively unexplored.

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interpretations/1304004 (“If the investment is 10% or less and *completely* passive, the exemption is available.” (emphasis added)).

<sup>7</sup> See, e.g., Marian R. Bruno, Assistant Dir., Fed. Trade Comm’n Premerger Notification Office, *Remarks before the American Bar Association: Hart-Scott-Rodino* at 25 (June 13, 2002) [hereinafter Bruno Remarks], available at <http://www.ftc.gov/public-statements/2002/06/hart-scott-rodino-25> (“The erroneous reliance on the ‘investment only’ exemption appears to be due, at least in part, to an overall change in institutional investor behavior. . . [s]ince 1978 when the Rules were adopted . . .”).

<sup>8</sup> *Id.*

This article seeks to fill this and other gaps in our understanding of the investment-only exemption. Part I provides background on the investment-only exemption and the HSR Act. Part II explores the ambiguities in the term “solely for the purpose of investment,” and examines how the agencies have enforced this exemption. Part III then evaluates how the agencies could define this exemption to accommodate investors who wish to express their views regarding an issuer’s business decisions, particularly by clarifying that investors may be vocal but still qualify for the exemption.

## **I. Background**

The HSR Act requires parties to certain acquisitions<sup>9</sup> to notify the FTC and the Antitrust Division of the Department of Justice (collectively, “Agencies”) and to observe the applicable waiting period before consummating their transactions.<sup>10</sup> The HSR Act serves as a prophylactic supplement to Section 7 of the Clayton Antitrust Act (“Section 7”), which prohibits transactions whose effect “may be substantially to lessen competition.”<sup>11</sup> Prior to the HSR Act’s enactment, the antitrust agencies faced significant hurdles in preventing or correcting anticompetitive mergers under Section 7. Many large mergers were consummated before the government had any realistic opportunity to challenge them, and by the time the lengthy and expensive litigation to undo such mergers concluded, the assets, technology, and management of the companies had become “irreversibly scrambled together.”<sup>12</sup> By requiring parties to wait for agency

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<sup>9</sup> 16 C.F.R. § 801.1(f)(1)(ii).

<sup>10</sup> The jurisdictional thresholds are adjusted annually based on the change in gross national product. 15 U.S.C. § 18a(a)(2)(A). The size-of-transaction thresholds are as follows: \$50 million, as adjusted (currently \$75.9 million); and \$200 million, as adjusted (currently \$303.4 million). 15 U.S.C. § 18a(a)(2)(B)(i). The size-of-part thresholds are as follows: \$10 million, as adjusted (currently \$15.2 million); and \$100 million, as adjusted (currently \$151.7 million). 15 U.S.C. § 18a(a)(2)(B)(ii)(I).

<sup>11</sup> 15 U.S.C. § 18.

<sup>12</sup> H.R. REP. NO. 94-1373, at 5, 8 (1976) [hereinafter H.R. Rep. No. 94-1373], *reprinted in* 1976 U.S.C.C.A.N. 2637, 2637, 2642.

clearance before consummation, the HSR Act assists the government in enforcing Section 7.

Congress and the Agencies have recognized that not all acquisitions should be subject to the HSR Act's pre-notification requirement. Pre-notification is costly to businesses, which must notify the antitrust agencies, pay a filing fee of up to \$280,000, and observe all statutory waiting periods provided for under the HSR Act.<sup>13</sup> Moreover, the Agencies have limited capacity to review transactions, and are required to divert scarce agency resources to the review of transactions that are highly unlikely to raise antitrust concerns. Because some categories of acquisitions are so unlikely to harm competition as to render pre-notification unnecessary,<sup>14</sup> the HSR Act's applicability is limited both initially by the threshold factors the parties must meet to trigger the Act's requirements, and subsequently by the statutory exemptions to these requirements.<sup>15</sup> This article addresses the "investment-only" exemption,<sup>16</sup> which provides that any person may acquire up to 10 percent of an issuer's outstanding voting securities, regardless of the value of the securities acquired or held, without pre-notification

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<sup>13</sup> See Michael L. Keeley, *Freedom from Filing: The FTC Should Reconsider Investor Activism Under the Hart-Scott-Rodino Act*, THE DEAL, at 20 (Feb. 6, 2006) [hereinafter Keeley], reprint available online at [http://www.axinn.com/media/article/67\\_MLK%20Freedom%20from%20Filing.pdf](http://www.axinn.com/media/article/67_MLK%20Freedom%20from%20Filing.pdf); Bilal Sayyed, *A "Sound Basis" Exists for Revising the HSR Act's Investment-Only Exemption*, ANTITRUST SOURCE, at 1 (April 2013) [hereinafter Sayyed], available at [http://www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/apr13\\_sayyed.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/apr13_sayyed.authcheckdam.pdf); see also Council of Institutional Investors and Nat'l Ass'n of Corporate Dirs., *Framework and Tools for Improving Board-Shareholder Communications: The Report of the Council of Institutional Investors and the National Association of Corporate Directors Task Force on Improving Board-Shareowner Communications* (Feb. 2004), available at <https://www.sec.gov/rules/proposed/s71903/nacd030904-attach.pdf>.

<sup>14</sup> H.R. REP. NO. 94-1373, *supra* note 12, at 6; 15 U.S.C. § 18a(c). The HSR Act, for example, provides authority to the FTC, with the concurrence of the DOJ, to exempt transactions that "are not likely to violate the antitrust laws." 15 U.S.C. § 18a(c)(12), (d)(2)(B).

<sup>15</sup> H.R. REP. NO. 94-1373, *supra* note 12, at 6; 15 U.S.C. § 18a(c).

