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Client Alert

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Proposed HSR Rule Change Would Benefit Activist Investors by Creating New De Minimis Exemption from Filing and Waiting Period Requirements

On September 21, 2020, the U.S. Federal Trade Commission (the "FTC") published a notice of proposed rulemaking that would, among other things, create a new de minimis exemption under the Hart-Scott-Rodino Antitrust Improvements Act of 1986 (the "HSR Act"), which subjects proposed acquirers of an issuer's voting securities to notification, filing and waiting period requirements. Significantly, the new exemption would make it possible for activist investors intending to influence an issuer's business decisions to purchase up to 10% of the issuer's voting securities without being subject to these requirements. The FTC is currently seeking comments to the proposed rule changes.

Background

The HSR Act requires a person seeking to acquire an issuer's voting securities to notify the issuer, file a notification with the FTC and the Department of Justice, Antitrust Division, and observe a waiting period prior to consummating the acquisition if as a result of the proposed acquisition the acquiring person would hold voting securities in excess of certain thresholds, the lowest being $94 million currently.[1] The filing and waiting period requirements allow the antitrust agencies an opportunity to review the proposed acquisition and determine whether it would be anticompetitive in nature and to enjoin the transaction if it would violate the federal antitrust rules.

There are a number of existing exemptions from these requirements under current HSR Act rules, including the "investment-only" exemption, which applies to acquisitions of 10% or less of an issuer's outstanding voting securities that are made "solely for the purpose of investment."[2] To rely on the exemption, an acquiring person must have "no intention of participating in the formulation, determination, or direction of the basic

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[1] HSR Act reporting thresholds are adjusted annually.
[2] 16 C.F.R. §802.9.

business decisions of the issuer."[3] Accordingly, the "investment-only" exemption is only available to passive investors who stay below the 10% threshold.

We have generally advised our clients that they should assume they will not be able to rely on the "investment-only" exemption for HSR Act purposes once they file a Schedule 13D with respect to an investment in a portfolio company, particularly when it contains Item 4 language reserving the right to take any and all action to influence management. However, under the current HSR Act regime, having a "passive" intent for SEC reporting purposes and being a passive Schedule 13G filer does not necessarily mean an investor can also rely on the "investment-only" exemption for HSR Act filing purposes. Conversely, a shareholder disqualified from relying on the "investment-only" exemption under the HSR Act is not necessarily ineligible to file a passive Schedule 13G with the SEC. The interplay between Schedule 13G versus Schedule 13D reporting and reliance on the "investment-only" exemption is complex and discussed in further detail in a prior client alert. The new de minimis exemption would eliminate the need for activists to rely on the "investment-only" exemption, except in limited circumstances, and remove these SEC reporting considerations from the HSR Act filing equation.

Proposed Amendment – New De Minimis Exemption

The proposed rules would add a new exemption, Rule 802.15 (Certain De Minimis Investments) that would exempt the acquisition of 10% or less of an issuer's voting securities when the acquiring person does not have a competitively significant relationship with the issuer, as determined by the rules.

Proposed Rule 802.15 would apply to exempt an acquisition resulting in an acquiring person holding 10% or less of an issuer's voting securities only if the following conditions are satisfied:

- the acquiring person is not a competitor of the issuer (or any entity within the issuer);
- the acquiring person does not hold voting securities in excess of 1% of the outstanding voting securities or non-corporate interests of any entity that is a competitor of the issuer (or any entity within the issuer);
- no employee, principal or agent of the acquiring person is an officer or director of the issuer (or of an entity within the issuer);

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[3] 16 C.F.R. §801.1(i)(1).

- no employee, principal or agent of the acquiring person is an officer or director of a competitor of the issuer (or of an entity within the issuer); and
- there is no vendor-vendee relationship between the acquiring person and the issuer (or any entity within the issuer), where the value of the sales between the acquiring person and the issuer in the most recently completed fiscal year is greater than $10 million in the aggregate.

Further, for the purpose of implementing Rule 802.15, the FTC proposes to define the term "competitor" as "any person that (1) reports revenues in the same six-digit NAICS Industry Group as the issuer, or (2) competes in any line of commerce with the issuer."

