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PREMERGER NOTIFICATION

BNA Insights: DOJ's ValueAct HSR Compliance Case Raises Four Questions That Are Hard to Pass Over

BY JACK SIDOROV

The Hart-Scott-Rodino Act compliance case brought in April by the Department of Justice against two investment funds and their general partner (collectively "ValueAct", https://www.justice.gov/atr/file/838076/download) may be different from all other HSR compliance cases in one key respect: it may be litigated to judgment. Each of the more than 50 previous HSR compliance cases has been resolved via consent decree, nearly always at the time the complaint was filed. (An index of HSR enforcement actions, current as of December 2014, can be found at https://www.ftc.gov/system/files/attachments/hsr-resources/hsr_enforcement_actions_update_12-14.pdf). The Agencies brought three additional HSR enforcement actions before *ValueAct*: *Third Point* (https://www.justice.gov/atr/case/us-v-third-point-offshore-fund-ltd-third-point-ultra-ltd-third-point-partners-qualified-lp); *Blavatnik* (https://www.justice.gov/atr/case/us-v-len-blavatnik-co-access-industries); and *Leucadia* (https://www.justice.gov/atr/case/us-v-leucadia-national-corporation).

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In this instance, however, statements from ValueAct and its reported hiring of David Boies indicate that litigation and the first-ever reported decision interpreting the premerger notification requirements of the HSR Act and Rules may be within sight. Such a decision could provide an important judicial interpretation of the HSR "solely for the purpose of investment" exemption (or the prospect of such guidance may be a mirage in the nearly 40-year journey since the HSR Act took effect in 1978 when the implementing Rules were promulgated).

Overview of the HSR "Solely for the Purpose of Investment" Exemption

The HSR Act requires parties to notify the FTC and DOJ ("the Agencies") and observe a waiting period before acquiring voting securities or assets resulting in holdings above certain dollar thresholds, unless an exemption from HSR reporting applies. The HSR Act exempts various categories of acquisitions, most often because those acquisitions were deemed unlikely to adversely affect competition. The exemption at issue in the ValueAct case and in many of the prior HSR enforcement cases is for acquisitions of voting securities made "***solely for the purpose of investment***" that result in holdings of 10% or less of the issuer.

The HSR Act grants the Agencies authority to define the terms used in the Act, and since the HSR Rules were adopted in 1978 the relevant definition has provided:

> 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.
>
> *Example:* If a person holds stock "solely for the purpose of investment" and thereafter *decides to influence or participate in management* of the issuer of

that stock, the stock is no longer held ''solely for the purpose of investment.''

16 CFR 801.1(i)(1) (emphasis added).

The Federal Register Statement of Basis and Purpose accompanying the 1978 HSR Rules provides some additional guidance, stating that certain types of conduct could be viewed as inconsistent with investment purpose, including nominating a candidate for the board, soliciting proxies, proposing corporate action requiring shareholder approval, and being a competitor of the issuer. It also states that a person could make exempt acquisitions ''solely for the purpose of investment'' and later decide to participate in the management of the issuer, in which case any subsequent acquisitions would fall outside the exemption. (Neither the Statement of Basis and Purpose nor the Rule itself refers to the similar language in Section 7 of the Clayton Act that exempts from Section 7 acquisitions of stock ''solely for investment'' and not used by voting or otherwise to bring about the substantial lessening of competition. For a summary of the limited, older case law interpreting that Section 7 exemption, see Axinn et al., Acquisitions Under the Hart-Scott-Rodino Antitrust Improvements Act (3rd ed., 2015), Section 6.11[3][c].)

(For more extensive analysis of the exemption and possible alternatives, see, e.g., S. Sher and C. Williams, Rethinking the Investment – Only Exemption, ABA Antitrust Section *Threshold* Fall 2014 40, available at https://www.wsgr.com/publications/PDFSearch/sher-1214.pdf; B. Sayyed, A ''Sound Basis'' Exists for Revising the HSR Act's Investment-Only Exemption, available at http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/apr13_sayyed.authcheckdam.pdf; M. Pfunder, Shareholder Activism and the Hart-Scott-Rodino Act Exemption for Acquisitions of Voting Securities Solely for the Purpose of Investment (2006), available at http://www.gibsondunn.com/fstore/documents/pubs/Pfunder-ShareholderActivism-Antitrust07.06.pdf).

