

**NATIONAL VENTURE CAPITAL ASSOCIATION'S COMMENTS TO THE FEDERAL  
TRADE COMMISSION'S NOTICE OF PROPOSED RULEMAKING**

*Premerger Notification; Reporting and Waiting Period Requirements*

**Submitted to the Federal Trade Commission**

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*On behalf of National Venture Capital Association*

## I. Introduction

The National Venture Capital Association (“NVCA”) appreciates the opportunity to present our views to the Federal Trade Commission (“FTC”) in response to the FTC’s Notice of Proposed Rulemaking (“Notice of Proposed Rulemaking” or “Notice”), published December 1, 2020 and Advance Notice of Proposed Rulemaking (“ANPR”), announced September 21, 2020.

NVCA is the nonprofit trade association that supports the U.S. Venture Capital (“VC”) community in fermenting the formation and growth of emerging, innovative companies and continuing to advance the U.S.’s stature as the best place in the world for entrepreneurs to launch a high-growth company. NVCA convenes VC investors, entrepreneurs, and industry partners to shape public policy priorities, to develop new industry initiatives, to provide premier research, and to participate in professional development opportunities with their peers. These comments reflect significant input from our members.

NVCA serves hundreds of VC members as they take on significant risk investing in emerging companies, many of which do not succeed, and supporting the nation’s entrepreneurial talent in turning ideas and basic research into products and services that have transformed the world. NVCA members invest across various capital stages (i.e., from seed to growth equity) and in critical areas of our economy, such as life sciences and cutting edge high tech industries like information technology, blockchain, and cybersecurity. Two recent examples of companies that have been backed by venture capital are Moderna, which has an approved COVID-19 vaccine, and Zoom, which has enabled video communication during the pandemic.

Venture Capitalists (“VCs”) build companies that would not otherwise have access to capital through traditional financing (e.g., bank loan). In its simplest form the company begins as just an entrepreneur with an idea expressed as a business plan. In other situations, VCs provide capital to growth stage companies. In both situations, the investment is high risk. In 2020 alone, more than 11,000 VC-backed companies received \$156 billion in funding. These investments are essentially illiquid, do not bear any financial return unless the companies can successfully exit through an IPO or an M&A event, and many never provide any return if the company fails. More information about NVCA and its members can be found on NVCA’s website [here](#).

VC is critical to American entrepreneurship. A 2015 academic study, *The Economic Impact of Venture Capital: Evidence from Public Companies*, analyzed the impact venture-backed companies—as a subset of all U.S. public companies founded after 1974—have had on the economy.<sup>1</sup> The study found that of the 1,339 U.S. companies that went public between 1974 and 2015, 556 (or 42%) were venture-backed. Moreover, those 556 venture-backed companies represented 63% of the market capitalization and 85% of the total research and development of the companies that went public over this time.

NVCA and its members have a significant interest in the subject matter of the Notice and ANPR. While NVCA very much appreciates the FTC’s efforts to update and improve the HSR Rules and Regulations (the “Rules”), NVCA has a strong conviction that certain aspects of the proposed amendments, if implemented, would have a material, negative impact on the capital markets

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<sup>1</sup> “The Economic Impact of Venture Capital: Evidence from Public Companies,” Stanford University Graduate School of Business Research Paper No. 15-55, *available at* [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2681841](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2681841).

ecosystem, including reducing the competitiveness of U.S. entrepreneurs, and hindering the ability of U.S. startup companies to attract venture capital.

We respectfully urge the FTC to be mindful of the important role of VC in the U.S. before implementing changes to the Rules that would have such damaging consequences, especially weighed against the same time, NVCA is concerned that the proposed amendments would result in minimal, if any, improvement to the FTC's ability to carry out its mission under the HSR Act, particularly as applied to VCs.

NVCA and its legal counsel, Cooley LLP, stand ready to assist the FTC in its further assessment of these issues and potential means of mitigating negative consequences that we discuss below.

## **II. The FTC's Proposed Change to the Definition of "Person," as Applied to VC Funds, Would be Unwarranted—and Competitively Harmful.**

The FTC's Notice of Proposed Rulemaking proposes to amend the definition of "person" to require acquiring persons to (a) "disclose additional information about their associates in Items 4 through 8 of the HSR Form" and (b) "aggregate acquisitions in the same issuer across their associates when making an HSR filing."<sup>2</sup>

Below, we explain why this proposal, particularly insofar as it would require aggregating acquisitions in the same issuer across associates, is not only a solution in search of a problem, at least as applied to "common ownership"<sup>3</sup> by VCs, but would result in tangible harms to capital markets for early-stage innovative companies in the U.S.