The FTC views the addition of the new de minimis exemption as bolstering the "investment-only" exemption's function as a screen to eliminate filings for transactions that have a low risk of violating antitrust laws. The FTC noted that it regularly receives filings for acquisitions of 10% or less of an issuer but which are not solely for the purpose of investment (and accordingly are not subject to the "investment-only" exemption), even though these filings "almost never" present competition concerns. In fact, according to the FTC, of the 1,804 HSR filings for acquisitions of 10% or less of an issuer that were received by the antitrust agencies from 2001 to 2017, none was challenged during this time period. By providing a better filter for transactions that are unlikely to violate the antitrust laws, the new exemption would allow the antitrust agencies to better focus their resources on acquisitions that have the potential for competitive harm.

In addition, the FTC seems to suggest that adoption of the new de minimis exemption would address the antitrust agencies' historically narrow interpretation of the "investment-only" exemption that some have argued has had a chilling effect on shareholder engagement with company management. As discussed above, the "investment-only" exemption is only available for acquisitions of 10% or less of the voting securities of an issuer if the person holding or acquiring such securities has "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer," which has been interpreted narrowly by the antitrust agencies. On one end of the spectrum, merely holding and voting stock will be considered evidence of an "investment-only" intent. On the other end of the spectrum, there are specific types of overt actions, enumerated in a Statement of Basis and Purpose for the premerger notification rules originally adopted in 1978 (the "1978 SBP"), that the antitrust agencies will generally view as inconsistent with an "investment-only" intent, including nominating directors, proposing corporate action requiring shareholder approval, having board representation or soliciting proxies. The FTC acknowledges that given "changes in investor behavior"

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since the HSR Act was adopted, however, "a great deal of potential shareholder engagement involves more than merely holding (and potentially selling) stock, but does not encompass what the 1978 SBP discusses." Therefore, a discussion between an investor and company management on "even the simplest of topics can present subtleties that complicate whether the ["investment-only" exemption] might exempt an acquisition of 10% or less of an issuer's voting securities," which arguably dampens "beneficial interaction" between investors and companies. The proposed de minimis exemption would promote such interaction between investors and companies.

Proposed Amendment – Affiliate Aggregation

However, it is important to note that another proposed change to the rules would expand the definition of "person" under the HSR Act to include any "associates" of the person. For an acquiring person that is an investment fund, the change would mean that the acquiring person would have to include both the fund itself and any affiliated investment funds, which the FTC expects will increase the number of HSR filings required by funds under common control of an investment manager. For example, this proposed rule change would require two funds with a common manager to aggregate their holdings of an issuer's voting stock for the purpose of determining whether the HSR Act's size-of-transaction test is met. Whereas under the current rules the HSR filing requirements would not apply as long as each fund qualifies as its own "ultimate parent entity" and individually holds less than $94 million worth of an issuer's voting stock, under the proposed amendment an HSR filing would be required if collectively the two associated funds hold more than $94 million. This change may also limit the availability of the de minimis exemption, as expanding the definition of "person" may make it more difficult for an acquiring person that includes associated funds to satisfy the conditions to the exemption. For the purpose of using the de minimis exemption, an acquiring fund would, for example, need to ensure that neither it *nor any of its affiliated funds* holds more than 1% of the voting securities of any competitor of the issuer.

Impact and Limits of the Proposed Rule

Subject to the proposed affiliate aggregation amendment described above, the proposed de minimis exemption of Rule 802.15 would benefit acquiring persons generally by allowing them to build up to 10% positions in companies regardless of their investment intent as long as they do not trip one of the determinants of a competitively significant relationship listed under the proposed rule. The "investment-only" exemption under Rule 802.9 would remain unchanged and would still be available to acquisitions of 10% or less of an issuer where the acquiring person has no intention to influence the business decisions of that issuer.

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In particular, the de minimis exemption would benefit activist investors whose investment strategy often precludes reliance on the "investment-only" exemption. Practically speaking, under the proposed de minimis exemption, an activist investor would be able to build a 10% position in a target company and file a Schedule 13D containing Item 4 language reserving the right to take any and all action to influence the business or management of the target without the need to comply with the HSR Act filing and waiting period requirements as long as it satisfies the conditions of the proposed exemption. As such, in order to rely on the exemption, activists could not have board representation and could not hold more than 1% of the voting securities of a competitor of the issuer. We note the rule proposal specifically precludes reliance on the de minimis exemption if the acquiring person has a representative on the board of the issuer and does not preclude an intention or reservation of right to seek board representation (a common disclosure by activists in Item 4 of Schedule 13D). We will monitor to see whether commenters address this and call for clarification in the final rule.

Please contact the Olshan attorney with whom you regularly work or one of the attorneys below if you would like to discuss further or have questions.

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