Via Email

February 1, 2021

Federal Trade Commission
Office of the Secretary
April Tabor, Acting Secretary
600 Pennsylvania Avenue, NW, Suite CC-5610 (Annex J)
Washington DC 20580

Re: Premerger Notification; Reporting and Waiting Period Requirements; RIN 3084-AB46 – Notice of Proposed Rulemaking (16 CFR Parts 801-803: Hart-Scott-Rodino Coverage, Exemption, and Transmittal Rules; Project No. P110014).

Dear Ms. Tabor:

The Council of Institutional Investors (CII) welcomes the opportunity to comment on the Federal Trade Commission (FTC or Commission) December 1, 2020 Notice of Proposed Rulemaking (Proposed Rules)[1] and the FTC's December 1, 2020 Advanced Notice of Proposed Rulemaking (ANPRM)[2] with respect to the Premerger Notification Rules that implement the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act).[3]

CII is a nonprofit, nonpartisan association of U.S. 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 of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management.[4]

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[1] Premerger Notification; Reporting and Waiting Period Requirements, 16 CFR parts 801–803: Hart-Scott-Rodino Coverage, Exemption, and Transmittal Rules; Project No. P110014, 85 Fed. Reg. 77,042 (notice of proposed rulemaking Dec. 1, 2020), https://www.govinfo.gov/content/pkg/FR-2020-12-01/pdf/2020-21753.pdf.
[2] Premerger Notification; Reporting and Waiting Period Requirements, 16 CFR parts 801–803: Hart-Scott-Rodino Coverage, Exemption, and Transmittal Rules; Project No. P110014, 85 Fed. Reg. 77,053 (advance notice of proposed rulemaking Dec. 1, 2020), https://www.federalregister.gov/documents/2020/12/01/2020-21754/premerger-notification-reporting-and-waiting-period-requirements#:~:text=The%20reporting%20and%20waiting%20period,anticompetitive%20transactions%20prior%20to%20consummation.
[3] Hart-Scott-Rodino Antitrust Improvements Act, 15 U.S.C. § 18a (1976), *available at* https://www.ftc.gov/enforcement/statutes/hart-scott-rodino-antitrust-improvements-act-1976.
[4] For more information about the Council of Institutional Investors (CII), including its board and members, please visit CII's website at http://www.cii.org.

CII appreciates the Commission's efforts to update current rules to increase the efficiency and effectiveness of the Premerger Notification Program and provide the FTC and the Antitrust Division of the Department of Justice (collectively, Agencies) with information necessary to assess transactions that may harm competition. CII, however, strongly opposes the Proposed Rules for three reasons: (1) the Proposed Rules do not provide clarification of the investment-only exemption, a position which CII has long advocated; (2) the Proposed Rules' new *de minimis* exemption is likely unuseable for many institutional investors; and (3) the Proposed Rules change to the definition of "person" would result in substantial costs to asset managers (and indirectly their pension fund clients) with no clear or even plausibly compelling benefit to the public interest.

As we indicated in our joint letter with the Managed Funds Association of August 13, 2018 (August 2018 Letter),[5] CII believes that the FTC's existing narrow interpretation of its investment-only exemption[6] is inconsistent with promoting issuer and investor engagement about corporate governance best practices.[7] More specifically, the August 2018 Letter describes in detail why we believe the existing investment-only exemption imposes "an undue regulatory burden . . . on institutional investors . . . that undermines the strong public policy in favor of management-shareholder communications [about corporate governance matters] and involves significant and unnecessary costs . . . ."[8]

The August 2018 Letter proposed a relatively simple, and we believe cost-effective, two-part remedy to address the negative policy effects of the current investment-only exemption: (1) a simple, 10% *de minimis* exemption from the HSR Act's filing requirements for persons acquiring shares of an issuer;[9] and (2) clarification of the meaning of "investment-only" to accord more closely with the FTC's Statement of Basis and Purpose (SBP) that accompanied the issuance of the HSR Act rules.[10]

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[5] Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association & Jeff Mahoney, General Counsel, Council of Institutional Investors to Office of the Secretary, Federal Trade Commission (Aug. 13, 2018), https://www.ftc.gov/system/files/documents/public_comments/2018/08/ftc-2018-0048-d-0010-147719.pdf.

[6] Definitions, 16 U.S.C. § 801.1(i)(1) (2018), *available at* https://www.law.cornell.edu/cfr/text/16/801.1 ("Voting securities are held or acquired "solely for the purpose of investment" if 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.").