Overview of DOJ's ValueAct Complaint

According to the Complaint, ValueAct — which promotes itself as having a strategy of ''active, constructive involvement'' in the management of companies in which it invests — began acquiring significant holdings of Halliburton Company and Baker Hughes Incorporated shortly after those competing companies announced plans to merge in November 2014. (That proposed merger was challenged by DOJ in April of 2016, two days after it filed the ValueAct Complaint, and was abandoned by the parties shortly thereafter.) ValueAct's holdings of both Halliburton and Baker Hughes crossed the HSR threshold in early December 2014, and ValueAct eventually held over $2.5 billion of voting securities of the two companies.

The Complaint alleges that ValueAct, from the beginning, ''anticipated influencing the business decisions'' of the companies. ValueAct told investors it would ''be a strong advocate for the deal to close'' and would be well positioned as an owner to both companies to help develop new terms if the deal encountered regulatory issues. ValueAct executives also discussed internally a back-up plan to ''sell at least some of Baker's pieces'' if the merger were blocked or abandoned.

''ValueAct planned from the outset to take steps to influence the business decisions of both companies, and met frequently with executives of both companies to execute those plans.'' Without filing under the HSR Act, ''ValueAct intended to use its position as a major shareholder of these companies 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.'' (The Complaint provides more detailed allegations concerning ValueAct's intent and conduct under the topic headings ''ValueAct's Initial Investment Decision and Strategy'', ''ValueAct's Efforts to Influence the Management of Both Companies'', and ''Consistent with Its Initial Plans, ValueAct Worked to Restructure the Merger or to Sell Parts of Baker Hughes.'' The conduct alleged continued into November 2015.)

Press accounts (but not the Complaint) indicate that ValueAct made an HSR filing for Baker Hughes at some point in the process (presumably on the basis of a belief that its intent had changed and no longer came within the ''solely for the purpose of investment'' exemption), but do not indicate when that occurred. The Complaint seeks more than $19 million in civil penalties — more than three times the highest HSR civil penalty obtained to date — and alleges that ValueAct remains in violation of the HSR Act with respect to Baker Hughes. (That violation — and potential for penalties of up to $16,000 per day — would continue until either the waiting period for that HSR filing expired or ValueAct's holdings of Baker Hughes fell below the HSR $78.2 million size of transaction threshold. The violations alleged with respect to Halliburton ended in January 2016 when ValueAct's holdings fell below the HSR threshold.)

Assistant Attorney General Bill Baer cited ''the seriousness of the violation and ValueAct's prior HSR violations'' as reasons for ''seeking significant civil penalties and an injunction against further violations.'' https://www.justice.gov/opa/pr/justice-department-sues-valueact-violating-premerger-notification-requirements. (ValueAct had in 2007 agreed to pay $1.1 million in civil penalties with regard to more technical HSR violations that it self-reported. https://www.justice.gov/atr/case/us-v-valueact-capital-partners-lp. The violations alleged in that case did not involve intent inconsistent with the ''investment only'' exemption. According to the Complaint in that 2007 case, ValueAct had previously self-reported a set of seemingly inadvertent HSR violations and had outlined steps it would take to prevent future violations. In addition to its previous HSR violations, ValueAct has also made at least 21 HSR filings since 2005, as reflected by grants of early termination listed on the FTC's website.)

The Four Questions

1. What does ''participating in'' (the formulation, determination, or direction of the basic business decisions) mean?

ValueAct will likely argue that its intent at the relevant time was to support basic business decisions — the merger — that management had already made and announced, and to make suggestions on how to get there, and that such ''active, constructive, involvement'' is not ''participation'' in the formulation, determination or direction of the basic business decisions of the companies.

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More generally, if A acquires voting securities of B clearly intending to *make suggestions* to B's management regarding basic business decisions, does A fall outside the exemption? Is an intent to make suggestions, without any explicit or implicit threat of action in support of those suggestions (such as a proxy fight or seeking board seats), enough to fall outside the exemption? Do suggestions to management regarding basic business decisions from *a major shareholder* implicitly convey more than mere suggestions, so that its intent to make those suggestions equates to intent to participate in those decisions?

Further, is there a difference between ''participating in'' (the language of the HSR Rule) and ''influencing'' (language used in the Example to the Rule and in the Complaint) management?

2. What does it mean to have ''no intention'' of doing something (participating in the . . . basic business decision of the issuer)?

At one extreme, I may clearly *intend* to do something: I may go to a restaurant intending to order a hamburger. There may be an opposite extreme of having absolutely *no intention* of doing something: if you are a vegetarian, you may go to that restaurant and have no intention of ordering a hamburger — in looking at the menu, you may not even consider a hamburger.

