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June 5, 1991

BY HAND

Richard B. Smith, Esq.
Premerger Notification Office
Federal Trade Commission
6th and Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Re: Informal Hart-Scott-Rodino Opinion Letter

Dear Mr. Smith:

As you suggested, I am writing to obtain the Staff's position on the applicability of the "solely for the purpose of investment" exemption under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("the Act") under the facts outlined below.

ISSUE

Whether a corporate officer and director who acquires voting securities as part of his compensation from an issuer may claim the "solely for the purpose of investment" exemption where his intent upon acquisition is to obtain his bargained for compensation and not to exercise any rights as a shareholder beyond voting; and where the percentage of securities acquired is less than 10 percent.

FACTS

1. Description of the Issuer

Company "C", the issuer, is a publicly held company that since its founding has been dominated by Stockholder A who has always controlled in excess of two-thirds of the outstanding voting power of Company C and had the right to nominate a majority of Company C's Board of Directors.

As a result of the reduced voting rights of the Company C stock in public hands and as a result of shareholder

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agreements, Company C's public stockholders, including the officer/director involved in this request, are not collectively able, among other things (i) to elect or defeat the election of any of Company C's directors, (ii) to amend Company C's restated Certificate of Incorporation, (iii) to effect a merger or sale of assets or other corporate transaction, or (iv) to accept any hostile bid that would result in a takeover of Company C.

2. Description of "Investor I"

Stockholder A, the dominant stockholder of Company C, employed Investor "I" to be president of Company C.[1/] When he became president, Investor I was allowed to purchase approximately $1 million of voting shares in the company as part of his employment package. In light of A's dominance, however, those shares carried with them no influence or control over the company's activities. They were an investment that entitled Investor I to share in the profits of the company should it be successful under his leadership.

In addition to the initial purchase of shares, Investor I's annual compensation package included the usual components: cash, stock options and other fringe benefits. The stock options were a material part of that compensation, and were designed to be an incentive for Investor I to excel in the management of Company C.

Investor I desires to exercise his stock options solely in order to realize (and convert to cash) that portion of the financial compensation to which he is entitled from the stock option component of his compensation package. His holdings amount to less than 2% of Company C's voting securities and each time he exercises a stock option, it is with the intent to purchase the stock from Company C at the option price in order to sell the stock in the open market at a higher price.

SIZE OF PERSON

Both Investor I and Company C satisfy the jurisdictional requirements of Section 7A(a)(2)(C).

1/ Investor I was also appointed a director by Stockholder A.

ANALYSIS

Section 7A(c)(9) of the Act exempts "acquisitions, solely for the purpose of investment, of voting securities, if as a result of such acquisition, the securities acquired or held do not exceed 10 percent of the outstanding voting securities of the issuer." This exemption is restated in 16 C.F.R. § 802.9. The regulations define "solely for the purpose of investment" by providing that "[v]oting 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." 16 C.F.R. § 801.1(i)(1).

Although we are aware of no informal interpretations to date that have analyzed the "solely for the purpose of investment" exemption in a factual context similar to the one outlined above, we believe that the available interpretations as well as the Statement of Basis and Purpose argue in favor of finding Investor I's acquisitions to be within this exemption.

First, the language of Section 7A(c)(9) and the relevant regulations, 801.1(i)(1), and 802.9, address the "purpose of the investment." These all contemplate the situation where the acquiring party is able to participate in the management of the issuer *as a result of the investment and the influence obtained by holding the issuer's stock*. For example, a 2% holder of the stock of a widely held company such as American Telephone & Telegraph or General Motors may have influence if he or she chooses to exercise it as a result of his or her minority ownership. Thus, the conduct of such a small shareholder is both probative of the holder's intent and may have competitive ramifications subject to review under the Act. This point is illustrated in the original Statement of Basis and Purpose for Section 801.1(i)(1) which indicates that certain types of conduct may be viewed as inconsistent with an investment only purpose:

> (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

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> the foregoing with respect to any entity directly or indirectly controlling the issuer.

Implicit in these six examples is the acquiring party's ability to influence -- to some degree -- the management or Board of Directors of an issuer *as a result of the acquiring party's investment*. But the examples cannot be viewed in isolation where other factors are present. They do not address Investor I's situation, where his "investment" is a part of his compensation (instead of receiving cash, he exercises stock options and converts the stock into cash in the open market) and the issuer he invested in is clearly controlled by another person, Stockholder A, so that his less than 10 percent investment cannot give him influence or control over the issuer.

You suggested that the conduct that is closest to the instant case is illustrated in example (4) above -- having an employee of the shareholder serve as an officer or director of the issuer. We agree that such conduct is normally probative of the intent of a shareholder who purchases shares and uses the influence his investment confers to have a nominee appointed an officer or director of the issuer.[2/] Here by contrast the shareholder is an officer and director who has been given stock rights by the issuer to compensate him for service to the company. The stock is neither granted by the company, nor acquired by Investor I with the intent that Investor I's stockholdings invest him with influence over the Company. Rather, the intent of the stock rights -- and Investor I's exercise of them -- is to increase Investor I's income. As such, Investor I's status as an officer and director is not inconsistent with his acquiring and holding the shares for investment only.