<sup>16</sup> This statutory exemption has been incorporated into the HSR Rules. 15 U.S.C. § 18a (investment-only exemption); 16 C.F.R. §§ 802.9 (incorporating the statutory exemption) and 802.64 (exemption for acquisitions of voting securities by certain institutional investors).

if the acquisition is “solely for the purpose of investment.”<sup>17</sup> This exemption recognizes that minority acquisitions by parties who will not control or otherwise heavily influence the acquired firm’s management generally fall into the class of acquisitions that “pose no anticompetitive threats under Section 7.”<sup>18</sup>

## **II. Interpreting the Investment-Only Exemption: Current Guidance**

A requirement of the investment-only exemption is that *at the time of the acquisition* the investor has the intent to hold the stock “solely for the purpose of investment.”<sup>19</sup> Significant ambiguity and uncertainty exist today as to what it means for an acquisition to be “solely for the purpose of investment” and as to when an investor may transition from being a “passive” (in the sense of not controlling management) to an “active” investor. While the FTC has provided some guidance, it has not been clear or consistent in defining the investment-only exemption and has left open several important questions.

### **A. What does “Solely for the Purpose of Investment” Mean?**

To determine when the investment-only exemption applies, the first step is to discern precisely what “solely for the purpose of investment” means. The HSR Rules provide that an investment satisfies this standard when the investor has “no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.”<sup>20</sup> These Rules, however, offer no

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<sup>17</sup> *Id.* The Commission increased the percentage maximum to 15 percent for certain institutional investors if the acquisition of voting securities was made in the “ordinary course of business” and “solely for the purpose of investment.” 16 C.F.R. § 802.64(b)(2). This exemption, however, does not apply if (1) the acquisition is of an institutional investor of the same type as any included within the acquiring person or (2) any entity included within the acquiring person that is not an institutional investor holds any voting securities of the issuer whose voting securities are to be acquired. 16 C.F.R. § 802.64(c)(1)-(2).

<sup>17</sup> 15 U.S.C. § 18(c)(9).

<sup>18</sup> H.R. REP. NO. 94-1373, *supra* note 12, at 6; 15 U.S.C. § 18a(c).

<sup>19</sup> To be clear, the HSR Act only applies to acquisitions. Thus, a later change in intent does not create a filing obligation under the HSR Act. However, as discussed in Part II.C.ii *infra*, the Agencies may call the investor’s original intent into questions where the “change” in intent is in close proximity to the acquisition relying upon the exemption.

<sup>20</sup> 16 C.F.R. § 801.1(i)(1) (defining “solely for the purpose of investment”).

guidance as to what conduct constitutes such an intention or as to what “basic business decisions” are.

Based upon the Commission’s limited explanations and public comments by its staff, some authors have concluded that the FTC construes “solely for the purpose of investment” narrowly and contends the HSR Act does not permit investors to invoke the exemption merely because investment is “the [purchaser’s] ‘principal’ or ‘predominant’ intent.”<sup>21</sup> Under this narrow construction, investment must be the *only* intent for the exemption to apply.<sup>22</sup> This construction is not, however, embodied in the HSR Rules or any formal interpretations, which remain far more vague.

While the FTC has not yet offered clear guidance, the Statement of Basis and Purpose (“SBP”) accompanying the initial HSR Rules offers some insight into the types of conduct the FTC might consider to be inconsistent with an investment purpose, including but not limited to the following:

- [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
- doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer.<sup>23</sup>

The FTC’s Premerger Notification Office<sup>24</sup> (“PNO”) has stated that the import of most conduct on this list to the application of the investment-only

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<sup>21</sup> See, e.g., Sayyed, *supra* note 13, at 5 (quoting James W. Mullenix, *The Premerger Notification Program at the Federal Trade Commission*, 57 ANTITRUST L.J. 125, 128 (1988) (“The position of the Bureau of Competition is that solely for the purpose of investment means solely for the purpose of investment. It does not mean mostly, primarily, partially, largely, or any other ‘-ly.’”)); see also Plaintiff’s Statement of Legal Theory, *supra* note 6; Bruno Remarks, *supra* note 7.

<sup>22</sup> *Id.*

<sup>23</sup> Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33,450, 33,465 (July 31, 1978) (to be codified at 16 C.F.R. pts. 801–803) [hereinafter SBP]. However, the SBP notes that merely voting shares of stock is not inconsistent with an investment-only purpose. *Id.*

exemption can be rebutted.<sup>25</sup> But the PNO has also advised that certain conduct creates an irrebuttable presumption against an investment-only purpose, including: (a) being a competitor of the issuer; (b) having or nominating a candidate on the board of directors of the issuer, a subsidiary of the issuer, or any other affiliated entity; or (c) being an officer of the issuer.<sup>26</sup>

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<sup>24</sup> The PNO is responsible for administering the HSR premerger notification program, including providing informal interpretations on the application of the HSR Rules.

<sup>25</sup> See ABA Section of Antitrust Law, *Premerger Notification Practice Manual* (4th ed. 2007) (Practice Manual), Int. 16 [hereinafter PNP]; HSR Informal Interpretation No. 9906022 at 2 (June 1999) [hereinafter HSR Informal Interpretation No. 9906022], *available at* <http://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/9906022> (rebutting the presumption where “an individual serves as an officer but not a director of one or more corporate subsidiaries . . . and the officer will not participate in the management of the issuer’s parent corporation, . . . or intends to be involved in communications with the issuer’s board”); Bruno Remarks, *supra* note 7 (“It has been the long-standing position of the premerger office that the existence of a co-promotion agreement does not automatically eliminate the exemption’s availability.”); HSR Informal Interpretation No. 9501007 (Jan. 1995), *available at* <http://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/9501007> (finding that investment-only status was not lost due to being a co-partner or having a co-venture with the issuer); HSR Informal Interpretation No. 9908001 (Aug. 6, 1999) [hereinafter HSR Informal Interpretation No. 9908001], *available at* <http://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/9908001> (rebutting the presumption where the decision to enter into the supply agreement with the investor was reached before the investor obtained observer rights on the board but had no other intention of becoming involved in the business decisions of the issuer); HSR Informal Interpretation No. 0103013 at 2 (Mar. 2001), *available at* <http://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/0103013> (“vendor-vendee type relationship does not preclude the use of this exemption.”).