Similarly, an investor may acquire stock intending to participate in the basic business decisions of the issuer, and the ''solely for the purpose of investment'' exemption would not apply. But the other extreme — categorically ruling out such participation at any time and under any conditions — may not be realistic (or even possible if the investor owes some fiduciary duty to its own investors). None of the Agencies' statements or enforcement actions to date indicates that an investor need have such a Sherman-esque position in order to come within the exemption. The FTC Bureau of Competition issued a blog-post in connection with filing the *Third Point* case titled ''*Investment-only* means just that'' in which it emphasized that the investment only exemption ''is a narrow exemption'' and cited various statements of FTC officials and prior Complaints filed regarding the exemption, but it did not suggest that an investor must categorically rule out ever participating in basic business decisions of the issuer in order to come within the exemption. https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just.

So if ''no intention'' does not mean ''there is no way come hell or high water that I would ever do it'', what does it mean? Agency complaints in prior enforcement actions provide some insight into the Agencies' position. In the 1994 *Pennzoil* case, the Agencies alleged that Pennzoil *considered and anticipated participating in the management* of Chevron. In the 2012 *Biglari* case, the Agencies alleged that defendant's intent included such participation as evidenced by requesting board seats shortly after the acquisitions at issue. More recently, in the 2015 *Third Point* case, the Agencies cited conduct contemporaneous with acquisitions such as contacting individuals about becoming CEO or directors of the target and internally deliberating launch of a proxy battle for directors as evidence that defendant's intent was ''other than solely for the purpose of investment.''

As described above, DOJ alleges that ValueAct from the beginning ''*anticipated* influencing the business decisions'' and ''*planned* from the outset to take steps to influence the business'' of the companies. ValueAct may argue that it neither ''anticipated'' nor ''planned'' to influence or participate in the basic business decisions of the issuer, and that such participation as eventually may have occurred was only ''considered'' during the relevant time frame as a fallback option (and perhaps even a remote one) in case management's existing plans that ValueAct supported did not come to fruition. Returning to the restaurant analogy, ValueAct's intent may have been more like that of a restaurant patron who sometimes orders hamburgers but intends to order salmon, and orders a hamburger only after learning they have run out of salmon, or even more like that of a restaurant patron who prepares in advance for all possible scenarios involving menu items being unavailable. *See* http://www.theonion.com/article/backup-plan-case-menu-item-out-stock-most-well-tho-53083.

Does an investor ''considering'' doing something at some later date if certain events transpire mean that it cannot claim that it has ''no intention'' of doing it? Does it depend on how serious or concrete that consideration is? What if the investor's thought process is along the lines of: ''I am buying the stock because I think it is a good investment and a well-managed company. By making a sizable investment and becoming one of the company's largest shareholders (though under 10%), I plan to closely monitor my investment and can't rule out taking an activist posture (seeking board seats, proposing corporate action) in the future if I no longer believe the company is well-managed.'' Does the track record of the investor matter (e.g., one who has never previously become active versus one who has often become active with regard to previous investments)?

3. What are ''basic business decisions'' of the issuer?

The HSR Rule language seemingly does not make the exemption inapplicable merely because an investor intends to influence or participate in *some* management decisions. ''Basic business decisions'' of the issuer must be involved. That term is not defined in the HSR Rules, and at least two different interpretations are plausible.

First, anything requiring shareholder approval could be deemed a ''basic business decision.'' This reading has the benefit of being close to a bright line test for an investor, but the disadvantage of seeming unrelated to antitrust and the underlying purpose of HSR because some types of matters requiring shareholder approval would seemingly have no competitive significance.

Alternatively, ''basic business decisions'' could be construed to mean those decisions that could have some impact on the competitiveness of the company and competition. Under this reading, decisions to undertake significant acquisitions or to spin off significant assets or enter or exit particular markets would be ''basic business decisions'' whether or not they required shareholder approval, but decisions to use only recycled paper or to increase minority recruitment might not.

These two interpretations could also be combined into either a narrower interpretation, so that ''basic business decisions'' is construed to mean only those decisions requiring shareholder approval that could have some impact on the competitiveness of the company

and competition, or a broader interpretation, viewing the term as encompassing those decisions that require shareholder approval *or* could have some impact on competitiveness and competition.