[7] *See* Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association & Jeff Mahoney, General Counsel, Council of Institutional Investors to Office of the Secretary, Federal Trade Commission at 3 ("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."); 85 Fed. Reg. at 77,059 & n.26, 77,091; *see generally* Council of Institutional Investors, Corporate Governance Policies (updated Sept. 22, 2020), https://www.cii.org/files/policies/09_22_20_corp_gov_policies.pdf.

[8] Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association & Jeff Mahoney, General Counsel, Council of Institutional Investors to Office of the Secretary, Federal Trade Commission at 2.

[9] *See id.* at 16-17 (describing in detail a proposed a 10% *de minimis* exemption).

[10] *Id.* at 17-18 (describing in detail a proposed clarification of the investment-only exemption).

To be clear, CII's central goal in comments on the HSR Act since 2016 has been for the Agencies to clarify the meaning of "investment-only," and to align the definition more closely with the FTC's SBP[11] and the Securities and Exchange Commission (SEC) approach to "passive investors" under Section 13 of the Securities Exchange Act of 1934 (34 Act).[12] CII has been concerned that matters and statements surrounding the Agencies' actions against ValueAct Capital Management (in 2016)[13] and Third Point LLC (in 2014)[14] suggested that the HSR Act policy could have a chilling effect on issuer and investor engagement on a range of corporate governance matters, in direct conflict with CII views on the importance and value of issuer and investor engagement and, not incidentally, in conflict with SEC policy.[15]

We were surprised and disappointed by the Proposed Rules, which in our view, would significantly worsen the chilling effect of the HSR Act on issuer and investor engagement, and in that process substantially increase costs for investment managers and indirectly for their pension fund clients.

Clarification of Investment-Only Exemption

While the Proposed Rules failed to clarify the investment-only exemption, we acknowledge and appreciate that the issue is identified in the ANPRM.[16] More specifically, the ANPRM raises the following key question that we believe should have been the primary focus of the Proposed Rules or accompanying guidance: "In light of changing investor engagement with issuers, the Commission is interested in knowing if it is appropriate to rethink the definition of 'solely for the purpose of investment.'"[17]

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[11] *See* Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33,450, 33,465 (July 31, 1978), https://www.ftc.gov/sites/default/files/documents/hsr_statements/43-fr-33450/780731fr43fr33450.pdf (describing the types of conduct that would not be considered evidence of an intent inconsistent with investment purpose).
[12] Filing of Schedules 13D and 13G, 17 CFR § 240.13d-1 (2010), *available at* https://www.law.cornell.edu/cfr/text/17/240.13d-1.
[13] *See* U.S VA Partners I, LLC, et al., Docket No. 3:16-cv-01672-WHA (final judgment Nov. 1, 2016) https://www.justice.gov/atr/case-document/file/908516/download.
[14] *See* Federal Trade Comm'n, File No. 121-0019, Statement of the Federal Trade Commission in the Matter of Third Point (Aug. 24, 2015) (majority opinion), https://www.ftc.gov/public-statements/2015/08/statement-federal-trade-commission-matter-third-point.
[15] *See* Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors to William J. Baer, Assistant Attorney General for the Antitrust Division, U.S. Department of Justice (Apr. 27, 2016), https://www.cii.org/files/issues_and_advocacy/correspondence/2016/04_27_16_CII_letter_to_DOJ(1).pdf (referencing CII and Securities and Exchange Commission policies and statements in support of shareholder engagement).
[16] *See* 85 Fed. Reg. at 77,047-48 (discussing the "[d]efinition of ''Solely for the Purpose of Investment'').
[17] 85 Fed. Reg. at 77,047.

CII has two responses to this key question. First, we agree with the Commission that investor engagement with issuers has dramatically changed since 1978 when the HSR Act rules were first promulgated.[18]

As we explained in our December 6, 2018 letter to the FTC (December 2018 Letter):