<sup>26</sup> PNP, *supra* note 24, at 16; Bruno Remarks, *supra* note 7 (“First, if you are a competitor, even if only for a very small percentage of sales, or for a single product, you cannot claim that your acquisition of voting securities of your competitor is held for the purposes of investment only.”). *But see* HSR Informal Interpretation No. 0903001 (Mar. 4, 2009), *available at* <http://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/0903001> (permitting reliance upon the exemption, despite some possible minor competition between the parties, where acquirer will only hold the shares for a short period of time and a shareholders’ agreement prohibits the acquirer from nominating board candidates, proposing corporation action, or soliciting proxies); HSR Informal Interpretation No. 1202014 (Feb. 27, 2012), *available at* <http://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1202014> (allowing the exemption to apply where investor and issuer only compete outside the United States and the investor has no board seat or any intention to propose corporation action, solicit proxies, or acquire control of the issuer); HSR Informal Interpretation No. 1304004 (Apr. 10, 2013), *available at* <http://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1304004> (finding the exemption applies where investment of the acquired issuer in a competitor of acquirer is 10 percent or less and recognizing a rebuttable presumption if the acquired issuer’s investment is more than 10 percent but less than 50 percent).

With this limited framework in mind, we now turn to an examination of (i) whether statements an investor makes to, in its view, improve the future performance of shares it has purchased can be evidence that it purchased with non-investment intent and (ii) how to determine when an “intent” is formed. We also analyze the HSR enforcement actions that the agencies have brought to date to understand what they reveal about the agencies’ views regarding the scope of the exemption.

### **B. Can Recommendations to Management be Evidence of a Non-Investment Intent?**

One important question is whether an investor’s suggestions to management can be considered inconsistent with an investment-only intent. It is increasingly common for hedge funds and other institutional investors to offer various recommendations to the management of the companies in which they hold voting securities. Investors communicate their views to management in a variety of ways, including directly, such as by phone or email, and indirectly, such as by writing an editorial in the *Wall Street Journal* or being interviewed on *CNN Money*. Their suggestions may include recommending that management take a particular action to improve operational performance and maximize profits; criticizing management decisions; requesting the resignation of an officer or director; or recommending board candidates. Given that the suggestions often come from hedge funds and other investors concerned with maximizing the return of shares they have purchased, it seems likely that most such communications are intended only to maximize shareholder value – which is consistent with traditional notions of investment.<sup>27</sup> But can suggesting conduct to management amount to *participating* in the underlying basic business decisions and, therefore, prevent reliance upon the investment-only exemption?

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<sup>27</sup> Investors may also have non-financial goals, such as urging a company to change its social, environmental, or labor practices. Such goals should not be considered inconsistent with an investment-only intent because they are not for a financial purpose or intended to diminish competition between competitors.

The answer is currently unclear. While the language of the statute indicates such recommendations may be perfectly consistent with an investment-only intent, the agencies have indicated that under certain circumstances such behavior may be evidence of non-investment intent. There are at least three reasons why these kinds of recommendations should not be interpreted as evidence against an investment-only intent.

*First*, the wording of the statute indicates that more is necessary than mere recommendations to management or the board. The HSR Rules state that the investment-only exemption is available only if the shareholder does not have the intent to *participate in* or *influence* the formulation, determination, or direction of the basic business decisions of the issuer. While the Rules do not define these terms, each clearly connotes a degree of actual involvement in the decision-making process.<sup>28</sup> For example, we would not say that an investor whose advice was given but not taken participated in or influenced a business decision. So it would seem inconsistent to conclude that an investor who made a recommendation – and did nothing more – acted in a manner inconsistent with an investment-only purpose.

*Second*, offering a recommendation is akin to voting the shares the investor owns – an act that the SBP holds is consistent with an investment-only purpose. Both voting shares and making recommendations are non-invasive methods of indicating how an investor believes the company will best maximize its value. Again, it would seem contradictory to find that one, but not both, of these actions indicated an intent other than pure investment.

*Third*, such recommendations are not comparable to anything on the SBP's list of inconsistent conduct. Each of the first three examples (the only

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<sup>28</sup> See, e.g., Definition of “participate”, Merriam-Webster Online Dictionary, [available at http://www.merriam-webster.com/dictionary/participate](http://www.merriam-webster.com/dictionary/participate) (last visited Sept. 8, 2014) (defining participate as “to take part” or “to have a part or share in something”); Definition of “influence”, Merriam-Webster Online Dictionary, [available at http://www.merriam-webster.com/dictionary/influence](http://www.merriam-webster.com/dictionary/influence) (last visited Sept. 8, 2014) (defining influence as “the power to change or affect someone or something”).

potentially applicable ones) – director nominations, shareholder proposals, and proxy solicitations – require the shareholder to *take part directly* in formal governance procedures. Director nominations and shareholder proposals are brought before the company’s shareholders for vote at an annual or special meeting and thus bypass management. A proxy solicitation is an attempt by an investor to exert control over a company through the increased voting power gained by obtaining authorization from shareholders to vote on their behalf. Unlike those formal actions, offering a list of individuals to be considered as candidates for director or otherwise recommending corporate action are merely informal suggestions that are not voted on by the shareholders and can be summarily ignored by management. These examples in the SBP do not dictate that communications or recommendations from an investor disqualify the investor from the exemption.

