

Federal Trade Commission Walks Back Prior HSR Interpretation That Appointment Of A Board Observer Is Not Inconsistent With Passive Intent

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Under the Hart-Scott-Rodino Act (the “HSR Act”), parties to a transaction are required to file information about a proposed acquisition with the Federal Trade Commission (“FTC”) and the Antitrust Division of the Department of Justice (“DOJ”) if the value of the transaction exceeds certain dollar thresholds and no exemptions apply. Those thresholds are adjusted annually, with the lowest filing threshold increasing to \$90 million (effective as of April 3, 2019). One important exemption to the HSR filing requirements is the passive investor exception pursuant to which filing is not required for (i) acquisitions of less than 10% of an issuer’s outstanding voting securities, regardless of the value of the securities, and (ii) the acquisition is made “solely for the purpose of investment.”¹ The federal antitrust agencies interpret an acquisition to be “solely for purposes of investment” where the acquirer had “no intention of participating in the formulation, determination, or direction of the basic business decision of the issuer.”²

Importantly, mere exercise of voting rights is not considered as evidence of intent inconsistent with investment purpose. However, pursuant to the HSR Statement of Basis and Purpose, the following actions could run contrary to the passive investment exemption³:

- i) Nominating a candidate for the board of directors of the issuer;
- ii) Proposing corporate action requiring shareholder approval;
- iii) Soliciting proxies;
- iv) Having a controlling shareholder, director, officer or employee simultaneously serving as an officer or director of the issuer;

- v) Being a competitor of the issuer; or
- vi) Doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer.

In the past, FTC’s Premerger Notification Office (the “PNO”) has published a limited number of informal interpretations pertaining to the passive investor exemption. In a 2012 interpretation, the PNO has determined that an appointment of a non-voting board observer is not, in itself, inconsistent with a passive investment exemption.⁴ In November 2018, however, the PNO has issued an amended interpretation, stating that the exemption “may not be available to board observers, depending on the level of involvement with the Board that the role entails.”⁵ In doing so, the PNO has continued to narrow the passive investor investment afforded to the potential acquirers. The FTC has also additionally narrowed the passive investor safe harbor by withdrawing interpretations stating that:

- Non-passive intent of a third-party fund manager does not necessarily impute non-passive intent to the fund making the investment⁶;
- An investor is not disqualified from relying on the exemption if the investor competes with the issuer outside the U.S., but not in the U.S.⁷;
- Holding less than 10% of a competitor of the target does not eliminate the ability to rely on the exemption.⁸

It should be noted that the list of narrowing limitations is not exclusive, as they represent informal interpretations, and should not be relied upon as a substitute for reading the HSR Act and the

¹ 15 USC § 18a(c)(9).

² Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33,450 - 33,556 (July 31, 1978).

³ *Ibid.*

⁴ Available at: <https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1203011>.

Retrieved on 20 February 2019.

⁵ *Ibid.*

⁶ PNO Informal Interpretation No. 1308003, available at: <https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1308003>.

⁷ PNO Informal Interpretation No. 1202014, available at: <https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1202014>.

⁸ PNO Informal Interpretation No. 1403011, available at: <https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1403011>.

corresponding Rules.⁹ Correspondingly, the FTC encourages all parties that are in doubt the application of the investment-only exemption to contact the PNO for case-specific guidance.¹⁰

With narrowing of the investment-only exemption, there continues to be a high degree of uncertainty relating to shareholder engagement with management, which could disrupt any beneficial synergies of the shareholder-management relationship. For that reason, it would be beneficial if the PNO further clarified scope of the investment-only exemption.

⁹ In the words of the FTC: “Informal interpretations provide guidance from previous staff interpretations on the applicability of the HSR rules to specific fact situations. You should not rely on them as a substitute for reading the Act and the Rules themselves. These materials do not, and are not intended to, constitute legal advice.” General disclaimer regarding informal interpretations is available at: <https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/about-informal-interpretations>.

¹⁰ See for example the FTC’s press release, “Investment-only means just that”, available at: <https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just>. In the words of the FTC: “When in doubt about the application of the investment-only exemption (or any other aspect of the HSR law or rules), contact the FTC’s Premerger Notification Office. Our HSR experts are available to discuss your questions before you act.”