> CII was formed in 1985 by public pension funds concerned primarily with deficiencies in corporate governance at listed U.S. companies. . . .
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> . . . In the 1980's . . . U.S. public companies were quick to defend management prerogatives, boards of directors were generally weak, poorly functioning and insufficiently oriented to building long-term shareholder value. Too often, U.S. public company boards were "rubber stamps." Complacent boards and managers were slow to address problems and update business practices even as global competition increased and the pace of change in market dynamics accelerated. And dispersed ownership had created a collective action problem such that "agents," boards and management, were insufficiently disciplined in promoting the vitality of their enterprises and building long-term value for their "principals," the shareholders.
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> For these reasons, CII founders believed that pension fund investors and their asset managers – who have clear fiduciary obligations to clients – needed to be vocal with company management and boards to promote long-term shareholder value and the interests of pension participants. Extreme passivity (just putting shares in the drawer) was no longer acceptable.
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> The efforts of pension funds and other asset owners to get their asset managers to play an appropriate oversight role at portfolio companies have proven long and difficult; the mission is not yet fully accomplished. Since 1985, many asset managers' practices on shareholder engagement have improved dramatically from the standpoint of CII and our members, who have zero interest in returning to the suboptimal old days of extreme passivity. But our members remain concerned that some of their managers continue to err on the side of passivity and excessive deference to management, if only because engagement with entrenched management and complacent boards can take some effort, incur costs, and ruffle feathers (sometimes of potential asset management firm clients) . . . . .
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> Different asset owners have different expectations for the range of environmental, social and governance (ESG) matters to be addressed through company-shareowner engagement, which is a consideration in manager selection and often addressed in contractual arrangements with asset managers. But across the board,

[18] *See* 85 Fed. Reg. at 77,043 ("Certain rules interpreting and implementing the Act, some of which have not been changed since they were first promulgated in 1978, may need additional updating.").

> our members expect their asset managers . . . to be engaged . . . on the full range of ESG issues. If an asset manager were prohibited from . . . engagement, our members would see that as a serious disability in delivering long-term value to their funds.[19]

Since the December 2018 Letter, expectations about asset manager engagement with issuers appears only to have grown as the frequency and positive impacts from those engagements continue to increase.[20]

Our second response to the key question in the ANPRM: We believe that the Agencies should clarify as part of any final rule or in related guidance the investment-only exemption. In that regard, we would support either of the following clarifications.

SEC's Approach to "Passive Investors"

Our preferred clarification of investment-only, as identified in the ANPRM,[21] would align the investment-only exemption with the SEC's approach to "passive investors" pursuant to Section 13 of the 34 Act. Section 13(d) requires any person who, after acquiring directly or indirectly the beneficial ownership of an equity security registered under the 34 Act, is the "beneficial owner" of more than 5% of such class of securities, to file with the SEC certain information on Schedule 13D.[22] A "passive investor," however, is permitted to file the less onerous Schedule 13G, provided that the investor acquired the securities with no purpose or effect of changing or influencing the control of the issuer, and not in connection with or as a participant in any transaction having such purpose or effect.[23]

The SEC has long specified the types of shareholder engagement activities that would not convey the purpose or effect of changing or influencing control of the company, which include most solicitations regarding social or public interest issues and proposals and soliciting activity

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[19] Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors to the Office of the Secretary, Federal Trade Commission 3-4 (Dec. 6, 2018), https://www.cii.org/files/20181206%20CII%20letter%20to%20FTC%20on%20common%20ownership%20v3.pdf.
[20] *See, e.g.,* Jeffrey Karp et al., Cleary Gottlieb Discusses Shareholder Engagement Trends and Considerations, The CSL Blue Sky Blog (Jan. 24, 2020), https://clsbluesky.law.columbia.edu/2020/01/24/cleary-gottlieb-discusses-shareholder-engagement-trends-and-considerations/ (commenting on surveys indicating an increase in shareholder engagement in recent years and positive results of engagement on investing and voting decisions).
[21] *See* 85 Fed. Reg. at 77,049 ("Assuming no change in the SEC rule, should the Commission adopt the SEC definition of a person who acquires voting securities in the ordinary course of business and not with the purpose nor with the effect of changing or influencing the control of the issuer?").
[22] 17 CFR § 240.13d-1(a) ("Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is specified in paragraph (i) of this section, is directly or indirectly the beneficial owner of more than five percent of the class shall, within 10 days after the acquisition, file with the Commission, a statement containing the information required by Schedule 13D").
[23] *See* 17 CFR § 240.13d-1(b)(1)(i) ("Such person has acquired such securities in the ordinary course of his business and not with the purpose nor with the effect of changing or influencing the control of the issuer, nor in connection with or as a participant in any transaction having such purpose or effect, including any transaction subject to § 240.13d-3(b), other than activities solely in connection with a nomination under § 240.14a-11").

related to general corporate governance matters such as executive compensation, shareholder rights and certain board practices.[24] SEC staff has subsequently provided similar guidance, in identifying forms of engagement that, without more, generally would not preclude a shareholder from filing on Schedule 13G.[25]

We believe applying a similar approach with "investment-only" under the HSR Act rules would be appropriate as applied to institutional investors. It would provide greater regulatory certainty. It would also promote greater operational efficiencies and fewer burdens for institutional investors. In general, it is costly for institutional investors and other market actors to respond to conflicting regulatory regimes, and we believe that as a general principal, government agencies should seek to harmonize their rules.[26]

The SEC's approach has helped to shape institutional investors' views regarding permissible subject matter for engagement. Harmonization would ensure that the update to the HSR Act rules would properly account for institutional investor approaches that should not raise competition concerns. We also believe that the SEC's approach is generally consistent with our alternative proposed clarification.