Although good reasons exist for viewing investor recommendations as consistent with an investment-only intent, agency advice on this issue is dated and inconclusive.<sup>29</sup> For example, the PNO has generally allowed shareholders to rely upon the investment-only exemption where they have a non-voting board observer or the right to receive all information provided to the board, which could potentially include financial and other non-public information.<sup>30</sup> But a 2012

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<sup>29</sup> Compare HSR Informal Interpretation No. 9906022, *supra* note 24 (conditioning reliance upon the exemption on the investor having no intention to be involved in communications with the issuer’s board), with HSR Informal Interpretation No. 9504007 (Apr. 1995), available at <http://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/9504007> (memorializing verbal advice that an investor could rely on the exemption even though it may have private communications with the management of the issuer), and HSR Informal Interpretation No. 9908001, *supra* note 24 (allowing the exemption to apply where the investor may be asked to make a presentation to the board of the issuer regarding an ongoing contractual relationship).

<sup>30</sup> HSR Informal Interpretation No. 1203011 (Mar. 26, 2012), available at <http://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1203011> (finding the exemption to apply where a non-voting board observer has the right to attend all meetings and receive all information that is delivered to the board and its committees); Bernard A. Nigro Jr., Peter Guryan and Alyson Leigh Redman, *Antitrust agencies penalize activist investor for HSR violations*, LEXOLOGY (Sept. 27, 2012), available at <http://www.lexology.com/library/detail.aspx?g=c3a33229-6c98-47fe-8ecd-c2c805db8f43> (“[H]aving board observer rights in a private company and/or the right to receive certain financial and other non-public information from the company, likely would be viewed as passive”).

action by the Antitrust Division, *United States v. Biglari Holdings, Inc.*,<sup>31</sup> indicates that the investment-only exemption may be unavailable to a shareholder who makes public statements or privately communicates with an issuer's management.<sup>32</sup>

*Biglari Holdings* is the only case in which the agencies have used such public or private communications as evidence of an intent inconsistent with investment. In that case, the government contended that on June 8, 2011, Biglari Holdings acquired voting securities of Cracker Barrel that resulted in its holding shares valued in excess of the size-of-transaction threshold without submitting an HSR filing,<sup>33</sup> and continued to acquire shares through June 13, 2011.<sup>34</sup> Two days after the last purchase, Sardar Biglari, Chairman and CEO of Biglari Holdings, spoke to Cracker Barrel's CEO and CFO, informing them he had ideas to increase shareholder value and requesting an in-person meeting.<sup>35</sup> At the meeting, Mr. Biglari told Cracker Barrel's CEO and CFO that he had ideas to improve traffic to Cracker Barrel restaurants and requested that he and his colleague be appointed to

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<sup>31</sup> It also has been reported that the FTC has opened several investigations about practices such as "a fund address[ing] a board and suggest[ing] that it wished to see a greater return on investment." STEPHEN M. AXINN, ET AL., ACQUISITIONS UNDER THE HART-SCOTT-RODINO ANTITRUST IMPROVEMENTS ACT § 6.11[3][b], at 6-102 (3d ed.).

<sup>32</sup> Complaint for Civil Penalties for Failure to Comply with the Premerger Reporting Requirements of the Hart-Scott-Rodino Act ¶ 13, *United States v. Biglari Holdings, Inc.*, No. 1:12-cv-01586-RJL (D.D.C. Sept. 25, 2012), ECF. No. 1 [hereinafter *Biglari Complaint*]; Keeley, *supra* note 13 ("The FTC staff, however, has adopted the position that even writing a letter to management suggesting a course of action would be inconsistent with the intent required to rely on the investment-only exemption."); see Malcolm R. Pfunder, *Shareholder Activism and the Hart-Scott-Rodino Act Exemption for Acquisition of Voting Securities Solely for the Purpose of Investment*, in ANTITRUST, VOL. 20, NO. 3, at 74 (Summer 2006) (cautioning that communications between shareholders and management may be viewed as inconsistent with "passive" investor status).

<sup>33</sup> *Biglari Complaint*, *supra* note 30, ¶ 13.

<sup>34</sup> *Id.* On June 13, 2011, Biglari Holdings also filed Form 13D with the Securities and Exchange Commission ("SEC"), disclosing its holdings in Cracker Barrel, in which the investor stated that it "plan[ned] to communicate with the Issuer's management and members of the Board regarding the business, governance and future plans of the Issuer." Biglari Holdings Inc. Schedule 13D filed with the SEC on Form 13D, dated June 13, 2011 at 7, available at [http://www.sec.gov/Archives/edgar/data/93859/000092189511001292/sc13d07428cra\\_06032011.htm](http://www.sec.gov/Archives/edgar/data/93859/000092189511001292/sc13d07428cra_06032011.htm).

<sup>35</sup> *Biglari Complaint*, *supra* note 30, ¶ 17.

the Board of Directors.<sup>36</sup> The government relied, in part, upon Biglari's recommendations and requests in arguing the investment-only exemption did not apply to Biglari Holdings' acquisitions of Cracker Barrel shares.<sup>37</sup> Notably, *Biglari Holdings* also involved an investment by a company that the FTC may have concluded was a competitor (the Commission's public statements were silent on the issue),<sup>38</sup> which would create an irrebuttable presumption that the acquisition was not solely for the purpose of investment. So it is not obvious whether the communications themselves would have been sufficient for the government to file the action, although they clearly played some role.

### C. When Is the Requisite Intent Formed?

Another important question is *when* the investor forms an intent other than investment. There are two related aspects to this question: (1) when the investor transitions from merely *considering* another purpose to actually forming an *intent* regarding that other purpose; and (2) the proximity of forming this intent to the stock purchase at issue.

#### i. Consideration Is Not Equivalent to Intent

First, to understand whether the exemption applies, we must determine whether an investor has formed an actual *intention* (or purpose) other than investment, as opposed to merely *considering* some other intention. "Intention" and "consideration" are not synonyms, as both the HSR Rules and the SBP recognize. Indeed, each of these legal authorities indicates that a decision is required in order to form an intention. For example, the SBP provides that:

If a person makes an exempt acquisition 'solely for the purpose of investment' and later *decides* to participate in the management of the issuer, this

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<sup>36</sup> *Id.* ¶ 18.

