MANAGED FUNDS ASSOCIATION

Council of Institutional Investors
The voice of corporate governance

August 13, 2018

Via Electronic Submission:

Mr. Donald S. Clark
Secretary of the Commission
Federal Trade Commission
600 Pennsylvania Avenue NW
Washington, DC 20580

Re: **Competition and Consumer Protection in the 21st Century Hearings, Project Number P181201 – Investment Community Request for HSR Reform**

Dear Mr. Clark:

The Council of Institutional Investors[1] ("CII") – "the voice of corporate governance" – and Managed Funds Association[2] ("MFA") – "the voice of the global alternative investment industry" – are pleased to submit this letter to the Federal Trade Commission ("FTC" or the "Commission") in connection with the Commission's upcoming Hearings on Competition and Consumer Protection in the 21st Century (the "Hearings"). In particular, this letter proposes that the Commission examine the premerger notification program under the Hart-Scott-Rodino Antitrust Improvements Act ("HSR Act") at the Hearings. CII and MFA believe that Topic 1 would be the most appropriate setting to consider HSR Act issues at one or more Hearings.[3]

CII and MFA members represent a broad swath of the investment community across the investment spectrum. As described below, the investment community is concerned that the Commission's increasingly narrow interpretation and application of

[1] CII is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management exceeding $3.5 trillion. CII also has associate members that include a range of asset managers totaling more than $25 trillion in assets under management. CII currently has more than 130 general members and over 130 associate members, the latter including more than 50 asset managers. CII's website can be accessed here: http://www.cii.org/.

[2] MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has over 3,000 members from firms engaged in many alternative investment strategies all over the world. MFA's website can be accessed here: https://www.managedfunds.org/.

[3] Topic 1 will consider the state of antitrust and consumer protection law and enforcement, and their development, since the Pitofsky hearings. As an alternative, Topic 11, the FTC's investigation, enforcement and remedial processes also might be a suitable setting.

the investment-only exemption under the HSR Act is imposing an undue regulatory burden and unnecessary costs on institutional investors, such as employee pension funds, charitable foundations and university endowments.[4] That burden undermines the strong public policy in favor of management-shareholder communications, involves significant and unnecessary costs, and is not justified by the Commission's mission to protect competition.

As a remedy, CII and MFA propose the adoption of a 10% flat, *de minimis* exemption and a clarification of the meaning of "investment-only".

I. Background – The Need for a *De Minimis* Exemption

A. Current Investor Expectations for Asset Managers.

MFA members and many CII associate members are professional investment firms that asset owners hire to help meet the asset owners' financial obligations. CII core members are institutional asset owners that either manage their assets directly, retain investment managers to manage them, or undertake a combination of both direct and outsourced management. Broadly speaking, asset owners include individual investors, public and private pension plans, charitable foundations, university endowments, non-profit organizations, insurance companies, and other organizations, each with potentially different investment objectives.

CII's member funds include major pension funds and other long-term asset owners with a duty to protect the retirement savings of millions of workers and their families. Nationwide, these institutions invest more than $2 trillion in hedge funds to help meet financial obligations, diversify their investment portfolios, manage risk, and deliver reliable returns over time.[5]

MFA members include hedge fund managers that pursue a wide range of investment strategies for their investors, including many of CII's pension fund members, to provide retirement security for workers and increased resources for endowments, charities, and foundations. Today, nearly 60% of all hedge fund assets under management come from pension plans and other institutional investors. These investors typically invest in hedge funds to diversify portfolio risk and to minimize exposure to market fluctuations. Hedge fund managers use a variety of approaches to manage their investors' assets in a highly competitive marketplace.[6]

[4] The HSR Act exempts from its notice and waiting period requirements "acquisitions, solely for the purpose of investment, of voting securities, if, as a result of such acquisitions, the securities acquired or held do not exceed 10 per centum of the outstanding voting securities of the issuer" whose voting securities are to be acquired. 15 U.S.C. § 18a(c)(9) (2012).
[5] Preqin, "2018 Global Hedge Fund Report", Jan. 2018.
[6] Hedge Fund Research, Inc. is independent of CII and MFA and provides data on the hedge fund industry. Hedge Fund Strategy Classification System provides background information on the many different strategies that hedge fund managers pursue. For more information, see HFR Hedge Fund Strategy Classification System.

In managing those substantial investments, many CII and MFA members routinely monitor their investments and communicate with company management on certain business decisions, such as executive pay and other corporate governance topics, as a means of value enhancement and investment oversight. Today, engagement with companies is a key part of many asset managers' service to their investors and provides ancillary benefits to the issuer, other shareholders, and markets as a whole; thus, institutional investors rarely just "put their shares in the drawer". As we discuss in Part II of this letter, the Securities and Exchange Commission ("SEC"), the business community, and empirical studies support such engagement between shareholders, management, and the board.

Institutional shareholder engagement differs across the investment management spectrum. Much investment monitoring (sometimes referred to as "stewardship" as it is a responsibility that many institutional investors assume for their clients or beneficiaries) is distinguishable from so-called "activist" engagement. An activist investor typically decides to use its share ownership to invoke the formal governance mechanisms of a company to effect a desired corporate change, for example, by soliciting proxies or nominating directors to a company's board. In contrast, investors that engage with company management, including directors, to monitor their investments typically have no intention of participating in the formal governance of issuers. Instead, they devote their resources to the study and analysis of issuers and sectors, undertake their own due diligence and investment analyses, communicate their views and suggestions to issuers, and respond to requests for feedback from issuers.