<u>Interpretation of SBP</u>

As an alternative, we would support clarifying the investment-only exemption to align with the interpretation of the SBP that accompanied the issuance of the HSR Act rules.[27] As explained in the August 2018 Letter:

> 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." "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."

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[24] *See* Amendments to Beneficial Ownership Reporting Requirements, Exchange Act Release No. 39,538 at 23 (Jan. 12, 1998), https://www.sec.gov/rules/final/34-39538.txt ("Proposals and soliciting activity relating to matters such as executive compensation, director pensions, and confidential voting normally would not prevent the use of a Schedule 13G.").

[25] *See* Compliance and Disclosure Interpretations, Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting, Question 103.11 (last update July 14, 2016), https://www.sec.gov/divisions/corpfin/guidance/reg13d-interp.htm (providing three examples where "[t]he subject matter of the shareholder's discussions with the issuer's management may be dispositive in making this determination, although the context in which the discussions occur is also highly relevant").

[26] *See, e.g.,* A Report of the Investors' Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 3 (July 2009), https://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf ("Regulation of banks and other depository institutions may be streamlined through the appropriate consolidation of prudential regulators [and] [s]imilarly, efficiencies may be obtained through the merger of the SEC and the Commodity Futures Trading Commission (CFTC)").

[27] *See* 16 U.S.C. § 801.1(i)(1).

> Yet one cannot form an intention to act until one has decided to act. The consideration of alternatives precedes a decision that selects an alternative and the formation of an intent to implement that decision. "Participate" means "to take part in," not to "influence."
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> 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. The SBP provides that the following actions could, but do not necessarily, reflect "evidence of an intent inconsistent with investment purpose:"
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> > (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 securities are held or acquired solely for the purpose of investment and thus not subject to the act's requirements.
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> [We] . . . 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. . . .[28]

Although clarification of the investment-only exemption under either of our alternatives would not provide the bright-line simplicity of the *de minimis* exemption, it would reduce, if not eliminate, the substantial ambiguity that is now unduly burdening legitimate activities of institutional investors to improve performance for the benefit of all shareholders.[29]

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[28] Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association & Jeff Mahoney, General Counsel, Council of Institutional Investors to Office of the Secretary, Federal Trade Commission at 17-18 (footnotes omitted).

[29] *See id.* at 18 ("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.")

10% *De Minimis* Exemption

As noted above, our preferred approach in discussions with the FTC all along has been clarification of "investment-only" and a closer alignment of its definition with the SBP or the SEC's approach to ''passive investors." However, we detected limited interest in this clarification at the FTC, and we have been open to a simple exemption at stock ownership by institutional investors of 10% or less.

Unlike the simple, 10% *de minimis* exemption proposed in the August 2018 Letter,[30] the Proposed Rule's 10% threshold includes five disqualifying conditions that we believe would likely render the exemption unusable.[31] More specifically, the Proposed Rules' exemption would not apply if:

1. the acquiring person is a competitor of the issuer;[32]
2. the acquiring person holds more than 1% of the outstanding voting securities or equity interests of a competitor of the issuer; [33]
3. an employee, principal, or agent of the acquiring person acts as a director or officer of the issuer;[34]
4. an employee, principal, or agent of the acquiring person acts as a director or officer of a competitor of the issuer;[35] or
5. there is a vendor-vendee relationship between the acquiring person and the issuer where the value of such sales was more than $10 million in the aggregate in the most recently completed fiscal year.[36]

