Reliance Group Holdings

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BY HAND

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Office of the Secretary
Federal Trade Commission, Rm. 136
Washington, D.C. 20580

Assistant Attorney General
Antitrust Division
Department of Justice, Rm. 3214
Washington, D.C. 20530

Re: Proposed Changes in Premerger Notification Rules

Dear Sirs:

This comment is submitted on behalf of Reliance Group Holdings, Inc. and its wholly owned subsidiary, Reliance Insurance Company, in response to the Federal Trade Commission's invitation to interested persons to submit comments on alternative proposed changes in its premerger notification rules and on the desirability of other amendments. Each of the alternative proposed changes would ease reporting requirements for acquisitions of 10 percent or less of an issuer's voting securities.

We endorse the principal proposed change, which would eliminate the investment purpose requirement with respect to acquisitions of not more than 10 percent of the voting securities of an issuer, and thereby exempt from Hart-Scott-Rodino premerger notification procedures all such acquisitions. Furthermore, we recommend that the Commission similarly eliminate the investment purpose requirement with respect to acquisitions by institutional investors of either 15 percent or less of an issuer's voting securities or voting securities of an issuer valued at $25 million or less.

We concur in the view expressed in the Commission's Public Notice that the principal proposal will "reduce compliance problems and reduce filing burdens" without compromising antitrust enforcement. Public Notice at 14. We concur in the Commission's view that acquisitions of 10 percent or less of an issuer's voting securities, regardless of value, "are unlikely to violate the antitrust laws." Id. As the Commission observes, "a major benefit [of the principal proposal] would be the freeing up of Commission resources currently expended on compliance investigations regarding transactions that lack antitrust significance." Id. Because in our view the Commission's Public Notice adequately states the advantages of the principal proposal, we focus in this comment on the desirability of a parallel change in the treatment of institutional investors.

The Commission also seeks comment on two variations on the principal proposal. Under the first alternative, acquirors would be permitted to purchase, but not take possession, of up to 10 percent of an issuer's voting securities without observing the advance notification procedures. Shares so purchased, however, would be placed in escrow and would be voted by the escrow agent in proportion to the votes cast by all other shareholders. The second alternative would create an optional notification procedure for acquisitions of not more than 10 percent of an issuer's voting securities. Under the optional procedure, the acquiror would not notify the issuer of the intended acquisition, provided the acquiror supplies certain information about the transaction and the issuer that is not now required. In our view, the alternative proposals do not significantly reduce filing or administrative burdens and do not reflect the Commission's conclusion that these acquisitions are unlikely to violate the antitrust laws. While a detailed comparison of the relative merits of the alternatives is beyond the scope of this comment, we believe that the principal proposal, amended as described in this comment, is the proposal best designed to achieve the underlying purposes of the Act with a minimum of burden to investors and the Commission.

Notification Requirements under Existing Law for Institutional Investors

Title II of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, codified as section 7A of the Clayton Act, 15 U.S.C. §18a, subjects certain would-be acquirors of voting securities to advance notification procedures. In general terms, and assuming that the volume of business of the acquiror and the issuer exceed certain threshold levels, the notification procedures must be observed if, as a result of the acquisition, the acquiror would hold 15 percent or more of the voting securities of the issuer or voting securities of the issuer valued in excess of $15 million. Certain classes of acquisitions are exempt from these requirements. The Commission's proposals address the investment purpose exemption, which exempts acquisitions made "solely for the purpose of investment" if, as a result of the acquisition, the acquiror does not hold more than 10 percent of the outstanding voting securities of the issuer.

Pursuant to its authority to create additional exemptions from the notification requirements, _see_ §7A(c)(12) and (d)(2)(B), the Commission has broadened the investment purpose exemption as applied to institutional investors. Subject to certain restrictions, the Commission's Rule §802.64 allows defined types of institutional investors to acquire more than 10 percent of an issuer's voting securities without observing the advance notification procedures if the acquisition is "[m]ade solely for the purpose of investment." Rule §802.64(b)(3). This exemption is not available if, as a result of the acquisition, the institution would hold both more than 15 percent of the outstanding voting securities and voting securities valued at more than $25 million.

Reasons for Separate Treatment of Institutional Investors

In Rule §802.64, the Commission has provided a higher initial reporting threshold for institutional investors because it recognized that the 10 percent limit of §7A(c)(9) "may not in fact be sufficient for the ordinary operations of institutional investors." Statement of Basis and Purpose, 43 Fed. Reg. 33,450, 33,504 (1978). By trading in large blocks of securities, institutional investors in the ordinary course of their business "may frequently exceed 10 percent and $15 million, thus making reportable numerous acquisitions that merit exemption . . . ." Id. In the Commission's view, higher reporting thresholds for institutional investors minimize the disruption of the normal operations of institutional investors without creating appreciable anticompetitive potential. Id. at 33,503.