The topics on which asset managers may engage with companies cover a broad range of topics related to shareholder value and accountability to shareholders. Areas of focus vary by the investment objectives of their investor-clients and the strategies of the asset managers. Some asset managers discuss corporate governance topics, such as board effectiveness and executive pay, and others focus on value-enhancing topics of an operational and strategic nature. Those operational and strategic topics can include cost reduction, use of working capital, corporate structure, operational efficiency, and business strategies, all with a view of contributing to a company's long-term durability and profitability.

In executing their investment strategies and monitoring investments for clients, many MFA members and some CII associate members routinely rely on the investment-only exemption for any ordinary-course investment of 10% or less in an issuer that exceeds the applicable HSR filing threshold. As filing fees and legal expenses are borne by the client or fund, this important exemption from filing premerger HSR Act notifications saves significant costs for their investor-clients.

The continued reliance, however, by many asset managers on the investment-only exemption, even when they engage in ordinary-course shareholder communications with the management of issuers, has been jeopardized by regulatory statements and recent enforcement actions by the federal antitrust agencies.

The FTC, with the concurrence of the Antitrust Division of the Department of Justice (the "Antitrust Division" or the "DOJ," and, together, the "Agencies," or individually, an "Agency"), has interpreted narrowly the investment-only exemption, more narrowly than the original Statement of Basis and Purpose[7] and the text of the HSR Act rules require. That narrow interpretation has not only unnecessarily restricted the application of the investment-only exemption, but it also has introduced significant ambiguity and uncertainty as to the circumstances within which an investor may properly claim reliance on the investment-only exemption. The stakes are high if an investor violates the HSR Act by improperly relying on the exemption: Failure to file subjects the violator to a $41,000 per day fine and significant reputational damage.

A number of MFA members have reported reluctance to share their views with, or make suggestions to, issuers on governance, management and performance topics because of the ambiguity surrounding the meaning and scope of the investment-only exemption. Both MFA and CII affirm that investment-only ambiguity has had, and will continue to have, a distinct chilling effect upon shareholder engagement, which is preventing issuers from receiving some valuable direct feedback from shareholders and threatens to deprive shareholders generally of a voice on such topics.

When reliance on the investment-only exemption is in doubt, the "just-file" response is unworkable for the investment community. It imposes unnecessary filing costs on investor-clients of asset managers for 10% or less investments that pose no substantive threat to competition.[8] These filing costs reduce the investment returns to clients. Filings based on ordinary-course shareholder engagement without any intention of participating in the management of an issuer can also send an erroneous signal to the issuer and potentially to the market that the investor is or may become "activist" or "hostile," which inhibits open and constructive dialogue. Over-inclusive filings can also unnecessarily divert Agencies' resources to matters that are highly unlikely to raise competitive concerns.

B. HSR Reform is Overdue.

The HSR Act rules, adopted 40 years ago, define an acquisition as "solely for the purpose of investment" when the acquirer has "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer."[9]

[7] Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33450, 33465 (July 31, 1978) ("SBP"). The SBP provides several examples of conduct that "could" be viewed as "evidence of an intent inconsistent with investment purpose." Those include:
(1) Nominating a candidate for the board of directors of the issuer; (2) proposing corporate action requiring shareholder approval; (3) soliciting proxies; (4) having a controlling shareholder, director, officer or employee simultaneously serving as an officer or director of the issuer; (5) being a competitor of the issuer; or (6) doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer.

[8] We note that there is another closely related institutional investor exemption from the HSR filing and waiting period requirements. *See* 16 C.F.R. § 802.64 (2018). To the extent that some CII and a few MFA members may be eligible to use such exemption, the Agencies will still need to clarify the scope and meaning of the operative phrase "solely for the purpose of investment" in clause (b)(3) of the exemption.

[9] 16 C.F.R. § 801.1(i)(1) (2018).

The Commission, however, has interpreted that language to exclude an acquirer that even considers the possibility of trying to influence a basic business decision of an issuer.

Over 15 years ago, Marian Bruno, Deputy Director of the Commission's Bureau of Competition (the "Bureau"), acknowledged the emerging conflict between institutional-investor practice and the Commission's interpretation of the investment-only exemption:

> "Since 1978 when the Rules were adopted, institutional investors and money managers have acquired increasingly larger stakes in many publicly traded companies. As a result, many such institutional investors, who served as the model for 'passive' investor behavior when the Rules were first adopted, **have become routinely more active in seeking to influence** the business decisions of the issuers of voting securities. Some of these large investors have sought to rely on the 'investment only' exemption despite **seeking to influence** the management decisions of an issuer. . . . Such activity is inconsistent with the **purely passive** intent necessary to rely on the exemption.
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> [Any] investor who **anticipates seeking to influence** management decisions **is an 'active' investor and not entitled to rely on the 'investment only' exemption**."[10]

Ms. Bruno has captured well the motivating concern for our submission. She is correct that investors are increasingly communicating with management and rarely place their shareholdings "in the drawer." Indeed, the trend that Ms. Bruno observed has accelerated and, for many in the investment community, is now considered ordinary-course shareholder engagement.