Depending on how ''basic business decisions'' is construed, much of ValueAct's alleged conduct (such as conduct relating to the proposed merger and, if necessary, restructuring it or selling off parts of Baker Hughes) seemingly involves basic business decisions of the companies, while other conduct alleged may not. For example, the Complaint alleges ValueAct efforts to change Halliburton's executive compensation plan and to recommend a firm to Halliburton for post-merger real estate integration services — the intent to engage in that conduct alone would not seem to involve participating in basic business decisions.

4. Does buying the stock of *both parties to a proposed merger of competitors with an intention to engage with management mean* that the acquisitions are not solely for the purpose of investment?

The one aspect of ValueAct's alleged conduct that is seemingly unique when compared to previous HSR enforcement actions dealing with the ''investment only'' exemption is that ValueAct was acquiring the stock of both parties to a proposed merger of competitors that was pending antitrust review. According to Assistant Attorney General Bill Baer, ''ValueAct's substantial stock purchases made it one of the largest shareholders of two competitors in the midst of our antitrust review of the companies' proposed merger, and ValueAct used its position to influence decision-making at both companies.'' https://www.justice.gov/opa/pr/justice-department-sues-valueact-violating-premerger-notification-requirements. DOJ may view this factor as particularly troubling for two reasons, one more narrowly focused on the HSR violation alleged and one more broadly focused on the potential for competitive harm.

First, from an HSR-oriented perspective, focusing on the language of the HSR statutory exemption — ''solely for the purpose of investment'' — it may appear that an investor buying stock of competitors A and B that have announced plans to merge is not merely buying stock of each hoping for the value of *that* stock to increase. It may be buying stock of both A and B hoping that its holdings of *each* will help the value of *both* to increase. (In this instance, ValueAct's objective in acquiring Halliburton stock may appear at least partially linked to the gain that ValueAct would realize as a Baker Hughes shareholder from the merger being consummated — by voting its Halliburton shares in favor of the Baker Hughes acquisition, it could also increase the likelihood of realizing the premium that Halliburton was paying over the current Baker Hughes share price.) In addition, the Statement of Basis and Purpose for the definition of ''solely for the purpose of investment'' indicates that being a competitor of the acquired issuer may be viewed as inconsistent with the requisite investment-only intent (but does not address buying stock of two competitors).

Although not a question posed by the allegations in the Complaint, query how the Agencies would have viewed an investor buying stock in both Halliburton and Baker Hughes if that investor merely intended to vote its shares (including intending to vote in favor of the merger) but had not even considered making any kind of suggestions to management of either company. Would the Agencies view such an investment as falling outside the statutory exemption based on the wording of that exemption, or would they view the exemption as applying because, under the definition in the Rules, that investor clearly would have no intention of participating in the basic business decisions of either company? (The ABA Antitrust Section's *Premerger Notification Practice Manual* (5th ed. 2015), Interp. 128, suggests that passive investments of 10% or less in competitors are within the exemption.)

Second, the *ValueAct* case (and, unlike most HSR civil penalty cases, the failure of the parties to reach a settlement prior to its filing) may reflect the Agencies' broader concern that buying both sides of a pending merger of competitors, particularly when combined with the kind of subsequent actions alleged, poses a threat of competitive harm. The Complaint alleges, for example, that in August and September of 2015, ValueAct met first with the CEO of Baker Hughes and then spoke with the CEO of Halliburton during which it ''shared Baker Hughes's plans if the merger could not close . . . . In short, ValueAct offered [Halliburton] to use its position as a [Baker Hughes] shareholder to pressure Baker Hughes's management to change its business strategy in ways that could affect Baker Hughes's competitive future.'' (Complaint at Par. 37.) The Complaint goes on to allege that ValueAct's notes of their discussion with Halliburton's CEO indicate that in discussing the competitive future of Baker Hughes absent the merger, one of the options that the CEO mentioned was ''Cripple a competitor.'' (Complaint at Par. 38.)

Although the Complaint alleges only violations of the HSR Act, DOJ may view both the intent and conduct of ValueAct as encompassing being a conduit for sharing competitively sensitive information of one competitor with another. And while such conduct may be troubling to DOJ, it is not readily apparent that it could be reached under Section 1 or Section 2 of the Sherman Act, thus making an HSR enforcement action seeking large civil penalties (''at least $19 million'') an attractive means of deterring ValueAct and others from similar conduct.

If the case is litigated, it will be interesting to see how much weight DOJ suggests the court give to the fact that whatever ValueAct's intent was at the relevant time, that intent pertained to acquisition of stock of both companies to a merger undergoing antitrust view, and equally interesting to see how ValueAct, and ultimately the court, respond.

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