There are other, less damaging methods to address the issues raised by the FTC, however, and NVCA offers several alternative approaches that would be more than sufficient to address these issues without many of the significant downsides identified below.

### **A. The proposed amendment is a solution in search of a problem.**

The Notice repeatedly emphasizes that the Agencies have a "strong interest" in not "receiving filings related to acquisitions that are very unlikely to raise competition concerns."<sup>4</sup> Ironically, as applied to common shareholdings by VC funds, this is exactly what this amendment would do.

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<sup>2</sup> Premerger Notification; Reporting and Waiting Period Requirements, 85 Fed. Reg. 77053, 77054 (proposed Dec. 1, 2020), available at <https://www.govinfo.gov/content/pkg/FR-2020-12-01/pdf/2020-21753.pdf> (hereinafter, Notice).

<sup>3</sup> Throughout these comments we distinguish "cross-ownership, which describes a company holding an interest (stock or otherwise) in a competitor" from common ownership, i.e., "minority shareholding by a common investor." *See, e.g.*, <https://www.justice.gov/atr/page/file/1312321/download>.

<sup>4</sup> Notice, at 77055. As Commissioner Phillips correctly observes, the HSR Rules should be aimed at "eliminating unnecessary regulatory burdens on beneficial investment activity that does not harm competition and, indeed, often promotes it." *Id.* at 77091.

**1. VCs rarely seek to or actually acquire control of the companies they fund.**

Unlike private equity firms and other investment entities that are primarily focused on buyouts or otherwise acquiring operational control of the businesses in which they invest, the VC business model does not at all revolve around acquiring control.<sup>5</sup>

Rather, VCs focus on providing critical capital to early-stage growth companies through minority investments.<sup>6</sup> VCs leverage their expertise with high-risk, early-stage growth companies to provide valuable strategic direction, such as with respect to hiring, human resources, marketing, enterprise sales, and raising additional funds. While VCs frequently do continue to acquire shares in the companies they fund through multiple financing rounds, this is typically to demonstrate support for the company and provide needed capital, and virtually never is for the purpose of building up equity for the ultimate goal of acquiring the company.

VCs typically exit the investment once the business has advanced beyond its early growth phase, such as upon an acquisition, post-IPO, or—in many cases—at bankruptcy. NVCA estimates that most VCs exit their investments holding an approximate 15% - 25% stake in a company, and rarely hold a stake of 50% or more.

**2. VC investment through multiple investment vehicles is typically for competitively benign reasons.**

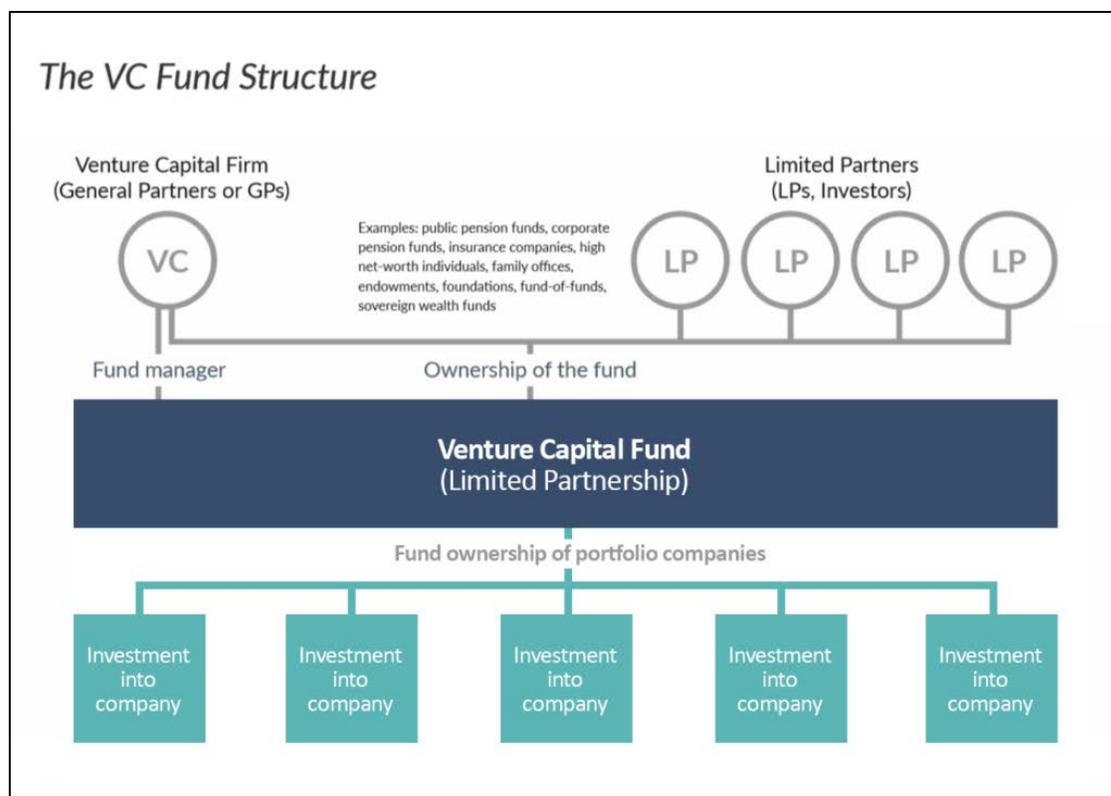
The FTC appears to be motivated to implement the proposed amendment in part based on the misperception that multiple funds in a fund family are essentially fungible because they share an investment manager. The reality is more complicated.