<sup>37</sup> *Id.* ¶ 20.

<sup>38</sup> Two of Biglari Holdings' subsidiaries, Steak n Shake Operations, Inc. and Western Sizzlin Corporation, operate chain restaurants similar to those of Cracker Barrel.

change in *intent* does not require filing with respect to the exempt purchase, because the act applies only at the time of an acquisition.<sup>39</sup>

Similarly, the HSR Rules require a person filing notification to declare a “good faith *intention*” to complete the transaction;<sup>40</sup> a declaration that the filer “may” complete the transaction is not sufficient<sup>41</sup> because “may” implies that the transaction is merely under consideration.

A “consideration,” meanwhile, is generally a much more preliminary action, being only “the act of thinking carefully about something you will make a decision about.”<sup>42</sup> In other words, *consideration* precedes both a *decision* and an *intention*. The investment-only exemption presumably applies when an investor has decided to commit to a non-investment-only purpose, but not when he is merely considering such a purpose.

*ii. Proximity of the Formation of an Intent to the Purchase of Stock*

Second, the difficulty of discerning precisely when an intention is formed may be complicated if the behavior inconsistent with an investment-only purpose occurs close in time to the purchase of stock. As noted, investment intent is to be measured at the time the stock purchase is made. But while the SBP espouses this principle, the Agencies’ enforcement actions suggest that they may, under certain circumstances, view a change of intent occurring close in time to the investment at issue as evidence of a non-investment intent. For example, in *Biglari Holdings*, the FTC cited Mr. Biglari’s request for two board seats as evidence that an acquisition of shares made ten days prior were not solely for the purpose of

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<sup>39</sup> SBP, *supra* note 24, 43 Fed. Reg. at 33,466; *see also* 16 C.F.R. § 801.1(i)(1) (using “intent” and “decide” interchangeably).

<sup>40</sup> 16 C.F.R. § 803.5(a)(2) (“‘A’ states, inter alia, that, ‘depending on market conditions, it *may* acquire 100 percent of the shares of B.’ ‘A’’s notice does not comply with § 803.5 . . . .” (emphasis added)).

<sup>41</sup> *Id.*

<sup>42</sup> Definition of “consideration,” Merriam-Webster Online Dictionary, *available at* <http://www.merriam-webster.com/dictionary/consideration> (last visited Sept. 8, 2014).

investment.<sup>43</sup> Similarly, in *Coastal* and *Farley*, the purchasers claimed reliance on the investment-only exemption for prior acquisitions and announced tender offers to acquire control within eight days and forty-two days, respectively, following those earlier acquisitions.<sup>44</sup>

Additionally, in *Reliance Group Holdings*, the government may have relied upon an intention formed after the purchase of shares in arguing that the investment-only exemption did not apply. In that case, Reliance had been acquiring shares of Spectra-Physics between August 27 and December 31, 1986.<sup>45</sup> On January 15, 1987, Reliance submitted an HSR filing to increase its shareholdings from 12.8 to 15 percent,<sup>46</sup> and the next day announced that it might seek to acquire Spectra-Physics, noting that it could “[not] continue to be merely passive investors’ in Spectra-Physics because of a proposal to change the company’s [state of] incorporation from California to Delaware.”<sup>47</sup> Reliance then “succeeded in placing a nominee on the company’s board” and, on February 13, 1987, withdrew its HSR filing.<sup>48</sup> By at least January 1987, Reliance had formed

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<sup>43</sup> Biglari Complaint, *supra* note 30, ¶ 20.

<sup>44</sup> Complaint for Civil Penalty ¶ 11, *United States v. Coastal Corp.*, No. 1:84-cv-02675 (D.D.C. Aug. 30, 1984); Complaint ¶¶ 23-24, *United States v. William F. Farley*, No. 1:92-cv-01071 (N.D. Ill, Feb. 12, 1992), ECF No. 1; *see also* Complaint, *United States v. Manulife Fin. Corp.*, No. 1:04-cv-0722-RBW (D.D.C. May 3, 2004), ECF No. 1 (announcing agreement to merge 100 days after relying upon exemption but citing evidence that parties contemplated merger prior to and during Manulife’s reliance upon the exemption).

<sup>45</sup> Complaint for Civil Penalties for Violation of Premerger Reporting Requirements of Hart-Scott-Rodino Act ¶¶ 10-11, *United States v. Reliance Group Holdings, Inc.*, 1:90-cv-02698-JGP (D.D.C. Oct. 30, 1990), ECF No. 1 [hereinafter Reliance Complaint].

<sup>46</sup> *Id.* ¶ 14; *Spectra-Physics Filing by Reliance*, NEW YORK TIMES (Jan. 16, 1987), <http://www.nytimes.com/1987/01/16/business/company-news-spectra-physics-filing-by-reliance.html> [hereinafter Spectra-Physics Filing by Reliance] (stating that it “cannot continue to be merely passive investors’ in Spectra-Physics because of a proposal to change the company’s incorporation from California to Delaware”).

<sup>47</sup> Spectra-Physics Filing by Reliance, *supra* note 45.

<sup>48</sup> Reliance Complaint, *supra* note 44, ¶ 15; Lawrence M. Fisher, *Ciba-Geigy Pursues Spectra-Physics*, NEW YORK TIMES (May 27, 2007), <http://www.nytimes.com/1987/05/27/business/company-news-ciba-geigy-pursues-spectra-physics.html>; James F. Peltz, *Swiss Company Offers to Buy Spectra-Physics*, ASSOCIATED PRESS (May 26, 1987), <http://www.apnewsarchive.com/1987/Swiss-Company-Offers-To-Buy-Spectra-Physics/id-0ad0290546290d1bf7594a4dd0acb98b>.

an intent to influence Spectra-Physics' proposal to change its state of incorporation – a decision concerning basic corporate governance of the issuer – by either acquiring Spectra-Physics or nominating a Board candidate. Both of these actions are indicative of an intent that is inconsistent with an investment-only purpose.<sup>49</sup> However, it is not clear whether Reliance had formed this intent *before* or *after* its last acquisition of Spectra-Physics stock on December 31, 2014, leaving open the question whether the FTC relied upon a change of intent in close proximity to the acquisition claimed to be solely for the purpose of investment.

