

When Passive Investors Take a Stand – HSR Act Enforcement Put to the Test

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Enforcement actions for violations of the Hart-Scott-Rodino Act (HSR) often are announced with substantial money penalties or other restrictions agreed in advance between the agency and the parties. Not so with the Department of Justice's complaint filed April 4 against ValueAct Capital and its affiliated investment funds. ValueAct has said that it will vigorously defend its position.

The HSR Act, among other things, requires certain investors to file notice with the Department of Justice and Federal Trade Commission, and to put off acquiring stock valued above the reporting thresholds (presently \$78.2 million) until the agencies have completed their review of the investment's potential for anticompetitive impact. The HSR rules provide several exemptions, including an exemption for purely passive investors that hold less than 10% of a company's voting stock. The rub is that the agency views the exemption very narrowly, and any intent to do more than simply holding the stock for investment likely will draw the agency's ire. In the complaint filed against certain ValueAct Capital entities for violating the HSR Act with respect to the purchase of over \$2.5 billion of Halliburton and Baker Hughes stock following the companies' November 17, 2014 merger announcement, the agency is seeking civil penalties of \$19 million plus an injunction against further violations.

The agency has alleged that ValueAct made the investments with the intent to influence the companies' business decisions, using access to senior executives of both companies to influence their merger and other business strategies. According to the complaint, ValueAct planned from the outset to play an active role at Halliburton and Baker Hughes, and began developing strategies to use its ownership positions to influence management of each firm as necessary to increase the likelihood that the merger would be completed. The complaint cites internal ValueAct documents explaining that "our activist approach limits our downside in the unlikely case that the merger does not close;" that if the merger were not completed, ValueAct "would likely seek to take a more active role in overseeing the company;" and that ValueAct's "position in HAL should be meaningful enough to have a substantial role in those conversations" referring to getting antitrust clearance for the deal. The agency also alleges that if the transaction were to be restructured to achieve regulatory clearance, ValueAct expected it would be "well positioned as an owner of both companies to help develop the new terms" and that "[i]f the deal failed, the back-up plan would seem to be to sell at least some of Baker's pieces." ValueAct also filed a 13D with the SEC, reporting that it might discuss "competitive and strategic matters" with Baker Hughes management, and might "propos[e] changes in [Baker Hughes's] operations."

To the extent such statements provide evidence of an active intent, the agency has said in the past that "the test for the investment-only exemption is the acquirer's intention, and that determination may not turn on any particular conduct." The Complaint goes further though, cataloging numerous specific efforts to influence management, including correspondence, in-person meetings, and telephone meetings with both companies' senior management discussing strategy for regulatory clearance for the transaction, transaction integration and synergies, and the companies' executive compensation plans.

The issue is not new. In 2015, the FTC brought an enforcement action against an investment manager for HSR Act violations alleging improper reliance on the investment-only exemption upon a similar set of facts. The investment manager acquired less than 10% of the shares of Yahoo and relied on the passive investor exemption, and filed a 13D filing with the SEC. The investment manager demanded "sweeping changes in both the Board of Directors (the "Board") and Company leadership," and contacted individuals to gauge interest and willingness to become the CEO of Yahoo or a potential board candidate of Yahoo – all while assembling an alternate slate for the Yahoo Board and discussing the possible launch of a proxy battle for directors of Yahoo. The 2012 Biglari Holdings enforcement action matter was based on similar facts – contacting senior management with ideas to improve shareholder value and requests to be appointed to the board of directors.

ValueAct's vow to fight the allegations sets up a rarely seen test of the limits of agency enforcement, and of the scope of the HSR passive investor exemption. While the agency's narrow intent-based reading of the exemption appears to be satisfied by the allegations in the complaint, it has long been criticized as not in line with rationale for the exemption, severely limiting for investors, and not necessary to protect competition. Thus, the defense will likely assert that the FTC's application of the passive investor exemption is overbroad and flawed, and that, perhaps, a more bright line test would be appropriate – and make it easier for investors to know what the rules are. Since there is little risk that a court would read the exemption as more restrictive than the agency already has, a court battle appears to have limited downside for ValueAct – aside from potentially limiting its ability to negotiate a lower penalty. For the agency, though, an adverse ruling could lead to real changes in the scope of the exemption, so will be closely watched by businesses, practitioners and enforcers.

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