As reflected in the chart below, VCs form investment vehicles and fund them with investments from Limited Partners (“LPs”). In return for capital, these LPs acquire ownership percentages in the investment vehicles, based on the size of their investment. Examples of LPs include public pension funds, corporate pension funds, insurance companies, family offices, endowments, and foundations. In turn, these investment vehicles provide capital to portfolio companies, in exchange for what is almost always a minority ownership stake in the business:

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<sup>5</sup> In these comments we also distinguish traditional standalone VC firms—which are the focus of these comments—from investments by corporate venture capital (CVC) arms of operating companies. Unlike traditional VC firms, which virtually always only acquire minority stakes (i.e., common ownership), investments by corporate venture entities may raise different competitive considerations regarding cross-ownership. CVC arms still engage in minority investments in the same way as traditional VC firms, though the parent company of the CVC arm could conceivably go on to acquire the portfolio company of the CVC unit.

<sup>6</sup> National Venture Capital Association, “What is Venture Capital?,” *available at* <https://nvca.org/about-us/what-is-vc/>.



A VC will typically invest out of an investment vehicle or fund until it begins to run low on capital. At that point, the VC may create additional funds. The VC will once again seek to capitalize those new funds with new investment from various LPs and individuals.

Importantly, the new investors (i.e., LPs) in subsequent funds may overlap with the first fund, but this is not necessarily the case, and the ownership percentages in the new fund may be different from the first fund. Each “fund,” or portfolio, is a separate partnership. Further, the mandate provided by the owners of each fund to the VC firm may differ between funds, and the VC firm may owe different fiduciary duties to the owners of each fund. For example, some funds may be focused on investing at different stages of a company’s development. Other funds in the same family may have different industry mandates for their investments.

VCs also may create multiple funds that invest in the same companies, but which are made up of entirely different investors. For example, a VC firm may have a primary investment vehicle that makes relatively large investments, and which is funded by pension funds and other similar entities. The VC firm may also make smaller tag-along investments from a different investment vehicle, one funded by an entirely different set of LPs, such as individuals employed by or closely affiliated with the VC firm. Once again, the mandate provided by the owners of each fund to the VC firm may differ between funds, and the VC firm may owe different fiduciary duties to the owners of each fund.

<sup>7</sup> National Venture Capital Association, 2019 Yearbook at 8, available at <https://nvca.org/wp-content/uploads/2019/08/NVCA-2019-Yearbook.pdf>.

**3. There is no evidence common shareholding by VCs threatens competitive harm sufficient to justify this proposed amendment.**

Minority investments by VCs are inherently procompetitive because they enable new companies to develop innovative products that benefit consumers and disrupt the competitive landscape.<sup>8</sup>

One immediate impact of the proposed amendment would be to threaten those procompetitive benefits by vastly increasing the HSR compliance burden for VC firms, including because the proposed amendment would result in significantly more HSR filings by VC firms.

The FTC contends that, under the current rules, it does not receive sufficient information regarding the holdings by other funds within a VC firm or the complete economic stake being acquired. Yet, there is little reason to think that *minority* investments by VCs in multiple companies, even ones that may be competitive (i.e., common ownership, and not cross-ownership), carries any meaningful potential for substantive antitrust harm justifying increased HSR compliance burdens and an increase in the number of investments that require HSR filings. The evidence, in fact, is to the contrary: we are aware of no successful challenge by the Agencies to an acquisition by a VC fund of a *minority* holding in a company when it holds merely a *minority* stake in a competitor.

