

ANTITRUST, MERGERS AND ACQUISITIONS | APRIL 6, 2016

## Activism (Re)Defined: DOJ Files Complaint Against ValueAct for Alleged HSR Act Violation

On April 4, 2016, the US Department of Justice (“DOJ”) filed a civil antitrust suit against activist investor ValueAct Capital (“ValueAct”) seeking at least \$19 million of civil penalties for ValueAct’s alleged violation of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a (“the HSR Act”).

According to the DOJ complaint, ValueAct purchased over \$2.5 billion of voting securities of Halliburton and Baker Hughes after the two companies announced their merger in November 2014. While its stake represented less than 10% of each company’s voting share capital, according to the complaint, ValueAct purchased the shares with the intent to influence the companies’ business decisions in connection with the merger and therefore it could not rely on the HSR “investment-only” exemption, which the Federal Trade Commission (“FTC”) and DOJ interpret narrowly.

Under the investment-only exemption, acquisitions of voting securities made solely for the purpose of investment, regardless of the dollar value of the securities, are exempt from the requirements of the HSR Act provided that the purchaser will not hold more than 10% of the issuer’s voting securities as a result of the transaction. Voting securities are held or acquired “solely for the purpose of investment” if the person holding or acquiring such voting securities has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer. The mere voting of the stock will not be considered evidence of the absence of investment intent; however, any investor who anticipates seeking to influence management decisions is regarded by the DOJ and FTC as an “active investor” and is not entitled to rely on the investment exemption.

While the agencies view any amount of influence over management as inconsistent with the investment-only exemption, in a statement on Monday, ValueAct said that basic shareholder rights include “having a relationship with company management, conducting due diligence on investments and engaging in ordinary course communications with other shareholders.” Unlike most investors facing HSR Act suits who choose to settle with the antitrust regulators in exchange for reduced fines, ValueAct reportedly plans to contest the DOJ’s actions, arguing that its actions are in compliance with the law. If this occurs, it will be the first time the courts will have interpreted the scope of the investment-only exemption.

### **Solely for the Purpose of Investment**

Drawing from the HSR Statement of Basis and Purpose (which is part of the rule making proceeding required to be filed with the promulgation of the HSR Rules and essentially serves a Congressional history for the Rules), the agencies have always deemed certain types of conduct to be evidence of a lack of investment intent and therefore

inconsistent with the investment-only exemption. Such conduct includes: (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; and (6) doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer.

In 2015, the agencies again demonstrated their view that this is a narrow exemption when they charged hedge fund Third Point with misapplying the exemption for its acquisition of Yahoo stock in 2011. Although Third Point didn't actually engage in any of the above six activities, the fund took enough "activist" steps to negate a purely passive intent. According to the agencies, Third Point was not a passive investor because it: (i) communicated with third parties to determine their interest in becoming the CEO of Yahoo or a potential board member, and took other steps to assemble an alternate slate of board of directors for Yahoo; (ii) drafted correspondence to Yahoo to announce that Third Point was prepared to join the board of Yahoo; (iii) internally deliberated the possible launch of a proxy battle for directors of Yahoo; and (iv) made public statements that they were prepared to propose a slate of directors at Yahoo's next annual meeting.

The agencies did not seek civil penalties against Third Point, but the enforcement action put activist investors on notice that the agencies would continue to interpret the exemption as applicable only to the most passive style of investing.

### **Court to Be the Arbiter**

As with Third Point, the complaint does not contend that ValueAct engaged in any of the conduct that the Statement of Basis and Purpose originally included as inconsistent with the investment-only exemption. Rather, the complaint characterizes ValueAct as an "activist," focusing in part on how ValueAct describes itself on its website and marketing materials, and then details how ValueAct used its access to senior executives of both Halliburton and Baker Hughes to formulate merger and other business strategies with the companies, allegedly in violation of the HSR Act. The complaint quotes drafts of an investment memorandum in which ValueAct states that it "would likely seek to take a more active role in overseeing the company" should the merger not go through and highlighting that ValueAct's "[a]ctive role" is an additional reason to invest in both companies. The final memo that went to ValueAct's investors did not include similar language. Since ValueAct is challenging the DOJ's interpretation, it may now be up to a court to define what scope of activism, if any, is consistent with the HSR investment-only exemption.

While it remains untested with the agencies, there is a level of communication between investors, even otherwise activist investors, and a company that should still keep the investor within the scope of the exemption. For example, a simple request by a large shareholder that it wants to see "better governance" can hardly be viewed as an attempt to participate in the "basic business decisions" of the company.

Unless and until a court rules on the scope of the exemption, the lesson learned is not a new one—the antitrust enforcement agencies interpret the investment-only exemption as being limited to those investors whose *sole*—not merely principal or predominant—purpose is investment. Activist investors who push the boundaries face significant risks of DOJ or FTC investigation and potentially large fines.

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