The Agencies' reliance in the above actions – or potential reliance in the case of *Reliance Group Holdings* – upon the proximity of such conduct to the stock purchases is problematic because this temporal aspect is, at best, only circumstantial evidence that the acquirer had an intent to participate in the issuer's business decisions when he purchased the stocks and cannot be sufficient to demonstrate that an investor's intent remained investment-only. There are myriad valid reasons why an investor may change its intent within a short period of time following an acquisition. For example, shortly after a stock purchase the company could announce an acquisition or other business venture that could, in the opinion of the investor, put the company at financial risk. Or, the investor may learn that an executive had falsified credentials on his or her resume, or that management had covered up a socially irresponsible business practices that, in the opinion of the investor, might damage the company's goodwill with its suppliers and consumers (thereby diminishing the value of the shareholders' investments).

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<sup>49</sup> PNO Formal Interpretation No. 4 (Jan. 17, 1979), *available at* <http://www.ftc.gov/enforcement/premerger-notification-program/statute-rules-and-formal-interpretations/formal-0> (“The decision to acquire or seek working control of the issuer (regardless of the percentage of voting securities that may actually confer such control) is clearly inconsistent with investment intent under § 80[1].1(i)(1).”).

**D. The FTC's Enforcement Actions Involve Either Competitors or Investors with Board Representation**

While the Agencies' interpretations leave open several questions, the facts alleged in the cases they have brought indicate that the Agencies are the most concerned about acquisitions where the investor is also a competitor or has some sort of board representation. The agencies have brought fifteen enforcement actions alleging that an acquirer improperly relied upon the investment-only exemption. In ten of these actions, including *Biglari Holdings*, the acquirer was a competitor. In four others, the acquirer had a board seat, which also creates an irrebuttable presumption that that acquisition was not made solely for the purpose of investment.

## HSR Enforcement Actions

### Acquisitions Alleged to be Inconsistent with an Intent Solely for the Purpose of Investment

Defendant Investor / Issuer	Year	Board Seat	Competitors	Intent Control	to
Coastal Corp. / Houston Natural Gas <sup>50</sup>	1984		✓	✓	
Bell Resources / Asarco <sup>51</sup>	1986		✓		
Reliance Group Holdings / Spectra-Physics <sup>52</sup>	1990	*		✓	
Aero Limited Partnership / USAir Group <sup>53</sup>	1991		✓		
Cox Enterprises / Knight-Ridder <sup>54</sup>	1991		✓		
General Cinema / Cadbury Schweppes <sup>55</sup>	1992		✓		
Pennzoil / Chevron <sup>56</sup>	1994	†	✓		
William F. Farley / West Point-Pepperell <sup>57</sup>	1995		✓	✓	
William H. Gates III / ICOS Corp. <sup>58</sup>	2004	✓			
Manulife Financial / John Hancock <sup>59</sup>	2004		✓	✓	
Smithfield Foods / IBP <sup>60</sup>	2004		✓	✓	

<sup>50</sup> *United States v. Coastal Corp.*, No. 84-cv-02675 (D.D.C. 1984) (natural gas).

<sup>51</sup> *United States v. Bell Resources Ltd.*, No. 85-cv-06202-MJL (S.D.N.Y. 1986) (copper).

<sup>52</sup> *United States v. Reliance Group Holdings, Inc.*, No. 1:90-cv-02698-JGP (D.D.C. 1990).

<sup>53</sup> *United States v. Aero Limited Partnership*, No. 1:91-cv-01315-LFO (D.D.C. 1991) (airlines).

<sup>54</sup> *United States v. Cox Enterprises, Inc.*, No. 1:91-cv-00505-HTW (N.D. Ga. 1991) (media: newspapers, television, and radio).

<sup>55</sup> *United States v. General Cinema Corp.*, No. 1:91-cv-00008-TFH (D.D.C. 1992) (carbonated soft drinks).

<sup>56</sup> *United States v. Pennzoil Co.*, No. 1:94-cv-02077-PLF (D.D.C. 1994) (oil and gas).

<sup>57</sup> *United States v. William F. Farley*, 1995 No. 1:92-cv-1071 (N.D. Ill. 1995) (hosiery and other textiles).

<sup>58</sup> *United States v. William H. Gates*, No. 1:04-cv-00721-CKK (D.D.C. 2004).

<sup>59</sup> *United States v. Manulife Fin. Corp.*, No. 1:04-cv-0722-RBW (D.D.C. 2004) (insurance and investment products).

<sup>60</sup> *United States v. Smithfield Foods, Inc.*, No. 2:04-cv-00526-RGD-JEB (E.D. Va. 2004) (pork).

Defendant Investor / Issuer	Year	Board Seat	Competitors	Intent Control to
James D. Dondero / Motient <sup>61</sup>	2007	✓		
ESL Partners & ZAM Holdings / AutoZone <sup>62</sup>	2008	✓		
Biglari Holdings / Cracker Barrel <sup>63</sup>	2012	‡	✓	
Barry Diller / The Coca Cola Company <sup>64</sup>	2013	✓		
* Reliance placed a nominee on the board of Spectra-Physics after the acquisitions in question were made.				
† Pennzoil only discussed obtaining a board seat on Chevron.				
‡ Biglari only requested representation on the board of directors of Cracker Barrel.				

Only one enforcement action, *Reliance*, did not involve competitors or representation on the issuer’s board at the time of the acquisition.<sup>65</sup> The Agencies seem to have focused their efforts so far on cases in which the likelihood that an investor that also competes with the issuer may be attempting to exert control over the company’s management – thereby risking anticompetitive harm – is highest.

