Investors With ESG Aims Should Heed Antitrust Reporting Rules

By **Jonathan Gleklen and Francesca Pisano** (July 31, 2023)

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Investors globally are embracing ESG investing.

A PricewaterhouseCoopers International Ltd. report projected that institutional investment focused on environmental, social and governance criteria will increase 84% to $33.9 trillion by 2026.[1]

ESG investing can take many forms. Some investors seek to transition their portfolios to companies that have already pledged to meet sustainability or climate change goals, while other investors seek to engage with company management to encourage them to adopt ESG goals and targets.

Cooperatives comprised of ESG investors who make communal goals have also emerged, including Climate Action 100+, the United Nations-convened Net-Zero Asset Owner Alliance, the Investor Agenda, the Asia Investor Group on Climate Change, Ceres Accelerator for Sustainable Capital Markets, Paris Aligned Asset Owners and the Net Zero Asset Managers.

These climate-focused initiatives encourage their participants to influence the management of companies in their portfolios to reduce emissions or meet other ESG-related benchmarks.

The Hart-Scott-Rodino Antitrust Improvements Act requires firms acquiring stock or voting securities that exceed statutory thresholds to file a notification and report form and wait 30 days before consummating the transaction unless an exemption applies.[2]

Institutional investors typically rely on the investment-only exemption that allows acquirers to avoid an HSR filing when they are acquiring stock solely for the purpose of investment.[3]

The Federal Trade Commission and the U.S. Department of Justice have challenged stock acquisitions by activist investors that did not make an HSR filing on the basis of the investment-only exemption despite the investors' intent to pressure management to improve profitability or restructure business lines.

As we describe in this article, given the strict limitations on the investment-only exemption, ESG investors that intend to pressure company management to accept ESG benchmarks need to consider whether they can acquire stock that results in them exceeding the HSR threshold — currently $111.4 million — without making an HSR filing and observing the required waiting period.

ESG and Antitrust

Climate-related ESG initiatives have recently come under substantive antitrust scrutiny.

In October 2022, 19 state attorneys general started a coordinated investigation into six major U.S. banks, seeking documents and information relating to the banks' participation in

global climate change initiatives like the Net-Zero Asset Owner Alliance, or NZAOA, based on purported antitrust concerns that the companies were engaging in coordinated, collusive behavior.[4]

Recent remarks by FTC Chair Lina Khan and Jonathan Kanter, assistant attorney general of the Antitrust Division of the DOJ, have made clear that there is no exemption or special consideration under the antitrust laws for ESG commitments.[5] In regard to ESG cooperation or agreements, Khan stated "in as much as they can affect competition, [they] are always relevant" to the FTC.[6]

Kanter added that "when firms have substantial power and they use that power to achieve anticompetitive ends, that should be actionable under the antitrust laws."[7] Likewise with respect to merger review, Khan reiterated the commission's position in a December op-ed:

> Some in corporate America seem to think that the FTC won't challenge an otherwise illegal deal if we approve of its ESG impact. They are mistaken. The antitrust laws don't permit us to turn a blind eye to an illegal deal just because the parties commit to some unrelated social benefit.[8]

Although Kanter and Khan have made clear that ESG commitments can run afoul of the antitrust laws when it comes to collusion and illegal mergers, we are not aware of any government action or comment on ESG investing and the filing requirements of the HSR Act.

The HSR Investment-Only Exemption

The HSR Act requires that acquisitions that exceed statutory thresholds be reported to the DOJ and FTC and that the acquirer wait 30 days before consummating the transaction to allow the federal enforcers to conduct an initial review for antitrust issues.

The HSR Act provides for a variety of exemptions from the filing requirement, including an exemption for acquisitions of voting securities solely for the purpose of investment that is available if the acquisition does not exceed 10% of the outstanding voting securities of the issuer.[9]

Under the HSR rules, an acquisition can be characterized as solely for the purpose of investment if the buyer has "no intention of participating in the formulation, determination, or direction of the basic business decisions of the target."[10]

For 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.[11]

The investment-only exemption applies narrowly. Merely voting the stock is not considered evidence of active investment intent.[12]

The statement of basis and purpose issued at the time the commission promulgated the HSR rules further explains that certain conduct is inconsistent with a claim of investment purpose, and contains the following examples: nominating a candidate for the board of directors, holding a board seat or being an officer, proposing corporate action that requires shareholding approval, soliciting proxies or being a competitor of the issuer.[13]

In the absence of case law addressing the scope of the investment-only exemption,

investors and companies must rely on language in settlements with alleged violators, FTC speeches and informal interpretations of HSR rules for guidance.