The Commission's more recent enforcement actions involving *Third Point*[11] and *ValueAct*[12] and accompanying public statements have raised to an acute level the uncertainty as to the extent, if at all, that investors may communicate with management without jeopardizing their reliance on the investment-only exemption. The Bureau Director and two Bureau attorneys, upon the announcement of the *Third Point* enforcement action, warned the investment community that "*any investor who is considering engaging with management . . . should proceed with caution* when relying on the investment-only exemption."[13] At the same time, however, the Bureau also acknowledged that "[w]e have heard on occasion that our investment-only rules,

[10] Marian R. Bruno, Deputy Director, Fed. Trade Comm'n, Prepared Remarks Before the American Bar Association: Hart-Scott-Rodino at 25 (June 13, 2002) (emphasis added).
[11] *See generally* U.S. v. Third Point Offshore Fund, Ltd. *et al.*, Docket No. 1:15-cv-01366-KBJ (Dec. 18, 2015).
[12] *See generally* U.S. v. VA Partners I, LLC, *et al.*, Docket No. 3:16-cv-01672-WHA (Nov. 1, 2016).
[13] Debbie Feinstein, Ken Libby & Jennifer Lee, "*Investment-only" means just that*, F.T.C. BLOG (Aug. 24, 2015) (emphasis added), https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just.

promulgated many years ago, are too stringent."[14] This submission confirms the latter comment and reflects serious concern regarding the former.

The Commission's nearly forty-year experience with the HSR Act shows that acquisitions of 10% or less of an issuer's voting securities do not, except under very limited circumstances, raise competitive concerns.[15] Such experience does not justify the current narrow interpretation of the investment-only exemption, which has become more restrictive than the SBP that describes the reasons for and scope of the investment-only exemption.[16]

CII and MFA respectfully request that the Agencies reform the HSR filing requirements for investments of 10% or less in light of the significant increase in shareholder engagement (as discussed in Part II below) since the adoption of the HSR Act rules 40 years ago. We suggest that the Agencies focus their reform initiatives on two solutions to resolve the current ambiguity and its chilling effect on shareholder engagement: the FTC, in consultation with the Antitrust Division, (1) should adopt a 10% flat exemption (the "*de minimis* exemption") from HSR Act filing and waiting period requirements; and (2) should clarify that the Agencies will interpret the current HSR Act rules relating to the investment-only exemption in accordance with the SBP. Any interaction between these two solutions may depend on the manner in which each is adopted.

This letter addresses in Part II the basic proposition that, as Ms. Bruno observed, institutional shareholders are increasingly engaging with management on corporate policies and strategies. Part III identifies the ambiguity regarding the interpretation and application of the investment-only exemption and the adverse impact of that ambiguity on institutional shareholders' engagement with companies. In Part IV, we outline our recommended solution of a 10% *de minimis* exemption and clarification of the meaning of "investment only". Part V is a brief conclusion.

II. Many Shareholders Have Increasingly Engaged with Management over the Last 20 Years with the Support of the Regulatory, Business, and Academic Communities.

A. Regulatory Observations and Support for Shareholder Engagement

In a recent public statement, current SEC Chairman Jay Clayton acknowledged that shareholder engagement is now "a hallmark of our public capital markets", and noted that the "SEC's rules governing the proxy process are at the center of investor

[14] Debbie Feinstein, Ken Libby & Jennifer Lee, *"Investment-only" means just that*, FTC BLOG (Aug. 24, 2015), https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just.
[15] *See* Bilal Sayyed, *A "Sound Basis" Exists for Revising the HSR Act's Investment-Only Exemption*, ANTITRUST SOURCE, Apr. 2013, at 1, 14 & n.75.
[16] Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33450, 33465 (July 31, 1978) (to be codified at 16 C.F.R. pts. 801–803).

participation in, and influence over, corporate governance at U.S. public companies."[17] He cited the "dramatic increase in the number of U.S. companies reporting shareholder engagement, with 72% of S&P 500 companies reporting engagement with shareholders in 2017, compared to just 6% in 2010".[18]

As former SEC Commissioner, Daniel M. Gallagher has argued for management and boards to be as responsive to shareholders as politicians are to their constituents:

> If companies are republics, then **management and even at times boards need to engage with shareholders with the same vigor that politicians engage with their constituents. Clearly communicating your company's strategy and how the board is overseeing management's execution of that strategy to investors, and in turn hearing what's on your investors' minds, can help demonstrate to the SEC that boards are a tool for investor protection, not an impediment to it**.[19]

CII and MFA encourage the Agencies to resolve the policy tensions between the federal securities laws, which support shareholder engagement, and the Agencies' narrow application of the investment-only exemption, which discourages shareholder engagement. CII and MFA believe these two regulatory frameworks can be reconciled without unnecessarily compromising either one.

In that regard, CII and MFA are concerned that the current narrow application of the investment-only exemption is interfering with an animating policy objective of the federal securities laws to ensure a free flow of information and disclosure from issuers of securities to the investing public. To be sure, Congress enacted the Securities Act of 1933[20] (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act")[21] to protect the investing public by affording them access to material information about issuers. That important congressional policy, which has been reflected in many legislative and regulatory initiatives over the last 85 years, forms a basis for shareholder engagement with issuers.[22]

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[17] Public Statement of SEC Chairman Jay Clayton, "Statement Announcing SEC Staff Roundtable on the Proxy Process", July 30, 2018.

[18] *Id.* (citing Ernst & Young 2017 Proxy Season Review (June 2017)). CII and MFA suspect that shareholder engagement in U.S. public companies was likely close to zero when the HSR Act rules were adopted in 1978.

[19] Daniel M. Gallagher, Comm'r, Sec & Exch. Comm'n, Activism, Short-Termism, and the SEC: Remarks at the 21st Annual Stanford Directors' College (June 23, 2015) (emphasis added).

[20] Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (2016).

[21] Securities and Exchange Act of 1934, 15 U.S.C. §§ 78a-78qq (2016).