Indeed, in the analogous context of minority investments by institutional investors in competing companies—which, like investments by VC funds, typically do not involve acquiring operational control of companies—the United States has acknowledged that it has never “litigated a case involving common ownership by a single institutional investor.”<sup>9</sup> The sole example cited in this submission of enforcement by the Agencies in an analogous context is a case from 1976 when the “DOJ sued, but lost, a case against an individual under Section 7 for common ownership in Columbia Pictures and MGM Pictures.”<sup>10</sup>

The Notice correctly points out that such past enforcement history (or the lack thereof) is relevant to whether there is a justification for making changes that impact HSR reportability. In particular, the Notice justifies its proposed adoption of a new HSR exemption for certain acquisitions of 10% or less of an issuer (discussed further below) by citing evidence that between 2001 and 2017, the FTC received 1,804 HSR filing for acquisitions of 10% or less of outstanding stock, but did not challenge a single one.<sup>11</sup> For the same reason, i.e., the absence of any Agency enforcement actions

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<sup>8</sup> Notably, the legislative history of the Clayton Act “reflects an underlying policy of broad support for investment through stock purchases, when such purchases are not part of an effort to control or influence management of the firm,” as well as efforts to “minimize the impact of merger review on capital markets.” Hearing on Common Ownership by institutional investors and its impact on competition – Note by the United States, Directorate for Financial and Enterprise Affairs Competition Committee (Dec. 6, 2017), available at <https://www.justice.gov/atr/page/file/1312321/download> (citing S. Rep. No. 94-803 at 66 (May 6, 1976)) (hereinafter, Hearing on Common Ownership).

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> Notice, at 77055, n.1.

against multiple minority investments by VC funds, the proposed change to expand the information required and number of HSR filings by VC funds is unwarranted.

**4. Such a far-reaching HSR amendment should be made only where there is evidence to warrant potential competitive concerns – here there is none.**

The FTC may hypothesize that one reason for the absence of enforcement history is that it currently does not receive sufficient information about these types of investments in HSR filings. NVCA respectfully submits that this would not be a valid basis for the proposed rule change.

As Commissioner Phillips’ statement correctly observes, HSR “is not supposed to be a tax” or a “monitoring system for equity investments generally.” Rather, it should only “effectuate its purpose: helping the Agencies spot transactions *likely to violate the antitrust laws*, so that [the Agencies] can stop or remedy them prophylactically.”<sup>12</sup> Where, as here, there is no evidence that common ownership is “likely” to violate antitrust laws, there is no basis warranting amending the Rules to require additional filings.

Statements by the United States regarding antitrust policy as applied to common ownership by institutional investors are again instructive. Those materials indicate that “any antitrust enforcement or *policy effort* in this area should be pursued only if an inquiry reveals *compelling evidence of the anticompetitive effects of common ownership* by institutional investors in concentrated industries.” The submission goes on to provide: “Consistent with long-standing agency practice and legal precedent, any such enforcement by the U.S. antitrust agencies would address actual or predicted harm to competition from a particular transaction, would not be predicated on general relationships suggested by academic papers, and *would seek to avoid outcomes that would unnecessarily chill procompetitive investment.*”<sup>13</sup>

The proposed amendment to the definition of “person” is inconsistent with this sensible approach to addressing the evolving and often discordant schools of thought regarding the competitive impact of common ownership. The FTC’s proposed change would be a significant “policy effort” that could substantially chill procompetitive investments by VCs. However, there is no evidence—much less “compelling evidence”—that common ownership by VCs in competing entities carries potential harm to competition sufficient to justify such an impact.

If the FTC seeks to better understand the competitive impact of common ownership by VC funds, it has much less burdensome tools to do so. For one, the FTC has at its disposal decades of HSR filings. Where beneficial to the FTC’s proposed changes, it has provided analysis of these HSR filings (i.e., to justify the new proposed exemption for certain investments of less than 10%). The FTC should similarly assess and disclose what this evidence demonstrates regarding the competitive effects of common ownership, and only implement rule changes that increase the HSR burden where justified by such evidence.

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<sup>12</sup> Notice, at 77091 (emphasis added).

<sup>13</sup> See Hearing on Common Ownership, at 3 (emphasis added).

The FTC also has other tools available. For example, in 2018 the FTC held hearings specifically directed at the competitive impact of common ownership. Again, the FTC should disclose any conclusions it has drawn from those hearings, as well as the underlying data, prior to imposing substantial changes to the HSR rules to require additional information and HSR filings that would cause substantial harm to capital markets for entrepreneurial companies.