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[30] *Id.* at 16-17 (describing CII proposed *de minimis* exemption").
[31] Fried Frank Antitrust & Competition Law Alert®, Proposed Amendments to HSR Rules Could Fundamentally Change HSR Compliance for Asset Managers 2 (Oct. 5, 2020), https://www.friedfrank.com/index.cfm?pageID=25&itemID=11681 ("asset managers that invest broadly across sectors and other investors that hold multiple positions within an industry likely will not be able to avail themselves of this new exemption at all.").
[32] *See* 85 Fed. Reg. at 77,067 ("The acquiring person is not a competitor of the issuer (or any entity within the issuer")).
[33] *Id.* ("The acquiring person does not hold voting securities in excess of 1% of the outstanding voting securities (or, in the case of a non-corporate entity, in excess of 1% of the non-corporate interests) of any entity that is a competitor of the issuer (or any entity within the issuer)").
[34] *Id.* ("No individual who is employed by, a principal of, an agent of, or otherwise acting on behalf of the acquiring person, is a director or officer of the issuer (or of an entity within the issuer)").
[35] *Id.* ("No individual who is employed by, a principal of, an agent of, or otherwise acting on behalf of the acquiring person, is a director or officer of a competitor of the issuer (or of an entity within the issuer)").
[36] *Id.* ("There is no vendor-vendee relationship between the acquiring person and the issuer (or any entity within the issuer), where the value of sales between the acquiring person and the issuer in the most recently completed fiscal year is greater than $10 million in the aggregate"); *see also* Dechert LLP, Proposed HSR Rule Changes to Increase Burdens, Especially for Asset Managers and Private Equity (Oct. 6, 2020), https://www.dechert.com/knowledge/onpoint/2020/10/proposed-hsr-rule-changes-to-increase-burdens--especially-for-as.html.

At the outset, we note that the five disqualifying conditions are far broader than they might first appear because the Proposed Rules' new definition of "person"[37] applies to the exemption.[38] As explained by the law firm Hogan Lovells:

> [T]he FTC's proposed definition of "person" would apply to application of the proposed de minimis exemption. Thus, Fund A would not be able to utilize the proposed de minimis exemption if Fund A and its associates (such as Fund B and Fund C) (i) collectively would hold over 10 percent of the voting shares of issuer or (ii) hold more than 1 percent of a competitor to issuer.[39]

As a result, the availability of the new 10% d*e minimis* exemption would be limited at best. In addition, three of the disqualifying conditions may be unworkable and/or lack a sufficient basis further limiting the usefulness of the exemption.

<u>"Competitor"</u>

The new definition of "competitor" in the first and second qualifying conditions may create uncertainty around which of the acquiring person's investments may be deemed a "competitor."[40] That ambiguity may make those conditions unworkable and subject to costly disputes.[41] As explained by the law firm Dechert LLP:

> The new definition of "competitor" under the proposed rule would include any person that either (1) reports revenues in the same [North American Industry Classification System] NAICS industry codes as the issuer or (2) competes in any line of business with the issuer. While NAICS codes currently are used to classify reporting parties' lines of business in the HSR form as a means of identifying possible competitive overlaps, NAICS codes are overbroad and

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[37] *Id.* at 77,066 ("Except as provided in paragraphs (a) and (b) of § 801.12, the term person means: (i) An ultimate parent entity and all entities which it controls directly or indirectly; and (ii) All associates of the ultimate parent entity.").
[38] *See, e.g.,* Robert Baldwin, III & Michele Harrington, Hogan Lovells, FTC Rocks the HSR Boat: Proposed Rules Will Increase HSR Filings For Investment Funds and Others, JDSUPRA (Sept. 26, 2020), https://www.jdsupra.com/legalnews/ftc-rocks-the-hsr-boat-proposed-rules-15216/.
[39] *Id.*
[40] *See, e.g.,* Dechert LLP, Proposed HSR Rule Changes to Increase Burdens, Especially for Asset Managers and Private Equity ("Although the new exemption removes the uncertainty about the investment intent of the acquiring person, it creates new uncertainty around which of the acquiring person's investments may be deemed a 'competitor' of the acquired issuer.").
[41] *See* Dechert LLP, Proposed HSR Rule Changes to Increase Burdens, Especially for Asset Managers and Private Equity; *see also* Letter from Jeffrey Kupor, Head of Legal, Americas, Invesco to Federal Trade Commission, Office of Secretary, April Tabor, Acting Secretary 3 (Jan. 28, 2021), https://beta.regulations.gov/comment/FTC-2020-0085-0006 ("The broadness of the competitor definition, in combination with the Acquiring Person Amendment's requirement that the 1% limit be evaluated at the aggregated acquiring person, will render the New Exemption unusable by investment managers like Invesco"); Robert Baldwin, III & Michele Harrington, Hogan Lovells, FTC Rocks the HSR Boat: Proposed Rules Will Increase HSR Filings For Investment Funds and Others, JDSUPRA (explaining how the "FTC's proposed definition of 'competitor' significantly limits the availability of the proposed de minimis exemption").