### III. Rethinking the Investment-Only Exemption

Given the fundamental concerns outlined above, good reasons exist for rethinking the investment-only exemption. First, the “passive investor” approach is too restrictive and likely to impair the efficient operation of capital markets

<sup>61</sup> *United States v. James D. Dondero*, No. 1:07-cv-00931-ESH (D.D.C. 2007).

<sup>62</sup> *United States v. ESL Partners, L.P and ZAM Holdings, L.P.*, No. 1:08-cv-02175-JDB (D.D.C. 2008).

<sup>63</sup> *United States v. Biglari Holdings, Inc.*, No. 1:12-cv-01586-RJL (D.D.C. 2012) (family restaurant chains).

<sup>64</sup> *United States v. Barry Diller*, No. 1:13-cv-01002-GK (D.D.C. 2013).

<sup>65</sup> Unlike the other fourteen transactions, which involved statutory investment-only exemption, *Reliance* involved the institutional investor exemption set forth in § 802.64 of the HSR Rules. *Reliance Complaint*, *supra* note 44, ¶ 17.

while rarely preventing anticompetitive transactions. Second, construing this exemption more narrowly than Section 7’s investment-only exemption – when the HSR Act is intended to supplement Section 7 –likewise misallocates resources while not capturing anticompetitive transactions. And third, the FTC should seriously consider clarifying that investor speech – without more – is not inconsistent with the investment-only exemption.

**A. The “Passive Investor” Approach is Far Too Restrictive**

The “passive investor” approach, which essentially holds that an investor may not express any opinions whatsoever as to how the issuer’s management should act, is far too restrictive. There are several reasons why the exemption should be available to hedge funds and other investors “even if they buy stock with the intent of communicating views to management or publicly commenting about the conduct of the business.”<sup>66</sup> These investors are often highly sophisticated and have the resources to make suggestions to improve what they perceive as corporate under-performance, so prohibiting their recommendations prevents shareholders from obtaining the maximum return from their valuable insight.<sup>67</sup>

In addition, the passive investor approach interferes with the efficient operation of capital markets. As one commenter explained:

Vocal investors must now pay thousands of dollars in HSR filing fees because they are ineligible for the investment-only exemption, and they must to wait up to 30 days to make an acquisition, likely leading to suboptimal acquisition prices (to say nothing of purchases that are prevented or discouraged). The public disclosure of [early termination] grants means some investors may decline to seek [early termination] to protect proprietary trading strategies. Hedge funds are required to disclose their holdings

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<sup>66</sup> Keeley, *supra* note 13, at 2.

<sup>67</sup> *Id.* (“Hedge and private equity funds are sophisticated investors that have the resources to identify poor management and suggest profit-maximizing actions. In most cases, all shareholders will benefit from management improvements an investor’s statements can bring about.”).

only in limited situations; it is unreasonable for the HSR Act to mandate a level of transparency not required by securities laws.<sup>68</sup>

Finally, and perhaps most persuasively, acquisitions of ten percent or less of an issuer's voting securities are unlikely to violate the antitrust laws – as even FTC staff has recognized.<sup>69</sup> There are limited circumstances in which acquisitions of minority ownership interests may lessen competition, including when they: (1) create or enhance the acquirer's ability to influence the competitive conduct of the target; (2) reduce the acquirer's incentives to compete with the target; and (3) facilitate access to each party's competitively sensitive information. These concerns, however, largely do not apply to acquisitions by hedge funds or private equity firms of less than 10 percent of an issuer's stock. Importantly, minority acquisitions that have been found to violate Section 7 have generally involved holdings of at least 15 to 20 percent.<sup>70</sup> The first two concerns are not relevant because the investment-only exemption already excludes acquisitions by competitors. The last concern – sharing competitively sensitive information – may be an issue if the parties are in a vertical relationship, but the PNO has allowed parties to use the exemption when the investor received observer rights and access to company information, notwithstanding the existence of a vertical relationship between the investor and the issuer.<sup>71</sup>

Not only do concerns about minority acquisition generally not apply to these types of acquisitions, but post-acquisition divestiture is also an effective remedy for investors holding 10 percent or less of a company's stock. Where all the investor forced to divest owns is a minority stake in a liquid security, there is no “unscrambling problem,” which was the impetus for the HSR Act's premerger

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<sup>68</sup> *Id.*

<sup>69</sup> Premerger Notification; Reporting and Waiting Period Requirements, 53 Fed. Reg. 36,831 36,839 (proposed Sept. 22, 1998) (to be codified at 16 C.F.R. pts. 801-803) [hereinafter *De Minimis* Proposal] (noting that “the antitrust agencies appear never to have challenged . . . an acquisition [of 10 percent or less]”).

<sup>70</sup> ABA Section of Antitrust Law, *Antitrust Law Developments*, 333, 372 (7th ed. 2012) [hereinafter ALD].

<sup>71</sup> Informal Interpretation No. 9908001, *supra* note 24.

notification and waiting requirements.<sup>72</sup> In sum, a very narrow interpretation of the investment-only exemption requires investors to expend time and resources to file HSR notifications that may be unnecessary, and requires the antitrust agencies to devote scarce resources to reviewing HSR filings for transactions that are unlikely to identify such concerns.<sup>73</sup>

**B. The Investment-Only Exemption in the HSR Act Should be Interpreted No More Narrowly than the Companion Exemption in Section 7**

Like the HSR Rules, Section 7 contains an exemption for stock acquisitions that are “solely for investment.”<sup>74</sup> Because the HSR Act exists to assist the antitrust agencies in enforcing Section 7, the HSR Act’s investment-only exemption should be interpreted no more narrowly than Section 7’s companion exemption. The HSR Act’s pre-notification requirements are merely a preliminary screen – Section 7 always applies, even if the HSR Act does not. Thus, Section 7 would capture a competitively harmful merger that was not screened out by the HSR Act. Using the HSR Act to require pre-consummation review of transactions that would be exempt under Section 7 would contradict the HSR Act’s purpose of helping the agencies (and businesses) efficiently allocate resources. An investor should not be required to file a notification pursuant to the HSR Act if it would not be subject to Section 7 because it was “solely for investment.”