**5. The hypotheticals the FTC relies on are generally not relevant to common ownership by VCs.**

Many of the hypotheticals in the Notice are inapplicable to common ownership by VC funds (and other entities that may acquire minority shares in multiple entities) because the hypotheticals involve at least one fund in a fund family *controlling* a competitive entity (i.e., they apply the proposed amendment to scenarios involving cross-ownership).<sup>14</sup> In the context of VC funds, the amendments would almost entirely impact acquisition scenarios involving common ownership, i.e., *minority* investments in multiple entities.

Below we offer several hypotheticals to illustrate why the proposed amendment is not warranted in these scenarios:

VC Hypothetical #1:

- VC firm created VC Fund 1, and VC Fund 1 acquired 10% of early growth Company Y for \$45M, below the \$50M size of transaction threshold.<sup>15</sup>
- Once VC Fund 1 was no longer adequately capitalized, VC firm formed VC Fund 2. Some of the individuals and entities with ownership interests in VC Fund 1 and VC Fund 2 overlap, but not all, and the ownership allocation in VC Fund 2 differs from VC Fund 1. Each fund has the same Investment Manager but is its own ultimate parent entity.
- Neither VC Fund 1 nor VC Fund 2, nor any other entity in VC firm’s fund family, has any holdings in any entity that is a competitor to Company Y.
- VC Fund 2 proposes to acquire 2% of Company Y for \$10M.<sup>16</sup> Under the current HSR rules this would not be HSR reportable. Under the proposed new rules, the size of transaction would be \$55M (assuming VC Fund 1’s holdings have not appreciated), triggering HSR filings and the HSR waiting period.

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<sup>14</sup> See Notice, at 77055 (narrative describes a situation in which multiple funds within the same family acquire 100% interest in two competitors); Notice, at 77056-57 (hypothetical #1 presumes multiple funds controlling portfolio companies that are competitive).

<sup>15</sup> For purposes of these comments, NVCA refers to the \$50M threshold referenced in 15 U.S.C. § 18a(a)(2)(B).

<sup>16</sup> There are many reasons a VC fund would acquire such a small stake in a company. One common reason is where there is a different lead investor in a subsequent investment round and the VC fund is “filling out the round,” i.e., helping the company reach its anticipated raise.

There is no antitrust justification for changing the HSR rules to require HSR filings in this situation when they would not be required today. We are not aware of any Agency challenge to a minority 12% shareholding by a VC fund that does not have holdings in any other entities that are competitive (or even one that does). Further, a VC fund investing in this scenario (i.e., acquiring a 2% stake for \$10M) would almost certainly not receive enhanced board rights or representation, and there is no reason to think such a small increment (where total holdings remain well below the level that would confer control) could itself result in a substantial lessening of competition.

We note that the FTC's example in the Notice addressing this type of scenario is internally inconsistent. That example presumes that three funds in the same family each acquire 2% stakes in an issuer for less than \$50M, none of which is HSR reportable under the current rules, but which would be reportable if all these acquisitions were aggregated under the proposed rule change.<sup>17</sup> But elsewhere the Notice states that in nearly 2,000 HSR filings over nearly 20 years, the Agencies have never challenged acquisitions involving a stake of 10% or less.<sup>18</sup> Indeed, the FTC uses that fact to propose a new exemption for such acquisitions. Under the FTC's reasoning, there is no substantive antitrust reason to change the Rules to require HSR filings in this scenario.

#### VC Hypothetical #2:

- VC firm created VC Fund 1, and VC Fund 1 acquired a 10% stake of early growth Company Y for \$45M, below the \$50M size of transaction threshold.
- Once VC Fund 1 was no longer adequately capitalized, VC firm formed VC Fund 2. Some of the individuals and entities with ownership interests in VC Fund 1 and VC Fund 2 overlap, but not all, and the ownership allocation in VC Fund 2 differs from VC Fund 1. Each fund has the same Investment Manager but is its own ultimate parent entity.
- VC Fund 2 acquired a 5% stake of early growth Company Z for \$40M. Company Z and Company Y are early-stage life sciences companies seeking to develop products that, if approved, would target an orphan indication that currently is not served by an approved drug. Such holdings by funds within a VC firm in entities that may be competitors is relatively rare, as VCs predominantly invest in and support companies that they perceive will be the "winner." However, it can occur in some industries, such as life sciences, where the rate of success is very low and a VC firm may help to fund multiple shots on goal to increase the odds that any drug ultimately reaches patients.
- Company Y has largely depleted its cash through ongoing, capital intensive research and development efforts and requires additional funding to continue development of the orphan drug product. Company Y is now doing a follow on financing to fund upcoming clinical trials. Another VC fund is taking the lead on Company Y's latest financing and VC Fund 2 proposes to acquire a 2% stake Company Y for \$10M. Under 801.12, based on Company Y's board voting rights structure, the "pro rata" exemption does not apply.