Because the higher reporting thresholds apply only under certain conditions, acquisitions made under this Rule "are likely to have a relatively insubstantial effect on competition . . . ." Id. The higher initial reporting thresholds do not apply if the institutional investor is acquiring voting securities in another institutional investor of the same type or if a non-institutional affiliate of the institutional investor owns any amount of the voting securities of the issuer. Rule §802.64(c)(1)&(2). Additionally, for the higher reporting thresholds to apply the acquisition must be "[m]ade in the ordinary course of business" of the acquiror and must not result in the acquiror holding 50 percent or more of the outstanding voting securities or having the contractual power to designate a majority of the directors of the issuer. Id. (b)(2)&(4). See also Rule §801.1(b). Finally, and of particular interest for purposes of this comment, the higher reporting thresholds do not apply unless the acquisition is "[m]ade solely for the purpose of investment." Rule §802.64(b)(3).

Effect of the Principal Proposal

The effect of the Commission's principal proposal is to eliminate the investment purpose requirement as it applies to ordinary investors but to leave it in place as it applies to institutional investors. Under existing law acquisitions of voting securities valued at more than $15 million, but which do not exceed 10 percent of the outstanding voting securities of the issuer, are exempt from the advance notification procedures if the securities are held "solely for the purpose of investment." §7A(c)(9). The effect of the principal proposal would be to eliminate the investment purpose requirement in this context; all acquisitions of 10 percent or less of an issuer's voting securities, regardless of the acquiror's intent, would be exempt from the notification procedures. Under the principal proposal, however, the "solely for the purpose of investment" requirement would continue to appear in Rule §802.64. Institutional investors could acquire up to 10 percent of an issuer's voting securities, regardless of intent. But because institutional investors often trade in large blocks of voting securities, the investment purpose requirement will continue to impact upon their normal operations. Institutional investors will be permitted to exceed the 10 percent threshold and to acquire up to the greater of 15 percent or $25 million in voting securities without being subject to the advance notification procedures only if the acquisition is solely for the purpose of investment and the other requisites of §802.64 are met.

The Desirability of a Parallel <u>Change for Institutional Investors</u>

In our view, the same factors that militate in favor of eliminating the investment purpose requirement as applied to ordinary investors also militate in favor of eliminating the requirement as applied to institutional investors.

Eliminating the investment purpose requirement from Rule §802.64 will not appreciably increase antitrust potential. As the Commission recognized in the Statement of Basis and Purpose, acquisitions by institutional investors, within the special size-of-transaction limits of the Rule, are unlikely to raise antitrust concerns because, in the first place, these types of investors are unlikely to involve themselves in the management of the issuer:

> "Some of these investors, such as non-profit entities, are constrained by law or by their charters from participating in the management of most business corporations. Pension trusts, insurance companies and others are limited by their fiduciary duty to the ultimate beneficiaries of their investment. Entities such as broker-dealers and investment companies frequently engage in acquisitions that may meet the criteria of the act, but they generally have no interest in affecting the management of the companies whose stock they buy." Statement of Basis and Purpose, <u>supra</u>, at 33,503.

Thus, if the investment purpose requirement were eliminated, this change in the Rule would be unlikely to change the behavior of institutional investors.

Second, the other requisites of the Rule create sufficient safeguards against its exploitation for anticompetitive purposes. An institutional investor cannot use the Rule to acquire more than 10 percent of the voting securities of another institution of the same type. Rule §802.64(c)(1). This exception, as well as the exception for acquisitions of voting securities of issuers any of whose voting securities are owned by a non-institutional affiliate of the acquiror, stands in the way of abuse of the Rule. Additional safeguards are found in the existing requirements that the acquisition be made in the ordinary course of the business of the institutional investor and in the requirement that the acquiror not obtain control of the issuer as a result of the acquisition.

In large dollar transactions, i.e., those exceeding the $25 million threshold of Rule §802.64, an institutional investor will be limited to acquiring not more than 15 percent of the voting securities of the issuer. In its Public Notice, the Commission examines the antitrust case law under Section 7 of the Clayton Act, which prohibits acquisitions where the effect "may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. §18. The Commission concludes that the cases support the proposition that "acquisitions of up to 10 percent are less likely to violate the antitrust laws than acquisitions of greater percentages." Public Notice at 25. None of the cases cited by the Commission, nor any cases of which we are aware, support the proposition that ownership of 15 percent of the voting securities of an issuer is any more likely to raise antitrust concerns than ownership of 10 percent of those securities.* In the limited context then of acquisitions by institutional