The FTC has stated that eligibility to claim the investment-only exemption depends upon the acquirer's intention.[14] Clear evidence of nonpassive intent, even if not accompanied by conduct, can make the exemption unavailable.

The agencies consider the facts and circumstances of each case to determine if the exemption applies.[15] Nevertheless, the burden is on the investor to show a truly passive intent, meaning the investor has no "intention of participating in the formulation, determination, or direction of the basic business decisions of the target."[16]

The DOJ and FTC have brought complaints for HSR violations where the defendant bought stock while planning to undertake conduct inconsistent with the investment-only exemption, including:

- Nominating a person for the board of directors, proposing corporate action requiring shareholder approval, and soliciting proxies;[17]
- Serving on the board of directors;[18]
- Intending to become actively involved in or participate in the management of the target;[19] or
- Seeking to influence the target's management decisions, including by attempting to persuade management to put the target up for sale.[20]

While no actions for violating the HSR Act have been brought to date solely based on an investor's public statements, the federal enforcers have been clear that an intent to become actively involved in the management of the target is evidence of nonpassive intent.

For example, in United States v. Biglari Holdings Inc. in 2021, the DOJ alleged that Biglari''s acquisition of Cracker Barrel Old Country Store Inc. stock was not subject to the investment-only exemption.

This is because during the 10-day period following the last stock acquisition, the chairman and CEO of Biglari Sardar Biglari told the CEO and CFO of Cracker Barrel that he had ideas on how to improve shareholder value and requested to meet with him.

He then met with the CEO and CFO of Cracker Barrel, at which meeting he requested two seats on Cracker Barrel's board of directors, and said that he had ideas to improve traffic at Cracker Barrel stores.[21]

ESG Activist Investing

Climate initiatives and cooperatives typically involve a goal of incentivizing companies to institute decarbonization policies and implement a governance framework that articulates the board's accountability for climate change risk.[22]

Some initiatives allow for different levels of involvement, ranging from offering public support for climate change goals without participating directly with companies to actively lobbying companies and proposing shareholder resolutions on climate change policies.[23]

For example, investors that sign on to the Climate Action 100+ initiative can join as an investor participant and lead company investors to drive the Climate Action 100 engagement agenda with their focus companies. They can also join as investor supporters, which means they do not engage directly with companies.[24]

Members of the NZAOA commit to transitioning their investment portfolios to net-zero greenhouse gas emissions by 2050, but NZAOA gives responsibility to the asset owners to determine the range of tools best suited to implement the net-zero target in their complete portfolio.[25]

However, given the nature of the commitment, NZAOA believes that engagement is an obvious and necessary component to ensure that the global economy and individual companies set up transition policies that deliver the necessary emission reductions.[26]

Hence, the line between passive and activist investing can blur as many climate initiatives allow for different levels of involvement and commitment.

The FTC has acknowledged that its approach to the HSR rules can interfere with activist investing — or at least activist investing before making an HSR filing — stating in an August 2015 blog post that it has "heard on occasion that our investment-only rules, promulgated many years ago, are too stringent, particularly for activist investors."[27]

But the FTC's view is that the investment-only exemption is set forth in the statute enacted by Congress, even as it remains open on this issue to consider the views of those subject to the HSR rules.[28]

Takeaways

Just as Kanter and Khan have made clear that ESG initiatives and commitments are not immune from antitrust scrutiny regarding collusion and illegal mergers, ESG activist investors cannot count on receiving special treatment under the HSR Act.

Urging company management to reduce greenhouse gas emissions or improve their treatment of workers raises very different substantive antitrust questions than urging company management to sell to a competitor, but the federal enforcers are likely to see any form of shareholder activism as inconsistent with the strictly construed investment-only exemption.