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<sup>17</sup> Notice, at 77056.

<sup>18</sup> Notice, at 77055.

Under the current HSR rules this very small and competitively insignificant acquisition would not be HSR reportable. Under the proposed new rules, the size of transaction would be \$55M, triggering HSR filings, along with payment of the HSR filing fee, and the HSR waiting period.

There is no antitrust justification for changing the HSR rules to require HSR filings in this situation when they would not be required today. The only theoretical concern would be that the Agencies require HSR filings to examine any transaction in which a VC firm holds small minority holdings in competing entities through multiple funds. Yet we are not aware of any Agency challenge to common ownership by a VC firm of 10% in one company and 5% in a potential competitor, much less any strong evidentiary basis for increasing the HSR burden on VCs in this type of scenario.

**B. The proposed amendments would vastly increase the “HSR tax” on VCs, ultimately resulting in reduced investment in U.S. early stage growth companies.**

The Notice acknowledges that these amendments would increase the HSR burden on certain acquiring persons, although, as described below, erroneously downplays these impacts. In reality, the proposed amendments would impose significant harmful effects on VCs and, in turn, the companies they fund and competition overall, in several ways.

For one, the proposed amendments would delay access to critical capital from VCs to early-stage growth companies that often desperately need it as quickly as possible. Financings by VCs of early-stage growth companies typically move very quickly (so-called “venture speed”). NVCA estimates that 3-6 weeks is a normal window from execution of the term sheet to closing. This timeline often compresses over time—financings in later rounds and at higher valuations (i.e., the ones more likely to exceed the size of transaction threshold) can go from term sheet to closing in less than a week, and typically close in less than 3 weeks.<sup>19</sup>

In the context of early growth companies, financings are often critical inflection points and can be life-or-death events for the company that make the difference between making payroll or not. In these situations, the investment can (and needs to) come together in a matter of days. Delays of even a day or two can cause significant issues, and delays of several weeks can result in a business failing.

Even in less dire circumstances, delays can result in anticompetitive effects. Financings by VCs involve the company selling a piece of itself (equity in return for capital), and for obvious reasons company founders and early stage investors seek to retain as much ownership as possible. Thus, companies typically do not raise money just in case they need it in the future—they raise it because they need it imminently and often for a specific purpose (e.g., an R&D project). Given this dynamic, increased burdens on the ability for early stage growth to raise capital on a timely basis can challenge growth plans, such as new hiring, expanding into new product lines, research and development, launching clinical trials, etc.

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<sup>19</sup> This faster timeline is in part because the parties are already familiar with each other and there is alignment to infuse capital into the company.

The proposed amendments would negatively impact investment timelines by VCs:

- Even for transactions that would have required HSR filings under the current Rules, the proposed amendments would elongate investment timelines by requiring acquiring persons to compile the additional information from their associates on Items 4-8 of the HSR Form. The FTC's analysis under the Paperwork Reduction Act assumes this impact would be limited because acquiring persons already must look at the holdings of their associates under the current Rules, and thus calculates the impact would be only 10-15 hours of additional work.

The reality is more complicated, particularly as applied to minority holdings. Entities that already control portfolio companies have easier access to the information requested or can more easily require these companies to compile the relevant information and bear the costs of doing so. The same is not true with respect to minority investments, especially small minority investments, where getting companies to respond and bear the costs of compiling the information can be time-consuming and result in delays even beyond the already challenging impacts to deal timeline imposed by the existing Rules.

- By requiring acquiring persons to include their associates in the definition of "person," the proposed amendments would result in HSR filings that would not be required today. Parties to such investments would see their investment timelines delayed in at least three meaningful ways: (a) longer timelines to assess whether HSR filings are required due to the need to identify all associates and assess their holdings; (b) longer timelines to compile the additional information needed on Items 4-8 of the HSR form; and (c) observance of the HSR waiting period.