[22] *See* Garland S. Ferguson, Jr., Comm'r, Fed. Trade Comm'n, Address on the Securities Act of 1933, (Sept. 12, 1933) ("The outstanding purpose … of the Securities Act is that full disclosure shall be made of all material facts concerning an issue of securities that is offered for sale to the public. …The Securities Act is not predicated … upon the theory that the interests of investors are in conflict with the interests of issuers. On the contrary, it embodies the most practical recognition [ever] put into federal law of the fact that the investor and the corporation are mutually dependent. … A law which is founded upon this view and which seeks to give a new and practical meaning to the interdependence of these two interests,

The Securities Act and the Exchange Act provide for issuers to disclose mandated material information to potential public investors and for issuers periodically to report material information to public investors. The federal securities laws also provide for private placements in which sophisticated investors engage with issuers to obtain the information that the investors demand. In a more recent example, it is widely recognized that the required shareholder vote on executive compensation, the so-called "say-on-pay" vote adopted in the U.S. in 2011, has resulted in corporate boards more actively and more frequently reaching out to institutional investors to solicit their views on, and approval of, executive compensation plans.[23] Indeed, the SEC's regulatory actions and commentary have consistently supported a constructive dialogue between management and shareholders.[24]

CII and MFA urge the Agencies not to impede that policy but to allow it to progress by reforming the application of the HSR Act for investments of 10% or less of the voting securities of an issuer, which are highly unlikely to raise any substantive antitrust concerns.

B. **Business Leaders and Empirical Research Confirm the Fact of Increased Shareholder Engagement with Management**.

Companies such as Coca Cola, Pfizer, Allstate, Johnson & Johnson, and Prudential Financial appear to have responded to the increased interest by shareholders in a dialogue with management by offering more shareholder meetings and conference calls and releasing more detailed disclosures.[25] In 2016, a number of prominent leaders of U.S. public companies, such as Mary Barra, General Motors Company; Jamie Dimon,

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assuredly is a law that will work to the benefit of those corporations which, by telling their story to the public, can prove that they merit public confidence.").

[23] *See* Andrea Vittorio, CEO Pay Packages Get More Thumbs Down From Investors, Bloomberg, July 17, 2018 ("more shareholder outreach . . . have helped keep pay vote results relatively unchanged from year to year") https://news.bloomberglaw.com/employee-benefits/ceo-pay-packages-get-more-thumbs-down-from-investors; Gregorio Sanchez-Marin *et al.*, Say on Pay effectiveness, corporate governance mechanisms, and CEO compensation, 20(4) BRQ 226 (Oct.-Dec 2017) ("the SOP process increases communication between the compensation committee and shareholders encouraging the former to design executive compensation more carefully based on performance"), https://www.sciencedirect.com/science/article/pii/S2340943617300439; Paul Hodgson, Surprise Surprise: Say on Pay Appears to Be Working, Fortune.com, July 8, 2015 ("boards appear to be actively seeking shareholder approval even when they already have it"), http://fortune.com/2015/07/08/say-on-pay-ceos/.

[24] That support has been reflected in the evolution of the regulatory landscape. *See, e.g.*, Shareholder Approval of Executive Compensation, 15 U.S.C.A. § 78n-1 (encouraging shareholder engagement by mandating a shareholder vote on executive compensation); *and* Proxy Voting, 17 C.F.R.§ 275.206(4)–6 (2018) (encouraging shareholder engagement by essentially requiring investment advisers to vote on shareholder proposals in a manner consistent with the best interests of clients).

[25] *See* James Kim & Jason D. Schloetzer, *Global Trends in Board-Shareholder Engagement*, The Conference Board (October 2013) (finding that companies including Coca Cola, Pfizer, Allstate, Johnson & Johnson and Prudential Financial have been increasing shareholder engagement by increasing shareholder meetings, conference calls, letters, disclosures, and other means of interacting with shareholders).

JPMorgan Chase; Jeff Immelt, GE; and Lowell McAdam, Verizon endorsed a set of "Commonsense Principles of Corporate Governance". Those principles encouraged "[r]obust communication of a board's thinking to the company's shareholders".[26] They also recommended that asset managers, on behalf of their clients, "actively engage … with the management and/or board of the company, both to convey the asset manager's point of view and to understand the company's perspective".[27]

Empirical research validates the trend of increased shareholder engagement that has been recognized by both business leaders and current and former SEC leadership. In 2011, Marc Goldstein published results from a survey of 335 issuers of stock and 161 investors showing that shareholder engagement is increasing:

> A majority of the survey respondents reported that their engagement activity has been increasing, if not compared to the immediately previous year, then certainly compared to earlier years. **Reasons for the increase include the financial crisis and its impact on portfolios, regulatory developments, and corporate governance reforms, such as the adoption of majority voting for directors, which have raised the stakes for what were formerly viewed as routine shareholder votes**.[28]

Mr. Goldstein updated his survey and published the results in 2014, finding:

> While engagement was already increasing in frequency and importance three years ago, a variety of factors, the most significant of them the advent in the US of universal say-on-pay votes, has deepened the trend. **Compared to the situation three years ago, not only are overall engagement levels higher, but fewer respondents said that they do not engage**.[29]

Securities regulators, business leaders, and empirical research have thus reached a consensus that shareholder engagement with issuers is increasing.

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[26] *See* "Commonsense Principles of Corporate Governance" (July 2016) Section II.a, available at http://www.governanceprinciples.org/.
[27] *Id.* at Section VIII.a.
[28] MARC GOLDSTEIN, INSTITUTIONAL SHAREHOLDER SERVICES, THE STATE OF ENGAGEMENT BETWEEN U.S. CORPORATIONS AND SHAREHOLDERS 3, 27 (Investor Responsibility Research Center Institute 2011) (emphasis added).
[29] MARC GOLDSTEIN, INSTITUTIONAL SHAREHOLDER SERVICES, DEFINING ENGAGEMENT: AN UPDATE TO THE EVOLVING RELATIONSHIP BETWEEN SHAREHOLDERS, DIRECTORS AND EXECUTIVES 4 (Investor Research Center Institute 2014) (emphasis added) (updating the study conducted in 2011).

