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DOJ Action Against ValueAct for HSR Act Violation Signals More Caution for Minority Investors and Activist Stockholders

On April 4, 2016, the U.S. Department of Justice (DOJ) filed a complaint in federal court against activist investor ValueAct Capital (ValueAct) for violating the reporting and waiting period requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act). The complaint alleges that minority investments of over $2.5 billion in Halliburton Company (Halliburton) and Baker Hughes Incorporated (Baker Hughes), after they had announced an agreement to merge, by two of ValueAct's affiliated funds fell outside the HSR Act's so-called investment-only exemption and therefore were subject to premerger notification requirements.

This enforcement action follows a similar proceeding brought in August 2015 by the Federal Trade Commission (FTC) against Third Point, LLC (and three affiliated investment funds), another activist investor that, like ValueAct, relied on the investment-only exemption to the HSR Act notification requirements. Taken together, these cases reemphasize the need for investors to be cautious when relying on the investment-only exemption. The cases reveal that the U.S. antitrust agencies are aggressively enforcing their narrow interpretation of the exemption, particularly when it comes to activist investors.

The DOJ complaint against ValueAct, like the FTC's allegations against Third Point, focuses on whether ValueAct's actions and statements were consistent with an investment-only intent. Under the HSR Act, if an acquisition of voting securities of a public or private corporation would result in certain threshold tests being met, the "acquiring person" and the "acquired person" generally must (a) submit a premerger notification to the U.S. antitrust agencies and (b) observe a waiting period before the acquiring person may acquire such voting securities. These notification and waiting period requirements do not, however, apply if the acquisition falls within an HSR Act exemption—including the HSR Act's exemption for acquisitions made solely for the "purpose of investment."

Although ValueAct apparently sought to rely upon this investment-only exemption in connection with the investments in Halliburton and Baker Hughes, the DOJ complaint alleges that ValueAct's actions and public statements demonstrated a clear intention to take the business strategies of the two companies – facts inconsistent with an investment-only intent. Therefore, according to the DOJ, ValueAct could not rely on the investment-only exemption to justify its failure to file HSR notifications and observe the HSR waiting period before acquiring shares valued in excess of the HSR threshold tests.

The DOJ is seeking a civil penalty of at least US$19 million and a restraint against ValueAct from any future violations of the HSR Act. The complaint notes that this was the third violation of the HSR Act that ValueAct has committed by acquiring securities without filing the necessary notifications. The previous two violations resulted in no enforcement action and a settlement of $1.1 million, respectively.

Background

On November 17, 2014, Halliburton and Baker Hughes announced their plans to merge. In December 2014, ValueAct Master Capital Fund, L.P. (Master Fund) began purchasing Halliburton voting shares. By December 5, 2014, Master Fund held in excess of $75.9 million worth of Halliburton voting shares, exceeding the then-applicable HSR size-of-transaction threshold test. Master Fund continued to acquire Halliburton shares, holding in excess of $1.4 billion worth of such shares by June 30, 2015, but did not file an HSR notification to report its acquisition of Halliburton shares. By January 27, 2016, Master Fund had sold a sufficient number of Halliburton shares so that it held less than the applicable HSR size-of-transaction threshold amount. As a result, according to the DOJ, Halliburton was in violation of the HSR Act between December 5, 2014 and January 27, 2016. Maximum penalties for this violation would be $16,000/day for each day Master Fund was in violation of the HSR Act.

Toward the end of November 2014, Master Fund began purchasing voting shares of Baker Hughes. By December 1, 2014, it held in excess of $75.9 million worth of voting shares of Baker Hughes, exceeding the then-applicable HSR size-of-transaction threshold test. After subsequent acquisitions of Baker Hughes shares, on January 15, 2015, Master Fund held over $1.2 billion worth of such shares. According to the DOJ, Master Fund's violation of the HSR Act therefore began on December 1, 2014, and continues to the present because it still holds Baker Hughes shares valued over the HSR size-of-transaction threshold test. Again, maximum penalties are $16,000/day for each day of the violation.

In February 2015, ValueAct Co-Invest International, L.P.[1] (Co-Invest Fund), another affiliated entity of ValueAct, began purchasing voting shares of Halliburton. By March 10, 2015, it held Halliburton shares valued over the HSR size-of-transaction threshold test (then $76.3 million). By January 22, 2016, it had sold sufficient Halliburton shares so it no longer held Halliburton shares valued over the size-of-transaction threshold test. According to the DOJ, it was therefore in violation of the HSR Act from March 10, 2015 through January 22, 2016, again with maximum penalties of $16,000/day for each day of the violation.

The HSR investment-only exemption

Under the "solely for the purpose of investment" exemption of the HSR Act, "[a]n acquisition of voting securities shall be exempt from the requirements of the [HSR] act . . . if made solely for the purpose of investment and if, as a result of the acquisition, the acquiring person would hold ten percent or less of the outstanding voting securities of the issuer,…." 16 C.F.R. Section 802.9. The HSR Act rules define "solely for the purpose of investment" to mean that "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." 16 C.F.R. Section 801.1(i)(1).

In practice, merely exercising voting rights is not inconsistent with an investment-only purpose. However, the FTC has indicated that the following types of conduct would be considered inconsistent with an investment-only purpose:

- nominating a candidate for the board of directors of the issuer;
- proposing corporate action requiring shareholder approval;
- soliciting proxies;
- having a controlling shareholder, director, officer or employee simultaneously serving as an officer or director of the issuer;
- being a competitor of the issuer, holding over 10% interests in a competitor of the issuer, or having a board seat on a competitor of the issuer; or
- doing any of the foregoing with respect to any entity under common control with the issuer.

FTC Statement of Basis and Purpose for the HSR Regulations (July 31, 1978).