Second, the informal interpretations of this exemption implicitly, if not explicitly, require that there be a causal nexus between the making or holding of the investment and the investor's intent or purpose to influence the management of the issuer by virtue of the investment. In an informal interpretation the Staff stated that the exemption is not available if the securities are purchased "with the intention of influencing the basic business decisions of the issuer or with the intention of

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2/ This normally arises where one corporation purchases voting securities in another.

participating in the management of the issuer." See Letter to Michael N. Sohn, Esq. from Bureau Director Thomas J. Campbell dated August 19, 1982 (reprinted in ABA, Premerger Notification Practice Manual, No. 25, 1985). The Bureau's finding that certain activities associated with the acquisition -- statements that the acquiring party might seek control of the target, demanding a list of shareholders, and retention of a proxy solicitor service -- place the transaction outside the Section 802.9 exemption implies that a certain causal nexus between the investment and the "control conduct" is necessary.

No such nexus is present here. Investor I's only influence over the issuer is by virtue of his position as an officer and director of the issuer. His acquisition of less than 2% of the voting securities of that company is not relevant to that influence, and has no bearing on his continued ability to influence the company. He exercises influence over the company by virtue of the fact that he is an officer and a director appointed by Stockholder A, and not by virtue of his ownership of less than 2% of the company's stock. That ownership does not enhance Investor I's power or control in Company C, or his ability to maintain his positions as an officer and director. Nor does he have the intent to use his shareholdings in that manner. Indeed, if Stockholder A dismissed Investor I, Investor I's holdings would not be sufficient to permit him to exercise influence or control to maintain his positions.

In our view, unless Investor I intends to or actually takes steps as a *shareholder* to influence or control the company -- and to date he has taken none, and in any event he does not have the intent or sufficient power to do so -- no inference can be drawn that he lacks the requisite investment only intent. The mere fact that he is an officer and a director of Company C and exercises influence and control by virtue of his appointment to those positions is not probative.

Third, the Commission's current consideration of a blanket ten percent exemption, based upon its experience over the last eight years that such acquisitions are "unlikely to violate the antitrust laws" argues in favor of interpreting the language of the current exemption to apply here. See 53 Fed. Reg. 36,831, 36,841 (Sept. 22, 1988). It would be difficult to imagine any antitrust significance to acquisitions of 10% or less of outstanding voting securities by corporate officers or employees who

are merely exercising stock options in order to enjoy the fruits of their compensation packages.[3/]

Finally, finding the investment only exemption to apply would not be inconsistent with the policy recently articulated in the Prepared Remarks of John M. Sipple, Jr., Chief, Premerger Notification Office, Federal Trade Commission, January 16, 1990. In that speech, Mr. Sipple stated:

> The issues we now face relate to the question of what type of conduct or action, other than considering or taking steps in preparation for a takeover attempt, constitute sufficient evidence to establish that a person's intent is not consistent with an investment only intent.

This language suggests that it is Mr. Sipple's understanding that the investment only exemption applies only when investors use their *shareholdings* to control or influence a corporation. Where a person's influence results from his conduct as an officer or director of a corporation, and not from his conduct as a holder of less than 10% of the voting securities of that corporation, further acquisitions below the 10% threshold are not inconsistent with an "investment only intent." The fact that a person is an officer and director of an issuer does not alone "constitute sufficient evidence to establish that a person's stock ownership is not consistent with an investment only intent." The focus of any inquiry into an investor's intent must be (1) on his activities as a shareholder, and (2) on whether the ownership structure of the issuer in question permits a less than 10 percent shareholder to have influence and control. In the case of Investor I and Company C, his activities and the company's ownership struc-

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3/ Indeed, the SEC recently amended its rules such that the exercise of a stock option is no longer considered a purchase of stock and thus inside investors no longer have to hold that stock for six months to avoid penalties. Insider investors can thus exercise stock options and sell the stock the same day. An H-S-R requirement that one must report the exercise of a stock option makes no sense under these circumstances.

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ture are consistent with the solely for the purpose of investment exemption.

We would appreciate learning from you as soon as practicable what the Staff position is on this matter. We would be pleased to answer any questions or discuss this matter further.

Sincerely,

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7/2/91 - called [redacted] and advised that, in our view, an officer or director who holds stock in the company which employs him cannot avail himself of [illegible] of the [illegible] here will [illegible] the 1934 Act. We are interested in [illegible] modifying the rule or our interpretation to [illegible] the [illegible] if the option is [illegible] the holder intends to - and does - sell the stock immediately in order to pay his [illegible]. We're presently considering such an approach, but it is not yet in place. We might be back to him [illegible]. At present, it looks as though no [illegible] is required for the situation outlined in the letter!

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R.B. Smith

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