ACTIVIST FUNDS SHOULD HEED THE LATEST ENFORCEMENT OF THE HSR ACT

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The limits on an investor's ability to acquire stock under the "investment-only" exemption to the HSR Act's reporting requirements take center stage as the Antitrust Division of the U.S. Department of Justice (the "DOJ") filed suit against ValueAct Capital ("ValueAct") for violating the reporting and waiting period requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 in connection with the pending merger of Halliburton and Baker Hughes. In its Complaint, the DOJ alleged that ValueAct invested over $2.5 billion in voting securities of both companies after they announced their plans to merge. According to the DOJ, the investment was made in order to "obtain access to management, to learn information about the merger and the companies' strategies in private conversations with senior executives, to influence those executives to improve the chances that the merger would be completed, and to influence other business decisions whether or not the merger went forward."

Federal regulations provide an exemption from HSR notification requirements for up to 10 percent of the outstanding voting securities of an issuer, regardless of value, on the condition that the buyer intends to be a passive investor. But the exemption is only available when "the person holding or acquiring [the] voting securities has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer." When it adopted the exemption in 1978, the Federal Trade Commission (the "FTC"), which regulates the HSR Act, listed several activities that it claimed would be presumed inconsistent with a purely passive investment, and this list has guided advice in the HSR field ever since. The activities include, among other things, "proposing corporate action requiring shareholder approval." In its Complaint, the DOJ claimed that both ValueAct's investment philosophy (as outlined on its website) and its explicit communications to its shareholders demonstrate its intent to use its large ownership stake to influence the outcome of the proposed merger and other important corporate actions.

The FTC and DOJ are aggressive in their interpretation of the exemption, and litigation over it, though rare, is not unprecedented. The government sued Barry Diller in 2013 for acquiring voting securities in Coca Cola Company above the then-current HSR notification threshold, because he "intended to participate in the formulation, determination, or direction of the basic business decisions of Coke through his membership on the board of directors." The parties eventually settled on a civil fine of $480,000. And although the FTC and DOJ extend "free bite at the apple" for one inadvertent failure to file, that option was never available here; in 2007, ValueAct agreed to pay $1.1 million to settle government charges that it violated pre-merger notification requirements related to its investments.

Investors, particularly those with activist strategies, should watch this case closely. If it is not settled, a federal court may provide rare and important guidance on the scope of a very important exemption. In the meantime, investors should be cautious when making investment decisions that may result in holdings of an issuer

altogether worth more than $78.2 million, the current HSR notification threshold, and should be cautious about undertaking activities that arguably are intended to influence the business decisions of the issuer.

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