III. The Agencies' Restrictive Interpretation of the Investment-Only Exemption Serves No Competitive Purpose and Chills Shareholder Engagement with Issuers.

A. The Scope of the Investment-Only Exemption Has Been Restrictively Defined Through Agency Statements and Settled Enforcement Actions with No Competitive Purpose.

Given the absence of case law defining the content and bounds of the investment-only exemption, investors must rely on Agency statements and consent judgments for guidance on its scope and application. As described below, those statements and consent judgments have taken an increasingly narrow view of the investment-only exemption in direct conflict with institutional investors' reliance on the exemption while increasing their engagement with management.

Agency enforcement actions relating to HSR Act compliance, including compliance with the investment-only exemption, have often, if not always, resulted in settlements by investors with the Agency due to the cost of litigation and the risk of reputational damage. Agency statements in complaints, competitive impact statements, press releases and blog posts often generate concerns that reverberate throughout the investment community, prompting compliance questions about where "the line" is on the investment-only exemption.

These practices present other questions for investors and their counsel. What is the competitive concern that the Agencies are protecting? Institutional investors own voting securities, not assets of an operational nature, and the investors (typically) are not board members or otherwise involved in the formal governance of the issuer. The Agencies have not articulated how an institutional investor with a relatively small position can affect competition.

We are not aware of any enforcement action under the merger statute (Section 7 of the Clayton Act) against a shareholder with a 10% or less shareholding and no horizontal or vertical relationship to the issuer.[30] In light of this fact, many investors rightly ask how enforcement actions against institutional investors with 10% or less shareholdings promote the mission of the Agencies, and how is shareholder engagement with management a threat to competition? The HSR Act does not exist for its own sake but only to facilitate the enforcement of Section 7 of the Clayton Act, which is intended to prevent the substantial lessening of competition.

Based on research of enforcement actions against share acquisitions of 10% (or 15% as the case may be) or less in the last 40 years of Section 7 enforcement, we note that all such actions involved a complex vertical or horizontal relationship between the

[30] *See* Bilal Sayyed, *A "Sound Basis" Exists for Revising the HSR Act's Investment-Only Exemption*, ANTITRUST SOURCE, Apr. 2013, at 14 & n.75.

investor and the issuer.[31] Even if such rare instances were to recur, they would represent a *de minimis* exception to the rule that acquisitions of 10% or less pose no competitive concern. In addition, the rare exceptions to the rule would be acquisitions of voting securities that could be remedied by a simple divestiture with no "scrambled-egg" complications. To be sure, institutional investors, including CII and MFA members, rarely, if ever, will have a vertical or horizontal relationship with the issuers whose securities they are acquiring.

B. The Agencies "Double Down" on Their Restrictive Interpretation of the Investment-Only Exemption in *Third Point* and *ValueAct.*

1. Third Point

In 2015, the Commission split, 3-2, in favor of proceeding with an enforcement action against Third Point LLC for an alleged improper reliance on the investment-only exemption. The *Third Point* matter prompted a dialogue within the Commission that resulted in a majority statement by Chairwoman Ramirez and Commissioners Brill and McSweeny, a dissenting statement by Commissioners Ohlhausen and Wright, and a blog post by the Director of the Bureau of Competition and two Bureau attorneys. The dissenting statement challenged, and the majority statement and blog post confirmed, the restrictive interpretation that the Agencies have accorded the investment-only exemption.

The majority and dissenting statements agreed that "a public interest [is] associated with the legitimate expectation of the business community, practitioners, and the general public that the antitrust agencies will act clearly, consistently, and transparently in their interpretation and enforcement of the HSR Act and rules."[32] One of the motivating reasons for this submission is a concern by CII and MFA members that the Agencies' interpretation and enforcement record has not provided "the business community, practitioners, and the general public" with a "clear[], consistent[], and transparent[]" "interpretation and enforcement of the HSR Act and rules."

The dissenting Commissioners would not have proceeded with the *Third Point* enforcement matter not only because that matter itself posed no threat to competition but also because *matters like it* are unlikely to do so:

> [Our opposition] is based on the lack of competitive harm from this transaction, the unlikelihood that transactions in this class generate harm overall, and the benefits to the market that would result from interpreting the exemption more broadly to allow the type of shareholder advocacy

[31] *Id.*

[32] FEDERAL TRADE COMM'N, FILE NO. 121-0019, STATEMENT OF THE FEDERAL TRADE COMMISSION IN THE MATTER OF THIRD POINT at 2 (Aug. 24, 2015) (Majority opinion) (footnote omitted).

pursued in this matter. We thus believe it is not in the public interest to interpret the exemption as the majority does here.[33]

The majority did not dispute the dissent's assessment that acquisitions of 10% or less of an issuer's shareholdings are "highly unlikely" to affect competition. Rather, the majority observed that the HSR Act is "procedural" and that enforcement actions like that in *Third Point* are necessary to preserve the Agencies' "ability to enforce compliance with the HSR Act's notification and waiting period requirements."[34]. Even so, the majority did not dispute that the HSR Act exists in service of Section 7 of the Clayton Act and not for its own sake.