Of course, there is no need to rely on the investment-only exemption unless an HSR filing would otherwise be triggered, so the HSR rules are not a concern unless the ESG investor will hold more than $111.4 million of voting securities of an issuer it seeks to influence.

But any ESG investor who is considering engaging with management should proceed with caution when relying on the investment-only exemption where an HSR filing might otherwise be required.

Simply extending public support for climate change goals without engaging directly with company leadership or proposing shareholder initiatives is likely to keep shareholders on the safe side of the investment-only line.

But statements of express intent to influence management decisions about climate change or sustainability policies — including joining cooperatives whose members affirmatively

commit to seeking such changes from management — may be used to show that an ESG investor does not have the passive intent necessary to claim the exemption.

Investors seeking to claim the exemption should keep in mind that the HSR Act provides for civil penalties up to $50,000 for each day an acquirer is in violation of the act — i.e., for each day between the acquisition of voting securities exceeding the threshold and expiration of the HSR waiting period after making a filing.

The federal antitrust enforcers have not in the past not sought penalties for an investor's first inadvertent violation of the HSR rules. For example, the agency sought only injunctive relief in the action against Third Point.[29]

Likewise, the FTC took no action against ValueAct Capital following its first HSR Act violation in 2003, only seeking monetary penalties for being a repeat offender in failing to file HSR notifications for six acquisitions.[30] But there can be no guarantee that current FTC and DOJ leadership will continue this approach.

Notably, in their most recent HSR annual report, the FTC and DOJ omitted the note they had included in past HSR annual reports stating that the agencies generally will not seek penalties for a first failure to make an HSR filing.[31] That said, the agencies have not yet brought a penalty action for a first failure to file.

The previous settlements with antitrust regulators and the potential for a significant fine for failure to file serve as a reminder that the antitrust agencies take HSR violations very seriously and view the investment-only exemption to be quite narrow.

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[1] Asset and wealth management revolution 2022: Exponential expectations for ESG, PwC (Oct. 10, 2022), https://www.pwc.com/gx/en/news-room/press-releases/2022/awm-revolution-2022-report.html.

[2] 15 U.S.C. §18a.

[3] 15 U.S.C. §18a(c)(9); 16 C.F.R. §§ 801.1(i)(1), 802.9.

[4] See, e.g., Press Release, Kentucky Attorney General, Attorney General Cameron Announces Multi-State Investigation into Six Major Banks for ESG Investment Practices (Oct. 19, 2022), https://www.kentucky.gov/Pages/Activity-stream.aspx?n=AttorneyGeneral&prId=1269.

[5] See, e.g., Remarks of Assistant Attorney General Jonathan Kanter and FTC Chair Lina Khan, U.S. Senate Subcommittee on Competition Policy, Antitrust and Consumer Rights, Oversight of Federal Enforcement of the Antitrust Laws (Sept. 20, 2022), https://www.judiciary.senate.gov/meetings/oversight-of-federal-enforcement-of-the-antitrust-laws.

[6] Id.

[7] Id.

[8] Lina Khan, Opinion, ESG Won't Stop the FTC, Wall St. J. (Dec. 21, 2022), https://www.wsj.com/articles/esg-wont-stop-the-ftc-competition-merger-lina-khan-social-economic-promises-court-11671637135.

[9] 15 U.S.C. § 18a(c)(9).

[10] 16 C.F.R. § 801.1(i)(1).

[11] Id.

[12] 43 Fed. Reg. 33,450, 33,465 (July 31, 1978).

[13] 41 Fed. Reg. 55488 (Dec. 20, 1976).

[14] Debbie Feinstein, Ken Libby, and Jennifer Lee, Investment-Only Means Just That, Fed. Trade Comm'n (Aug. 24, 2015), https://www.ftc.gov/enforcement/competition-matters/2015/08/investment-only-means-just.

[15] Id.; 43 Fed. Reg. 33,450, 33,465 (July 31, 1978).

[16] FTC PNO Informal Interpretation No. 18010003 (Jan. 29, 2019), https://www.ftc.gov/legal-library/browse/hsr-informal-interpretations/18010003; see also FTC PNO Informal Interpretation No. 1809005 (Sept. 28, 2018), https://www.ftc.gov/legal-library/browse/hsr-informal-interpretations/1809005.

