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FTC Cautions Against Improper Reliance on "Investment-Only" Exemption

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Investment manager Investment manager Third Point LLC and three of its affiliated funds have entered into a proposed settlement agreement with the federal antitrust authorities for violations of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, arising from improper reliance on the "investment-only" exemption. According to the Federal Trade Commission, Third Point failed to obtain HSR clearance in 2011 prior to acquiring voting securities of Yahoo! Inc. in excess of the then-applicable $66 million threshold of the act, relying on the investment-only exemption despite taking action deemed to be inconsistent with passive investment intent. This enforcement action and related FTC guidance reminds investors that the investment-only exemption continues to be narrowly construed, and that enforcing compliance with the HSR Act remains a top priority of the federal antitrust authorities even where a transaction involves a minority stake and does not pose competition issues.

HSR reporting is required for an acquisition if an investor will hold voting securities in excess of the "size of transaction" threshold of the Act, currently $76.3 million. Under the investment-only exemption, however, acquisitions that result in holding ten percent or less of an issuer's issued and outstanding voting securities – regardless of dollar value – are exempt so long as the investor acquires the shares with passive investment intent – i.e., without the intention of participating in management or influencing the basic business decisions of the issuer.

In the transaction at issue, the funds acquired securities through open market purchases resulting in holdings exceeding the notification threshold but representing less than ten percent of the issuer's shares. Despite reporting its holdings of Yahoo! on a Schedule 13D, indicating non-passive intent, Third Point relied on the investment-only exemption and did not initially file HSR notifications. The FTC, however, contended that at the time of its acquisitions Third Point engaged in actions that foreclosed the availability of the exemption. Specifically, Third Point's conduct included:

- contacting certain individuals to gauge their interest and willingness to become the CEO or a potential board candidate of the issuer;
- assembling an alternative slate for the issuer's board;
- drafting correspondence to the issuer announcing that Third Point was prepared to join the board;
- internally discussing the possible launch of a proxy battle for directors; and
- stating publicly that Third Point was prepared to propose a slate of directors at the next annual meeting.

The FTC has long held that certain conduct is inconsistent with passive investment, including nominating a candidate for the board of directors of the issuer; proposing corporate action requiring shareholder approval; soliciting proxies with respect to such issuer; having a representative serve as an officer or director of the issuer; being a competitor of the issuer; or doing any of the aforementioned activities with regard to an entity controlled by the issuer. The Third Point settlement further delineates actions that preclude the use of the investment-only exemption, including:

- asking third parties about interest in being a candidate for the board or CEO of the issuer, and not abandoning such efforts;
- communicating with the issuer about potential candidates for the board or CEO of the issuer, and not abandoning such efforts; or
- assembling a list of possible candidates for the board or CEO of the issuer, if done with the knowledge of the CEO.

The settlement reinforces that the investor's subjective intent with respect to an issuer determines the availability of the exemption. Based on the conduct involved here, as in past enforcement actions, it is important to note that purely "internal" conduct (such as discussing the launch of a proxy contest) may be viewed circumspectly as "external" conduct (communicating with the issuer about candidates for the board). Further, investors must exercise caution with respect to statements regarding intent made in securities filings – including, possibly, the mere filing of a Schedule 13D (a long form beneficial ownership disclosure statement typically filed for transactions entered into for the purpose, or which may have the effect, of influencing control of an issuer) as opposed to a Schedule 13G (a short form beneficial ownership disclosure statement typically used by passive investors).

The FTC did not levy any fines against Third Point, taking into account that this was their first offense and that they filed the necessary corrective filings soon after the violation. The FTC is likely to be less lenient on repeat offenders, however; fines for non-compliance with the Act can amount to as much as $16,000 per day for every day of non-compliance.

If you have any questions, please contact Deidre Johnson, Simone Waterbury, Adam Eckart, or another member of Ropes & Gray's antitrust practice group.