On the same day that the Commissioners issued majority and dissenting statements, the Bureau Director and two Bureau attorneys issued a blog post entitled, "'Investment-only' means just that."[35] The Bureau invoked several prior statements by Bureau officials, including that of Ms. Bruno quoted in Part I of this letter. Those statements and the blog post emphasized that the investment-only exemption is "narrow" and unavailable to those that even "consider" an action that, if taken, may influence management.[36]

The Bureau further confirmed that the investment-only exemption cannot be claimed by an investor that "attempts to influence management" and repeatedly indicated that the exemption is reserved for investors that are "passive"[37] (and, according to Ms. Bruno, "purely passive").[38] The Bureau concluded with this warning to the investment community: "[A]ny investor who is *considering engaging with management* . . . should proceed with caution when relying on the investment-only exemption."[39] The Bureau would appear to deny an investor's eligibility for the investment-only exemption not just

[33] FEDERAL TRADE COMM'N, FILE NO. 121-0019, DISSENTING STATEMENT OF COMMISSIONERS MAUREEN K. OHLHAUSEN AND JOSHUA D. WRIGHT at 2 (Aug. 24, 2015); *see id.* at 3 (citing Bilal Sayyed, *A "Sound Basis" Exists for Revising the HSR Act's Investment-Only Exemption*, ANTITRUST SOURCE at 5-8, 13-15 (Apr. 2013) (supporting the conclusion that there is a lack of competitive harm resulting from transactions of 10% or less of an issuer's shares, and noting that the FTC and DOJ did not allege a substantive violation of Section 7 in conjunction with any HSR Act enforcement action during the 2003-2012 time period)); *see also id.* (citing Premerger Notification; Reporting and Waiting Period Requirements, 53 Fed. Reg. 36831, 36837 (Sept. 22, 1988) (noting request by FTC and DOJ for public comments on proposed flat 10% exemption from the HSR Act rules and quoting that "Available records indicate neither of the antitrust agencies has ever challenged an acquisition of 10% or less of an issuer's voting securities as a violation of section 7.")).
[34] FEDERAL TRADE COMM'N, FILE NO. 121-0019, STATEMENT OF THE FEDERAL TRADE COMMISSION IN THE MATTER OF THIRD POINT at 2 (Aug. 24, 2015) (Majority opinion).
[35] Debbie Feinstein, Ken Libby & Jennifer Lee, *"Investment-only" means just that*, FTC BLOG (Aug. 24, 2015), https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just.
[36] *Id.*at 1-2.
[37] *Id.* at 1, 3.
[38] Marian R. Bruno, Deputy Director, Fed. Trade Comm'n, Prepared Remarks Before the American Bar Association: Hart-Scott-Rodino at 25 (June 13, 2002) (emphasis added).
[39] Debbie Feinstein, Ken Libby & Jennifer Lee, *"Investment-only" means just that*, FTC BLOG at 3 (Aug. 24, 2015), https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just (emphasis added).

for engaging with management, but even for thinking about it. Based on reports from CII and MFA members, this pronouncement has had a profound chilling effect on ordinary-course shareholder engagement.

2. ValueAct

Less than a year after the announcement of the *Third Point* matter, the DOJ and certain ValueAct Capital entities settled an investigation of ValueAct's reliance on the investment-only exemption. The consent judgment prohibited ValueAct from relying on the investment-only exemption "if at the time of [the proposed acquisition of shares] (i) [ValueAct] intends to take any of the below actions, or (ii) [ValueAct's] investment strategy specific to such [proposed acquisition] identifies circumstances in which [ValueAct] *may take* any of the below actions":[40]

(A) proposing to an officer or director of the issuer that the issuer merge with, acquire, or sell itself to another person;

(B) proposing to an officer or director of any other person in which the investor owns voting securities or an equity interest the potential terms on which that person might merge with, acquire, or sell itself to the issuer;

(C) proposing to an officer or director of the issuer new or modified terms for any publicly announced merger or acquisition to which the issuer is a party;

(D) proposing to an officer or director of the issuer an alternative to a publicly announced merger or acquisition to which the issuer is a party, either before consummation of the publicly announced merger or acquisition or upon its abandonment;

(E) proposing to an officer or director of the issuer changes to the issuer's corporate structure that require shareholder approval; or

(F) proposing to an officer or director of the issuer changes to the issuer's strategies regarding the pricing of the issuer's product(s) or service(s), its production capacity, or its production output.[41]

Each of the prohibited acts, with the possible exception of (E), narrows the interpretation of the investment-only exemption from that contemplated by the SBP that accompanied the adoption of the HSR Act rule providing for the exemption. (A), for example, casts doubt on whether a shareholder loses the exemption simply by suggesting that an issuer divest a subsidiary that is not within the primary scope of business of the issuer. (C) could prohibit a suggestion to reprice a transaction after an unexpected fall in the value of the currency with which the transaction is to be completed. (D) may prevent a minority shareholder from proposing an amendment to a term in a proposed contractual

[40] U.S. v. VA Partners I, LLC, *et al.*, Docket No. 3:16-cv-01672-WHA (Nov. 1, 2016) (emphasis added).
[41] *See id.* at Section IV (Prohibited Conduct).

agreement that would protect its minority rights. (F), perhaps most importantly, jeopardizes any conversation relating to the pricing, capacity, or output of an issuer, topics that may cover almost the entirety of the customer-facing business of an issuer.

Investors are thus faced with continuing uncertainty about whether to file an HSR notification when they have, or even consider having, ordinary-course discussions with management on topics such as: executive compensation,[42] operational efficiency, business strategy, cost reduction, use of working capital, and capital investments, and have no intention of participating in management.

While we are not addressing the facts or outcome of either the *Third Point* or the *ValueAct* actions, we discuss those matters and the statements surrounding them because they have had a restrictive impact on the interpretive scope of the investment-only exemption and a chilling effect on the practices of CII and MFA members. *Third Point* and *ValueAct* confirm the concerns of the investment community: the investment-only exemption is now so narrowly construed that a vast portion of the ordinary-course shareholder communications with management risks depriving shareholders of the investment-only exemption.[43] The investment community has heard the words of the Bureau and find them inconsistent with current shareholder practice: use caution if you are "considering engaging with management."