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<sup>72</sup> H.R. Rep. 94-1373, *supra* note 12, at 5, 8.

<sup>73</sup> Sayyed, *supra* note 13, at 16 (describing the unnecessary costs resulting from the FTC’s narrow interpretation of the investment-only exemption); *De Minimis* Proposal, *supra* note 68, 53 Fed. Reg. at 36,841 (“The Commission’s current consideration of an unrestricted 10 percent exemption . . . responds to persistent problems enforcing filing obligations for acquisitions of 10 percent or less . . .”).

<sup>74</sup> 15 U.S.C. § 18 (“This section shall not apply to persons purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition.”).

*United States v. Tracinda Inv. Corp.*<sup>75</sup> is the only court decision that addresses the applicability of Section 7's investment-only exemption when a shareholder engages in communications and consultation with the issuer's management.<sup>76</sup> That case involved a consultation provision in a shareholders' agreement requiring the issuer "to consult with [the investor] on certain major and material financial matters and any changes in top management."<sup>77</sup> In determining whether the investment-only exemption applied, the court considered "whether the stock was purchased for the purpose of taking over the active management and control of the acquired company."<sup>78</sup> The government's stance was that the investor, through "consultation and other business and social meetings . . . could dominate the present directors and management to such an extent that he would control [the issuer]."<sup>79</sup> The court disagreed, concluding that management and the board of directors were free to adopt or reject any recommendations from the investor. The court further concluded that management "listen[ed]" to the investor's advice because of his "vast knowledge and experience in the business world," not due to his stock position.<sup>80</sup>

Additionally, the court noted that the consultation provision was "not inconsistent with a present intent that the acquisition is solely for investment."<sup>81</sup> According to the court, "[a]ny substantial investor, acting reasonably, would want to be kept informed about the possible major financial and top management changes contemplated in any corporation where he has placed his money."<sup>82</sup> *Tracinda*, therefore, demonstrates that shareholder advocacy is not inconsistent

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<sup>75</sup> *United States v. Tracinda Inv. Corp.*, 477 F. Supp. 1093 (C.D. Cal. 1979).

<sup>76</sup> No court has interpreted the meaning of "solely for the purpose of investment" under the HSR Act.

<sup>77</sup> *Tracinda Inv. Corp.*, 477 F. Supp. at 1101.

<sup>78</sup> *Id.* at 1099.

<sup>79</sup> *Id.* at 1101.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

with a present investment-only intent under Section 7. Under the same logic, the HSR Act’s investment-only exemption should be available to investors who offer advice or consultation to the board or management of the companies in which they invest.

**C. The FTC Should Clarify that Investor Speech Is Not Inconsistent with an Investment Purpose**

The FTC should actively consider clarifying that the investment-only exemption is available to vocal investors. There are two obvious ways to do so: (1) implementing a *de minimis* exemption; or (2) clarifying the definition of “solely for the purpose of investment” in the HSR rules. With respect to the first option, two such proposals have already been made. The first, proposed by the FTC in 1988, would replace the investment-only exemption with a *de minimis* exemption – i.e., an exemption for acquisitions resulting in the acquiring person holding ten percent or less of the outstanding voting securities of the issuer, regardless of the intent of the investment.<sup>83</sup> The second, proposed by a private practitioner in April 2013, would provide a *de minimis* exemption but exclude from the exemption transactions where the acquiring and acquired persons are competitors.<sup>84</sup>

The second approach would be to revise the HSR rules to clearly state that an investor may be vocal and simultaneously have an investment-only intent. For example, the FTC could redefine an acquisition “solely for the purpose of investment” to mean an acquisition “that does not result in the *effective control* of the issuer by the acquiring person.” This definition would be more consistent with the Section 7 cases construing the “solely for investment” exemption.<sup>85</sup> And there is precedent for it. The FTC could, for instance, adopt a definition of “effective control” similar to the definition of “control” set forth in the regulations

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<sup>83</sup> *De Minimis* Proposal, *supra* note 71, 53 Fed. Reg. at 36839.

<sup>84</sup> Sayyed, *supra* note 13, at 16-17.

<sup>85</sup> ALD, *supra* note 68, at 336-337.

governing the Committee on Foreign Investment in the United States (CFIUS Regulations), which define control as:

[t]he *power*, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, *to determine, direct, or decide* important matters affecting an entity; in particular, but without limitation, *to determine, direct, take, reach, or cause decisions* regarding the following matters, or any other similarly important matters affecting an entity . . . .<sup>86</sup>

The list of “matters” following this definition could then be tailored to antitrust. Moreover, the revised Rules could enumerate conduct that does not result in “effective control,” like investor speech.

Similarly, the FTC could add examples to sections 801.1(i)(1) and 802.9 of the HSR Rules to explain that investors who merely consult with or offer recommendations to management can still qualify for the investment-only exemption. The word “influence” could also be removed from the existing example to section 801.1(i)(1) because it is not contained in the definition and is more ambiguous than the phrase “participate in.” Any of these approaches would enhance both the current guidance and the efficiency of capital markets without constraining the agencies’ ability to review and effectively challenge problematic acquisitions.

At present, FTC guidance on the proper scope of the “investment only” exemption is unclear, at best. Before the Commission considers enforcement action related to whether a particular investment is passive or not, it should provide guidance to the investor community and clarify its policy as it relates to the solely for purposes of investment exemption.

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<sup>86</sup> 31 C.F.R. § 800.204(a) (emphasis added).