[17] U.S. v. Third Point LLC, No. 1:15-cv-01366 (D.D.C. Aug. 24, 2015), https://www.ftc.gov/legal-library/browse/cases-proceedings/121-0019-third-point-llc.

[18] See United States v. Diller, No. 1:13-cv-01002 (D.D.C. July 2, 2013), http://www.ftc.gov/sites/default/files/documents/cases/2013/07/130702dillercmpt.pdf, United States v. Gates, No. 04-0721-CKK (D.D.C. May 3, 2004), http://www.ftc.gov/sites/default/files/documents/cases/2004/05/040503gatespremrgrcmplt.pdf; United States v. Fayez Sarofim, No. 1:16-cv-02156 (D.D.C. Oct. 27, 2016), https://www.ftc.gov/system/files/documents/cases/161027_fayez_sarofim_complaint_filed.pdf.

[19] See United States v. Biglari Holdings Inc., No. 1:12-cv-01586 (D.D.C. Sept. 25, 2012), http://www.ftc.gov/sites/default/files/documents/cases/2012/09/120925biglaricmpt.pdf; United States v. VA Partners I LLC, et al., No. 3:16-cv-01672-WHA (N.D. Cal. Apr. 4, 2016), https://www.justice.gov/atr/file/838076/download.

[20] See Marian R. Bruno, Deputy Dir., FTC Premerger Notification Office, Remarks Before

the American Bar Association: Hart-Scott-Rodino at 25 (June 13, 2002), https://www.ftc.gov/public-statements/2002/06/hart-scott-rodino-25.

[21] United States v. Biglari, No. 1:12-cv-01586 (D.D.C. Sept. 25, 2012), http://www.ftc.gov/sites/default/files/documents/cases/2012/09/120925biglaricmpt.pdf.

[22] See Engagement Process, Climate Action 100+, https://www.climateaction100.org/approach/engagement-process/ (last visited July 5, 2023); Commitment Document for Participating Asset Owners, UN-convened Net-Zero Asset Owner Alliance (April 2022), https://www.unepfi.org/wordpress/wp-content/uploads/2022/07/AOA-COMMITMENT-DOC-2022.pdf.

[23] Id.

[24] See Climate Action 100+ Signatory Handbook, Climate Action 100+ (June 2023), https://www.climateaction100.org/wp-content/uploads/2023/06/Signatory-Handbook-2023-Climate-Action-100.pdf.

[25] FAQ, The Net-Zero Asset Owner Alliance, https://www.unepfi.org/wordpress/wp-content/uploads/2019/09/AOA_FAQ.pdf.

[26] Id.

[27] Debbie Feinstein, Ken Libby, and Jennifer Lee, Investment-Only Means Just That, Fed. Trade Comm'n (Aug. 24, 2015), https://www.ftc.gov/enforcement/competition-matters/2015/08/investment-only-means-just.

[28] Id.

[29] U.S. v. Third Point LLC, No. 1:15-cv-01366 (D.D.C. Aug. 24, 2015), https://www.ftc.gov/legal-library/browse/cases-proceedings/121-0019-third-point-llc.

[30] Press Release, FTC Obtains $1.1 Million Civil Penalty for Pre-Merger Filing Violations (Dec. 19, 2007), https://www.ftc.gov/news-events/news/press-releases/2007/12/ftc-obtains-11-million-civil-penalty-pre-merger-filing-violations.

[31] Compare Hart-Scott-Rodino Annual Report FY 2020 (Nov. 8, 2021), at 9 n.16 (noting that "If parties inadvertently fail to file, the agencies generally will not seek penalties so long as the parties promptly submit corrective filings after discovering the failure to file, submit an acceptable explanation of their failure to file, and have not previously violated the Act."), https://www.ftc.gov/system/files/documents/reports/hart-scott-rodino-annual-report-fiscal-year-2020/fy2020_-_hsr_annual_report_-_final.pdf, with Hart-Scott-Rodino Annual Report FY 2021, at 8-9, https://www.ftc.gov/system/files/ftc_gov/pdf/p110014fy2021hsrannualreport.pdf (omitting comparable footnote).