C. "Just File" Is Not the Answer.

The majority statement in *Third Point* suggests that shareholders "just file" if they wish to communicate with (*i.e.*, attempt to influence) the management of an issuer:

> [T]he Commission's enforcement action does not prevent Third Point from engaging in shareholder advocacy that may be beneficial or procompetitive. In our view, Third Point—like any other minority shareholder that chooses to *influence the business decisions of the issuer*—must observe the notification and waiting period.[44]

"Just file," however, ignores the costs of such a policy and treats the HSR Act as an end in itself, not as an instrument designed solely to aid in the enforcement of Section 7. "Just file" would result (and may already be resulting) in countless additional HSR Act filings by institutional shareholders accounting for trillions of dollars in investments, and burden institutional investment in at least the following ways:

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[42] *See, e.g.*, Complaint, U.S. v. VA Partners I, LLC, *et al.*, Case 3:16-cv-01672 at ¶¶ 24, 32 (filed Apr. 4, 2016) (citing discussions on executive compensation as indicative of "activist" conduct).

[43] *See, e.g.*, Phillip Goldstein, *A Critique of the ValueAct Settlement*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 5, 2016), https://corpgov.law.harvard.edu/2016/08/05/a-critique-of-the-valueact-settlement/.

[44] U.S. v. Third Point Offshore Fund, Ltd. *et al.*, Docket No. 1:15-cv-01366-KBJ at *3 (Dec. 18, 2015) (emphasis added).

- A filing investor may not purchase voting securities in the issuer until the required waiting period expires (10 to 30 days after filing), which can impose severe opportunity costs on the investor.

- An HSR Act filing can send the wrong signal ("activist" or "hostility") to the market (if the investor seeks early termination of the waiting period or if the issuer discloses the filing) and the issuer, chilling open and constructive dialogue, as it communicates to the issuer that the shareholder's intent is no longer for investment only or, in the colloquial language of the Agencies, is no longer "passive." The implications of that signal for the relationship between the shareholder and management may be serious and detrimental.

- Filing fees add a significant monetary cost of between $45,000 to $280,000 per fund, depending on the transaction size. The investor-clients of asset managers bear these costs, which reduces the clients' investment returns.

- Significant additional Agency and investor resources would be devoted to HSR Act filings and to ensuring HSR Act compliance in matters that are *"highly unlikely"* to raise competitive concerns.

- "Just file" would set an unworkable precedent for many investors; to avoid that precedent, many investors would limit or eliminate communication with issuers to the detriment of all shareholders who stand to benefit from the actions of engaged investors.

The last item is perhaps the most serious implication of the "just file" answer to the ambiguities of the investment-only exemption.

To resolve this uncertainty, CII and MFA propose the following solutions: (1) adopt a new HSR Act rule exempting acquisitions of voting securities that result in the acquiring person's holding not more than 10% of the issuer's voting securities; and (2) clarify that the investment-only exemption is unavailable to investors only when they decide to undertake conduct of the type listed in the SBP – that is, when the investor has decided to invoke the formal governance mechanisms of the issuer, such as nominating directors or soliciting proxies.

IV. Proposed Remedies: A *De Minimis* Exemption and Conforming the Investment-Only Exemption to the SBP

The Bureau acknowledged in its blog post on the *Third Point* matter that "[w]e have heard on occasion that our investment-only rules, promulgated many years ago, are too stringent."[45] The Bureau then stated that it was not "aware of specific conduct our rules are inhibiting," but offered that, "[n]evertheless, we remain open on this issue – as with other HSR rules – to consider the views of those subject to our rules on ways we can make our rules better or more clear."[46]

CII and MFA appreciate the Bureau's openness to HSR reform. In response, we propose the following two remedies.

A. *De Minimis* Exemption

Section (d)(2)(B) of the HSR Act provides that the Commission, with the concurrence of the Assistant Attorney General in charge of the Antitrust Division, may adopt rules that "exempt[] from the requirements of [the HSR Act] classes of [acquisitions or transactions] which are unlikely to violate the antitrust laws."[47]

A *de minimis* or "flat" exemption that relieves transactions of a given class from HSR Act filing requirements would eliminate any ambiguity as to the application of the exemption. CII and MFA propose that such a class be defined as transactions that will not result in the acquiring person's holding more than 10% of the voting securities of the issuer.

As observed by the dissenting Commissioners in the *Third Point* matter, substantive antitrust concerns are "highly unlikely" to arise under Section 7 of the Clayton Act with respect to an acquisition of 10% or less of an issuer's voting securities.[48] The majority statement did not rebut that conclusion. In his 2013 article, Bilal Sayyed identified only a handful of enforcement actions against transactions as a result of which an acquiring person would hold 10% or less of the issuer.[49] In each of those transactions, the acquirer had a horizontal or vertical relationship to the issuer,[50] a circumstance that rarely arises with respect to institutional investors.

Acquisitions of 10% or less of an issuer's voting securities thus fit the statutory description of "unlikely to violate the antitrust laws," and the benefits of shareholder engagement provide the Agencies with good reason to adopt such an exemption.