The FTC's analysis under the Paperwork Reduction Act downplays or ignores these timing impacts. In assessing burden, the analysis takes into account only (b), the need to compile additional information. It ignores the burden that would be imposed on the economy from the fact that additional companies would be making HSR filings that are not required to today, i.e., the substantial cost and delay from compiling and submitting an HSR filing and observing the HSR waiting period.<sup>20</sup>

As described above, many VC financings come together in a matter of weeks, or less, often because a company is in desperate need of capital for meeting payroll or recruiting new employees, for example. Forcing the parties to build in the potential for a 30-day waiting period, plus time to prepare HSR filings, can itself kill an investment and threaten the company's ongoing viability. NVCA notes that financing rounds typically close

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<sup>20</sup> This omission is striking given that the Notice discusses the reduced burden from fewer HSR filings in certain circumstances and calculates that impact, while ignoring the countervailing impact from increased HSR filings. The analysis also misleadingly suggests that acquired persons would only have lessened burdens as a result of the rule changes overall. In fact, the amendment would likewise increase the burden on acquired persons who would also need to file HSR under the proposed amendments, when they would not be required to today. Notice, at 77065.

simultaneously, so a delay due to an HSR filing by one of the investors in the round has the potential to delay closing of *the entire* round.

- In addition, even where HSR filings are not required under the proposed amendments, these changes would increase the complexity of assessing whether HSR filings are required, imposing further delay to undertake this analysis.

The proposed amendments would also impose substantial new compliance costs. Most obviously, any transaction that triggers HSR filings as a result of the new proposed rule, but which would not have triggered HSR under the current rules, would have to bear the new and increased costs of preparing HSR filings and paying the HSR filing fees (which range from \$45,000 to \$280,000). The FTC’s analysis does not take these significant impacts into account.

These higher costs would have a particularly detrimental impact on VCs, which tend to be lean operations as they earn far less in management fees than other investment funds. Like other private funds, VCs generally earn management fees (in the range of approximately 2%), but because VC funds are so much smaller than buyout or hedge funds, the management fees earned are far less, which means overhead costs must be kept low. For example, the assets under management (“AUM”) of the entire VC industry is roughly equivalent to the AUM of the two largest hedge funds in the U.S.<sup>21</sup>

NVCA members have already passed on investments because the added HSR cost is such a significant tax that the deal is not worth it. This typically is in the context of making smaller investments in later financing rounds, for example where a VC firm’s existing holdings have appreciated to above the threshold and the VC seeks to make a relatively small additional investment (e.g., a 1% stake for \$5 million, for total stake of 11%). Such an increment carries virtually no threat of competitive harm, but the impact on businesses from reduced investments due to even greater HSR compliance costs—particularly when viewed in the aggregate across the economy—would be substantial.

The proposed amendments also apply these enhanced HSR compliance burdens in an inequitable manner. As described above, many VCs invest through one investment vehicle until its capital is close to exhausted, and then form and invest out of a second investment vehicle (and so on). These vehicles may have some overlapping investors (LPs), but not necessarily, and even if so the ownership allocation frequently differs between funds.

Under the current rules, an investment vehicle that is its own UPE (and indirectly, its owners) is subject to the HSR compliance burden only if that vehicle itself triggers HSR. Under the proposed amendments, that vehicle could become subject to the full HSR compliance burden, including payment of the HSR filing fee, even though a part or even the majority of the holdings triggering

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<sup>21</sup> This burden is not something venture capital firms can easily absorb. This problem is particularly acute in venture funds that invest outside the major geographical areas for VC investment. For example, emerging ecosystems (e.g., Midwest; Southeastern U.S.) tend to have considerably smaller funds by assets under management, and therefore have less management fees and ability to absorb new compliance costs.

HSR are held by a different investment vehicle (which in turn would frequently be owned by a different slate of investors).

For example, assume Investment Vehicle 1 holds shares in Company A currently valued at \$499M. Investment Vehicle 1 is no longer capitalized (and does not maintain any funds to pay legal expenses). VC forms Investment Vehicle 2, and seeks to use that fund to acquire \$2M in a follow-on financing for Company A. Investment Vehicle 2 includes new LPs that were not owners of Investment Vehicle 1. Even though Investment Vehicle 2 will hold only \$2M in Company A, its owners would be forced to bear the full HSR filing fee (i.e., \$280,000, or 14% of its total investment), as well as the costs of preparing the HSR filing.

The overall impact of these further delays and higher HSR compliance costs is likely to result in reduced investment in early-stage growth companies in the U.S., in particular because jurisdictions outside the U.S. typically do not impose such burdens on minority investors. The net effect would make U.S. startups less attractive to venture investors and diminish the competitiveness of those entities relative to startups outside the U.S.

This impact is not just hypothetical: the share of global VC investment held by U.S. startups has decreased from over 90% a few decades ago to just over 50% in the last few years.<sup>22</sup> Given the burgeoning startup activity in countries such as Canada, Israel, China, and India, and as entrepreneurship increasingly becomes a global game, increasing the burdens on making investments in U.S. companies would both push capital to other jurisdictions as well as limit the interest of foreign investors in investing in U.S. companies.