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*As the Commission notes, several cases have recognized that an acquisition of approximately 20 percent of an issuer's securities creates the potential for the acquiror to influence the issuer's management. E.g., Dan River, Inc. v. Unitex, Ltd., 624 F.2d 1216, 1225 (4th Cir. 1980). But even an acquisition of as much as 20 percent appears to fall into "a gray zone." Crane Co. v. Harsco Corp., 509 F.Supp. 115, 123 (D. Del. 1981). For example, in Gulf & Western Industries, Inc. v. Great Atlantic & Pacific Tea Company, Inc., 476 F.2d 687 (2d Cir. 1973), noted at p. 26 of the Commission's Public Notice, the Court enjoined G&W's tender offer for slightly more than 15 percent of A&P's common stock. G&W already owned more than 4 percent of the outstanding shares prior to the commencement of the tender offer, the consummation of which would have resulted in its holding over 19 percent of the outstanding shares. Yet, in Crane Co., supra, although the court found that there was a substantial likelihood with a 20 percent interest that the acquiror "may have significant influence" over the issuer, 509 F.Supp. at 123, the court rejected the argument that the acquisition of 20 percent of an issuer's outstanding voting securities was necessarily inconsistent with an investment intent and declined to enjoin the transaction.

investors of the voting securities of issuers that are not other institutional investors of the same type, the acquisition of up to 15 percent of the voting securities of the issuer is not likely to raise any more risk of an antitrust violation than the acquisition of up to 10 percent of that issuer's voting securities by an ordinary investor. Further support for this proposition is found in the statutory size-of-transaction thresholds, which exempt acquisitions of voting securities valued at not more than $15 million and constituting less than 15 percent of the outstanding shares.*

In transactions in which the institutional investor does not exceed the $25 million threshold of Rule §802.64, the institution will be permitted to acquire voting securities constituting any percentage not equaling or exceeding 50 percent of the voting securities of the issuer. Rule §802.64(b)(4). See also Rule §801.1(b). The ability of an institutional investor in these smaller transactions to reach this level of percentage of ownership in the issuer does not

*The Commission observed that it was unable to uncover any instance of either the Department of Justice or the Commission ever challenging an acquisition of not more than 10 percent under §7 of the Clayton Act. Public Notice at 33. Similarly, we are unaware of any such enforcement action with respect to an acquisition of not more than 15 percent.

create appreciable antitrust concerns. The statute itself creates complete exceptions in cases in which the issuer or the acquiror does not meet certain size-of-the-parties thresholds. §7A(a)(2). In addition, the Commission has promulgated the minimum dollar value exemption which allows acquisitions of any amount constituting less than 50 percent of the voting securities of an issuer provided that the securities do not exceed $15 million in value. Rule §802.20. The Commission has previously determined that a $25 million threshold is appropriate in the context of institutional investors in light of their normal business operations. The additional safeguards that are contained in the Rule obviate any concern about the anti-competitive consequences of these smaller transactions.

The elimination of the investment purpose language in Rule §802.64 will create an objective standard for institutional investors, which will be both easier to administer and to observe than the existing formulation of the Rule. The Commission noted that one of the advantages of its principal proposal was that "[t]he antitrust agencies would not have to devote their resources to determining whether particular acquisitions were made solely for the purpose of investment." Public Notice at 47. The elimination of the investment purpose requirement from Rule §802.64 will provide the benefit of an objective test in the context of acquisitions by institutional investors as well.

The wisdom of applying the subjective criterion of investment purpose to institutional investors is questioned in a leading antitrust text:

> "It is unclear what is meant by certain of these activities said to be potentially inconsistent with investment intent [such as proposing corporate action requiring shareholder approval]. For example, the S.B.P. [Statement of Basis and Purpose] refers to 'nominating a candidate to the board of directors.' There are obviously circumstances where merely offering the name of a person to be considered as a candidate for director would be consistent with the role of an investor and perhaps desirable as a policy matter. For example, should a university lose its exemption by nominating a member of a minority group to a corporate board?" Axinn, Fogg & Stoll, <u>Acquisitions Under the Hart-Scott-Rodino Antitrust Improvements Act</u> at 254 (1984).

We believe that the existing subjective criterion contained in the investment purpose limitation creates the potential for unintended liability under the Act under circumstances that give rise to no appreciable antitrust concerns.

The Commission's Authority to Make a Parallel Change for Institutional Investors

As reflected in its Public Notice, the Commission is properly concerned with the question of its ability to create exemptions to statutorily required advance notification procedures. In our opinion, the Commission has the power to eliminate the investment purpose requirement as it applies to institutional investors in Rule §802.64(b)(3). The Commission, with the concurrence of the Assistant Attorney General, may "exempt, from the requirements of [the Act], classes of persons, acquisitions, transfers, or transactions which are not likely to violate the antitrust laws." §7A(d)(2)(B). For the reasons stated in this comment, the acquisitions that would be exempted from advance notification procedures by the adoption of the amendment proposed in this comment are not likely to violate the antitrust laws. Moreover, the Commission concluded in its Public Notice that it may properly eliminate the investment purpose requirement as it appears in the Act itself. It follows, therefore, that the Commission would have the authority to make a parallel change in an exemption previously created by the Commission.

Conclusion

We endorse the principal proposal of the Commission. For the foregoing reasons, we believe that the Commission should logically extend the principal proposal and eliminate the "solely for the purpose of investment" requirement as it applies to institutional investors in Rule §802.64(b)(3).

Respectfully submitted,

Howard E. Steinberg