> notoriously imprecise. Reasonable minds can differ as to which NAICS codes should be applied to any given activity. Moreover, determining whether two firms "compete[] in any line of business" is highly fact specific, and typically one of the more vigorously disputed questions in antitrust cases.
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> . . . Such vaguely defined terms have the potential to lead to disputes with the FTC over investor eligibility for the exemption. The definition as currently drafted does not include a "knowledge and belief" qualifier, so filing parties could face strict liability for failing to file based on what is later found to be an incorrect determination of eligibility. Parties that fail to file when required are subject to a civil penalty of up to $43,280 (adjusted annually) per day and per violation for non-compliance.[42]

In addition, we are very concerned that the proposed definition of "competitor" as applied to the investment-only exemption would narrow that exemption as well.[43] As explained by Hogan Lovells: "[T]he FTC's proposed definition of 'competitor' would narrow application of this exemption because simply reporting U.S. revenues in the same broad NAICS (industry-based) codes would cause two entities competitors to be deemed competitors even where they do not actually compete."[44]

Finally, we note that the FTC asserts that "competitors sometimes use different NAICS codes to describe the same line of business."[45] Yet the FTC also asserts that the codes are "objective and easy to administer."[46] It is unclear to us how both assertions can be true.

<u>1% of a "Competitor of Issuer"</u>

In addition to the ambiguity of the term "competitor," the second disqualifying condition is particularly objectionable to CII because it appears to be based on the unproven and disputed hypothesis of "common ownership."[47] Our December 2018 Letter set forth the following four reasons why we believe the theory of common ownership is an inappropriate basis for concluding that noncontrolling shareholders facilitate competitive harm:

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[42] *Id.*
[43] *See, e.g.,* Robert Baldwin, III & Michele Harrington, Hogan Lovells, FTC Rocks the HSR Boat: Proposed Rules Will Increase HSR Filings For Investment Funds and Others, JDSUPRA.
[44] Robert Baldwin, III & Michele Harrington, Hogan Lovells, FTC Rocks the HSR Boat: Proposed Rules Will Increase HSR Filings For Investment Funds and Others, JDSUPRA.
[45] 85 Fed. Reg. at 77,056.
[46] *Id.*
[47] *See id.* at 77,091 (Statement of Commissioner Noah Joshua Phillips: "To the extent that the feared competition harms of common ownership result from the passivity of the largest shareholders, the de minimis exemption may help mitigate the concern by facilitating the smaller, more active, voices [and] [i]t also does not apply to other transactions where a competitively significant relationship between the issuer of the voting securities and the acquirer claiming the exemption exists.").

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[W]e [find] . . . the common ownership theory counter-intuitive. First, it is not at all clear to us, . . . that noncontrolling holders – . . . index investors – exercise undue power or hold decisive sway in the minds of corporate managers. If anything, they remain too cautious in asserting views with portfolio companies from the perspective of many of our asset owner members.

Second, we note that index investors are sometimes called "universal investors," as, except for relatively limited sector funds, they own the entire universe of publicly held companies. Even aside from the complete lack of evidence, it does not stand to reason that a universal owner would encourage anticompetitive behavior in certain industries (e.g., airlines and banks) at the expense of other companies in their portfolios and to the economy more generally.

Third, in discussions with CII members and other large institutional investors on effective shareholder-company engagement practices, a strong takeaway is that most engagement on execution and strategy encourages managements and boards to compete better ("run faster and jump higher"), not the reverse. This includes conversations, which now are extensive, on executive compensation. Many larger managers have expressed a strong preference in recent years for relative performance as measured against peers and the particular industry. There have been loud arguments, particularly in the last seven years since shareholder "say-on-pay" votes were mandated in the United States, between company managers, investors and proxy advisors on the appropriate peer groups for measuring performance of companies. When evidence emerged that some companies set biased peer groups in order to pay their executives more, institutional investors became even more vocal. Assuming that institutional investors believe that executives care about their own incentives, it does not make sense that they would put so much emphasis on relative performance measures in benchmarking executive pay if they were encouraging collusive behavior within industries.

. . . .