We recognize that some have inquired about the effects of an investor's owning shares in competing issuers. We are aware of no convincing theoretical or empirical demonstration that a shareholding level of 10% or less, in and of itself, reduces either the

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[45] Debbie Feinstein, Ken Libby & Jennifer Lee, *"Investment-only" means just that*, FTC BLOG at 3 (Aug. 24, 2015), https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just.
[46] *Id.*
[47] 15 U.S.C. § 18a(d)(2) (2012).
[48] FEDERAL TRADE COMM'N, FILE NO. 121-0019, DISSENTING STATEMENT OF COMMISSIONERS MAUREEN K. OHLHAUSEN AND JOSHUA D. WRIGHT at 3 (Aug. 24, 2015).
[49] *See* Bilal Sayyed, *A "Sound Basis" Exists for Revising the HSR Act's Investment-Only Exemption*, ANTITRUST SOURCE, Apr. 2013, at 1, 14 & n.75.
[50] *Id.*

intensity of competition between the issuers or the incentives to compete. To the extent that companies behave in a manner that violates antitrust laws or a common owner facilitates an impermissible agreement between competing issuers, Section 1 of the Sherman Act and Section 5 of the FTC Act provide adequate remedies.

B. Clarification of The Investment-Only Exemption to Accord More Closely with the Statement of Basis and Purpose

The investment-only exemption states that acquisitions of not more than 10% are exempt from filing if the investor has "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer."[51] "Intention" and "participate" are the pivotal words in the definition. As discussed, the Agencies have construed "intention" to mean "considering the possibility of" and "participate" to mean "influence."

Yet one cannot form an *intention to act* until one has *decided* to act.[52] The *consideration* of alternatives precedes a decision that *selects an alternative* and the *formation of an intent* to implement that decision.[53] "Participate" means "to take part in," not to "influence."[54]

Those plain-English definitions accord with the interpretation of the investment-only exemption that is reflected in the SBP that accompanied the issuance of the HSR Act rules.[55] The SBP provides that the following actions could, but do not necessarily, reflect "evidence of an intent inconsistent with investment purpose:"[56]

> (1) Nominating a candidate for the board of directors of the issuer; (2) proposing corporate action requiring shareholder approval; (3) soliciting proxies; (4) having a controlling shareholder, director, officer or employee simultaneously serving as an officer or director of the issuer; (5) being a competitor of the issuer; or (6) doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer. The facts and circumstances of each case will be evaluated whenever any of *these actions* have been taken by a person claiming that voting

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[51] 16 C.F.R. § 801.1(i)(1) (2018); see also 15 U.S.C. § 18a(c)(9) (2012); 16 C.F.R. § 802.9 (2018).
[52] The Merriam-Webster Online Dictionary defines "intent" as "purpose," which, in turn, means "end to be attained." *See* Merriam-Webster Online: https://www.merriam-webster.com/dictionary/intent; https://www.merriam-webster.com/dictionary/purpose.
[53] The Merriam-Webster Online Dictionary defines "consider" as "to think about carefully" and "decide" to "select a course of action." *See* Merriam-Webster Online Dictionary: https://www.merriam-webster.com/dictionary/consider; https://www.merriam-webster.com/dictionary/decide.
[54] The Merriam-Webster Online defines dictionary defines "participate" as "to take part." *See* Merriam-Webster Online Dictionary: https://www.merriam-webster.com/dictionary/participate).
[55] 16 C.F.R. § 801.1(i)(1) (2018).
[56] Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33,450, 33,465 (July 31, 1978).

> securities are held or acquired solely for the purpose of investment and thus not subject to the act's requirements.[57]

CII and MFA recommend that the Agencies issue an interpretation of the investment-only exemption that would authorize investor reliance on it as long as the investor has not decided to engage in an act that is itemized in the SBP or an act that would constitute participation in the formal governance structure of the issuer. Adopting such an interpretation, preferably formally, could be implemented promptly by the Commission with the concurrence of the Antitrust Division, as it would not require the promulgation of a new rule.

Although clarification of the investment-only exemption would not provide the bright-line simplicity of the *de minimis* exemption, it would eliminate the substantial ambiguity that is now unduly burdening legitimate activities of institutional investors to improve performance for the benefit of all shareholders.

V. Conclusion

A 10% flat, *de minimis* exemption and a clarification of the scope of "investment-only" would eliminate unnecessary, and over-inclusive HSR filings; remove the HSR Act impediment to ordinary-course shareholder-management engagement; and promote a policy that has received broad regulatory, business, and research support, all without harming the Agencies' mission to protect competition.

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[57] *Id.* (emphasis added).

We thank the Commission for the opportunity to provide comments in anticipation of the Commission's Hearings and to request coverage of HSR reform regarding shareholdings of 10% or less under Topic 1 (or, if not under Topic 1, then Topic 11). We would welcome the opportunity to testify at the appropriate FTC Hearing, and to meet with the Commissioners and staff to discuss our responses and views in greater detail. Please do not hesitate to contact Richard H. Baker, Stuart J. Kaswell, or Laura Harper Powell of MFA at (202) 730-2600 and Ken Bertsch or Jeff Mahoney of CII at (202) 822-0800, or William H. Rooney, Esq. of Willkie Farr & Gallagher LLP at (212) 728-8259 with any questions the Commission or its staff might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

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Executive Vice President & Managing Director, General Counsel
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/s/ Jeff Mahoney, CPA

Jeff Mahoney, CPA

General Counsel
Council of Institutional Investors

CC: The Honorable Joseph J. Simons, Chairman
The Honorable Maureen K. Ohlhausen, Commissioner
The Honorable Noah Joshua Phillips, Commissioner
The Honorable Rohit Chopra, Commissioner
The Honorable Rebecca Kelly Slaughter, Commissioner
Mr. Bruce Hoffman, Director, Bureau of Competition
Mr. Bilal Sayyed, Director, Office of Policy Planning
Ms. Roberta Baruch, Acting Assistant Director, Compliance Division, Bureau of Competition