DOJ Allegations

The DOJ complaint claims that the investment-only exemption of the HSR Act does not apply to the two ValueAct funds' acquisitions of Halliburton and Baker Hughes voting shares. The DOJ supports this claim by alleging the following:

- When Value Act began acquiring shares of Halliburton and Baker Hughes, soon after the announcement of their merger, ValueAct "anticipated influencing the business decisions of the companies as the merger process unfolded." Complaint at ¶ 3. For example, ValueAct told its investors that its purchase of shares in the companies allowed it to "be a strong advocate for the deal to close" and, should the merger encounter regulatory hurdles, positioned ValueAct "to help develop the new terms" of the transaction. Id.
- ValueAct "met frequently with executives of both companies." Id. at ¶4. From December 2014 through January 2016, ValueAct met in person or had teleconferences more than fifteen times with senior management of Halliburton or Baker Hughes, including meeting multiple times with the CEOs of both companies. ValueAct partners also exchanged a number of emails with management at both firms about the merger and the companies' respective operations." Id. at ¶26.
- After crossing the HSR size-of-transaction threshold on December 1, 2014, ValueAct's CEO met with Baker Hughes's CEO and emphasized the importance of Baker Hughes focusing on certain opportunities, whether or not the merger occurred. Id. at ¶27.
- On January 16, 2015, ValueAct filed a Schedule 13D with the Securities and Exchange Commission (SEC) disclosing its stake in Baker Hughes and noting that "it might discuss 'competitive and strategic matters' with Baker Hughes and propose 'changes in [Baker Hughes'] operations.'" Id. at ¶28.
- In March 2015, ValueAct contacted Halliburton and offered to help with the shareholder vote on the merger. Id. at ¶30.
- On May 13, 2015, ValueAct met with Halliburton's CEO to discuss "actions that Halliburton could take in an attempt to achieve its target merger synergies." Id. at ¶31.
- On August 31, 2015, ValueAct met with Baker Hughes's CEO to discuss selling individual Baker Hughes segments if the merger ran into problems. Id. at ¶34. ValueAct also discussed with Halliburton restructuring the merger in August and again in September 2015. Id. at ¶36.
- At a September 18, 2015 meeting with Halliburton's CEO, ValueAct shared Baker Hughes's plans if the merger did not close. Id. at ¶37. According to the DOJ, "ValueAct offered to use its position as a shareholder to pressure Baker Hughes's management to change its business strategy in ways that could affect Baker Hughes's competitive future." Id
- In September 2015, ValueAct met with Halliburton's CEO to discuss plans for executive compensation changes. Id. at ¶32. ValueAct had reached out to Halliburton's CEO to schedule this meeting on July 14, 2015, and may have been considering this action as early as December 2014. Id. at ¶24.
- On November 5, 2015, ValueAct made a detailed presentation to Baker Hughes's CEO "proposing operational and strategic changes to the Company" Id. at ¶39. ValueAct also "lobbied Halliburton's senior management to pursue alternative ways to get the deal done." Id.

The DOJ complaint concludes that these actions demonstrate ValueAct's plan "from the outset to take steps to influence the business decisions of both companies" as they navigated the merger process. Id. at ¶4. According to the DOJ complaint, ValueAct:

> Intended to use its position as a major shareholder [of both] 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. Id. at ¶5.

In the DOJ's view, because of these activities, ValueAct could not invoke the "investment-only exemption" to justify its failure to report its acquisitions under the HSR Act.

Key Takeaways

The DOJ action against ValueAct, coupled with the FTC's action against Third Point, underscore the need to proceed with caution before relying on the HSR investment-only exemption, even when acquiring and holding only a minority stake in a corporation. This is especially true for activist funds whose publicly announced strategy may be to pursue "active, constructive involvement' in the management of the companies in which [they] invest." Complaint at ¶12 (quoting ValueAct's website).

In the view of the DOJ and the FTC, the investment-only exemption would not be available to acquiring persons who request and/or attend meetings with an issuer's management or board of directors to influence the issuer with respect to corporate decisions, or who recommend that the issuer undertake certain actions (including, among other things, actions related to executive compensation, strategy, cost cutting measures, or merger or acquisition agreements). Public or even internal consideration of seeking a board seat, soliciting new directors, or advocating for a change of directors could also be inconsistent with the exemption.

Moreover, because the exemption is not available if, among other things, the acquiring person has the subjective intent to influence management of the issuer, it is not only the acquiring person's actual acts that may make the exemption unavailable. The U.S. antitrust agencies will often examine, in addition to a company's actions with respect to an issuer, its public statements (including those that articulate general investment strategies), its SEC filings concerning the issuer, and its internal documents, including e-mails and other communications with its own investors. Of course, any communication (whether oral or in writing) between the acquiring person and management or directors of the issuer will also be relevant to assessing the acquiring person's subjective intent to influence management of the issuer.

The investment-only exemption may also be unavailable if the acquiring person holds an ownership interest greater than 10% in a competitor of the issuer, or holds any interest in a competitor of the issuer other than solely for investment purposes. Therefore, before relying on this exemption, the acquiring person should review its other holdings and contemplated acquisitions.

Given that the U.S. antitrust agencies have demonstrated an aggressive approach to enforcing the limits of the investment-only exemption, it is advisable for acquiring persons to exercise caution and consult with experienced HSR Act counsel before relying on the investment-only exemption to complete an acquisition of voting securities (even if only a small percentage of an issuer's outstanding voting securities).

With contributions by Michael P. Glasser, Professional Support Lawyer

[1] Co-Invest Fund does not share the same ultimate parent entity with Master Fund and is therefore considered a separate entity from Master Fund for HSR purposes.

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