Finally, we believe that some of the common ownership research does not adequately reflect aspects of modern asset management. For example, asset owners, including many of our members, retain voting authority for shares in their separate accounts, so the large indexers control fewer votes than their . . . [SEC] filings show for beneficial share ownership. A second example: active investor ownership of multiple companies within an industry does not mean the asset manager is not betting on one or a few of those companies. Often, particular companies are overweighted or underweighted in a portfolio, with some exposure to underweighted companies (rather than zero exposure) intended to modulate the level of risk. A third area where understanding may be insufficient: the asset management firm owes a duty to participants in each individual fund managed by

> that firm, and does not necessarily vote shares with a single purpose. Asset managers may split their votes, reflecting varying financial interests of different accounts or conflicting views of different individual portfolio managers or teams. There are other complexities in asset management that also do not seem to be reflected in some of the papers we have seen.

Our concern about the FTC's reliance on the common ownership theory for purposes of the condition is shared by many market experts.[48] As one example, a client alert on the Proposed Rules by the law firm of Willkie Farr & Gallagher LLP noted:

> The common-ownership disqualifying condition in the proposed *de minimis* exemption appears to credit a disputed theory of antitrust harm that asserts that a single investor's ownership of minority shares in competitors' voting securities causes incentives in the competitors to reduce competition between each other. The disqualifying condition sets the minority ownership share that purportedly may reduce competition at any percentage greater than one.
>
> The Agencies acknowledge that the academic debate over the common-ownership theory of competitive harm is not resolved. They contend, however, that the disqualifying condition in the de minimis exemption is designed to ensure that the Agencies have an opportunity to review common-ownership holdings at thresholds greater than one percent for anticompetitive effects.
>
> *Issues open for comment include whether a regulation should incorporate a theory of competitive harm that has not been recognized, regardless of the minority threshold of commonly owned shares, by the judiciary and that has not supported a merger challenge by the Agencies*.[49]

We also generally agree with the conclusion of investment manager Invesco that "[b]ecause the common ownership economic hypothesis is speculative and unproven, the [second disqualifying condition] . . . should be eliminated. Indeed, if the Commission retains the [second disqualifying condition] . . . the utility of the [10% d*e minimis* exemption] . . . will be greatly diminished,

[48] *See* Letter from Jeffrey Kupor, Head of Legal, Americas, Invesco to Federal Trade Commission, Office of Secretary, April Tabor, Acting Secretary at 20 ("Although the common ownership economic hypothesis has gained attention in recent years, it remains controversial and, in our view, suppositious"); Letter from John L. Thornton, et al., Committee on Capital Market Regulation 3 (Jan. 14. 2021), https://beta.regulations.gov/comment/FTC-2020-0085-0003 ("the academic proponents of common ownership theory have not argued that 1% ownership in competitor companies has a significant effect on competition [and] [t]he basis for the 1% threshold in the HSR Act Proposal is therefore without support from even the flawed academic research").

[49] William H. Rooney et al., Willkie Farr & Gallagher LLP, Client Alert, Reviewing Proposed HSR Rule Changes from the Perspective of the Institutional Investors at 6 (Dec. 15, 2020), https://www.willkie.com/-/media/files/publications/2020/12/reviewingproposedhsrrulechangesfromtheperspectiveo.pdf (emphasis added and footnotes omitted).

particularly for investment managers, and the Commission's intentions in proposing the [n]ew [e]xemption will be unfulfilled."[50]

"Vendor-Vendee Relationship"

The Proposed Rules also create uncertainty around when the acquiring person and the issuer are in a "vendor-vendee" (or vertical) relationship as described in the above referenced fifth disqualifying condition. As again explained by Willkie Farr & Gallagher LLP the vendor-vendee disqualifying condition would appear to require:

> [A]n examination of every vendor and customer of every controlled portfolio company of any fund under common management. Although the "Commission intends to exclude the purchase of ordinary course services and goods (e.g., office supplies, financial services, etc.),"[[51]]the distinction between the purchase of "ordinary course services and goods" and other goods and services may not be self-evident.[52]

Setting aside the broader issue of whether a vendor-vendee relationship negatively impacts competition—an issue not explicitly addressed in the Proposed Rules—this broad and ambiguous condition may be unworkable.

For all of the reasons, we view the Proposed Rules as a missed opportunity. The Agencies could have provided a clarification of the investment-only exemption and a simple, 10% *de minimis* exemption. The result would likely have removed the existing HSR Act impediment to issuer and investor communications about corporate governance matters to benefit of investors, issuers, and the capital markets without harming the Agencies' mission to protect competition.

Costs of Proposed Rules

One final and important point: we believe the costs of the Proposed Rules to asset managers (and indirectly their pension fund clients) would be substantial, and are not adequately reflected in any FTC cost/benefit analysis. And the costs would be imposed in the absence of any showing of harm from ordinary course investments by institutional investors.

The Proposed Rules re-define "person" for purposes of 16 C.F.R. §801.1(a)(1) to include "all associates of the ultimate parent entity." And the "Commission acknowledges that this proposed

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[50] Letter from Jeffrey Kupor, Head of Legal, Americas, Invesco to Federal Trade Commission, Office of Secretary, April Tabor, Acting Secretary at 21.
[51] 85 Fed. Reg. at 77,061.
[52] William H. Rooney et al., Willkie Farr & Gallagher LLP, Client Alert, New HSR Rule Proposal: 10% De Minimis Exemption and Aggregation Across Funds – A Regulatory Improvement or More Ambiguity and Burden 4 (Oct. 5, 2020), https://www.willkie.com/-/media/files/publications/2020/10/updatenewhsrruleproposal10deminimisexemptionandagg.pdf.

change would result in an increased burden . . . ."[53] We, however, believe the FTC has not accurately measured the very substantial cost this new aggregation rule would impose.

Given the number of clients that a typical adviser serves that would be deemed "associates," it is obvious to us that many more institutional investor share transactions (assuming current ownership and trading practices) would meet the notional thresholds for HSR Act reporting. And it is clear the change in definition alone would (1) trigger hundreds or more additional filings by institutional investors,[54] or (2) significantly disrupt investment strategies at cost to returns,[55] or more likely (3) lead to both higher costs and significant disruption of investment strategies.

"Disruption of investment strategies" could include modification of investments to cap holdings,[56] notwithstanding conflict with simple index models or optimal quantitative or active portfolio diversification strategies; and/or abandonment of corporate governance oversight activities that, with the strong encouragement of the SEC, have been critical elements for accountability and investment returns in recent decades.

Our strong opposition to the Proposed Rules is based to an important degree on the indirect costs that we believe our pension fund and other asset owner members will incur from the Proposed Rules. At a minimum, the FTC should provide much more careful cost/benefit analysis before re-defining "person" as part of the Proposed Rules.

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[53] 85 Fed. Reg. at 77,057.

[54] *See* Letter from Jeffrey Kupor, Head of Legal, Americas, Invesco to Federal Trade Commission, Office of Secretary, April Tabor, Acting Secretary at 10 ("Invesco estimates that the Acquiring Person Amendment would require that it make more than 150 HSR filings on behalf of its aggregated acquiring person upon effectiveness of the Acquiring Person Amendment, with potentially many additional filings required annually thereafter"); William H. Rooney et al., Willkie Farr & Gallagher LLP, Client Alert, Reviewing Proposed HSR Rule Changes from the Perspective of the Institutional Investors at 5 ("We understand that a number of asset managers believe that the aggregation rule in many instances will likely eliminate the exemptions upon which they often rely, thereby causing a substantial increase in the number of HSR filings by institutional investors and asset managers."); Dechert LLP, Proposed HSR Rule Changes to Increase Burdens, Especially for Asset Managers and Private Equity ("The definition of 'person' determines which entities and their respective holdings are included when assessing the HSR thresholds, and would be significantly expanded under the proposed rules in ways that are likely to lead to more HSR filings for institutional investors"); Fried Frank Antitrust & Competition Law Alert®, Proposed Amendments to HSR Rules Could Fundamentally Change HSR Compliance for Asset Managers at 2 ("If the rules are implemented as proposed, the FTC would receive hundreds of additional filings from institutional investors and other large asset managers for investments in which the 10% or 15% thresholds are exceeded, when measured across all commonly managed funds.").

[55] *See, e.g.,* Letter from Jeffrey Kupor, Head of Legal, Americas, Invesco to Federal Trade Commission, Office of Secretary, April Tabor, Acting Secretary at 12 ("At the same time, [the change in the definition of "person"] . . . would deprive investment management clients of the potential for investment returns on the investment opportunities foregone and could even disrupt investment managers' delivery of certain desirable investment strategies to clients.").

[56] *Id*. at 12 ("given the challenges and impediments to completing an Antitrust Improvements Act Notification and Report Form on behalf of an aggregated acquiring person that includes a multitude of its clients, an investment manager might decide to cap aggregate ownership of an issuer's common stock held widely across its clients' portfolios at 10% (or less) of shares outstanding to ensure that the aggregated acquiring person can qualify for the §802.9 exemption").

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Thank you for the opportunity to comment on the Proposed Rules. Please contact me with any questions.

Sincerely,

Jeffrey P. Mahoney
General Counsel