An analogous context is in healthcare innovation. For over three decades VCs have spurred the creation and growth of revolutionary medical innovations and groundbreaking treatments by small, venture-backed companies. Indeed, venture capital backed 42% of all FDA-approved drugs from 2009-2018.<sup>23</sup>

More recently, however, VC investment in medical devices has come under pressure due to the escalating time, cost, and uncertainty of new product development, combined with increasing coverage and reimbursement challenges. The result of these challenges has been a tremendous decline in investment and promising startups unable to raise the capital needed to grow and prosper. As one illustration: \$3.55 billion was invested in medical device companies in 2009, which accounted for 13% of all venture deals that year. Ten years later, in 2019, \$7.22 billion was invested in medical device companies but only accounted for 5.45% of all venture deals that year. Many VCs cite misguided reimbursement policy as challenging the economics of medical device investing.

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<sup>22</sup> See Scott Kuper, Written Testimony before the U.S. Senate Committee on Banking, Housing, & Urban Affairs “CFIUS Reform: Examining the Essential Elements” (Jan. 18, 2018), available at <https://nvca.org/wp-content/uploads/2019/07/Scott-Kuper-written-testimony-Senate-Banking-Committee-CFIUS-hearing.pdf>.

<sup>23</sup> See Healthcare Innovation, NVCA, available at <https://nvca.org/healthcare-innovation/>.

Increasing the HSR burden risks similar impact, as the increased challenges and costs may result in a decline in investment across the U.S. economy in favor of other jurisdictions that do not impose such a burden.

### **C. There are many less restrictive alternatives available.**

The Notice offers two competition rationales to justify the proposed amendment:

- Rationale #1: The Notice contends that filings from certain investment entities do not “capture the complete competitive impact of a transaction.” The Notice acknowledges that the HSR rules already require acquiring persons to include certain information about their associates. However, the Notice argues this information is “too limited.”<sup>24</sup>
- Rationale #2: The Notice contends that in some circumstances it does not receive relevant HSR filings because multiple funds in the same family make investments that on their own do not trigger HSR filings, but the investments in the aggregate would.<sup>25</sup>

As described above, NVCA strongly believes that neither of these rationales applies to VC funds, as underscored by the evidence of actual HSR enforcement from the past forty years. However, if the FTC insists on imposing some form of an amendment to the Rules, NVCA respectfully submits that there are other ways to address these concerns that would result in much less burden and competitive harm.

#### **1. Directly require additional information from associates.**

The FTC’s proposed amendment—a sea change to the longstanding and well understood definition of “person”—is clearly not necessary to address Rationale #1. If the FTC believes it needs additional information from a fund’s associates (which as we explain above it does not, at least from VC funds), it could simply require acquiring persons to include that information in addition to the information it already requires from associates, or request the information during the initial waiting period, which it is entitled to do under the HSR investigatory rules and regulations.

#### **2. Exempt acquisitions where aggregate holdings do not confer control in any relevant company.**

These comments distinguish between common ownership and cross-ownership, demonstrating that there is no evidence of successful enforcement by the Agencies regarding a VC firm acquiring minority interests in multiple companies. The absence of any enforcement activity is relevant to whether HSR amendments are warranted; indeed, the Notice itself uses such reasoning to justify adding the new proposed 802.15 exemption.

Accordingly, if the FTC insists on aggregating holdings by multiple funds within the same family, it should require HSR filings only when a VC firm’s aggregate holdings, including the new proposed acquisition, (a) would *confer control* in one company and (b) involve investments in a

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<sup>24</sup> Notice, at 77055-56.

<sup>25</sup> Notice, at 77056.

competitor. This revision would result in the Agencies receiving filings for transactions that may (but frequently do not) have some potential antitrust risk, while not receiving filings for transactions where there is no precedent for thinking there is any substantive antitrust risk.

### **3. Reduce HSR filing fees for acquisitions involving common ownership.**

As discussed above, one way the proposed amendments impose burden and harm competition is because of the higher compliance costs, including the HSR filing fee. However, we are aware of no enforcement action involving common ownership by VC funds, and indeed the vast majority of these investments sail through the HSR review process with minimal investigation and burden on FTC or DOJ staff.

Accordingly, if the FTC insists on increasing the number of HSR filings it receives, it should reduce the filing fees for transactions that carry virtually no risk of competitive harm and require minimal resources to assess, such as minority acquisitions by VC funds that do not hold a controlling stake in any other actual or potential competitor.

### **4. Allow for post-closing filings for acquisitions involving common ownership.**

Another way the proposed amendments impose burden and harm competition is the delay imposed by the mandatory HSR waiting period. If the FTC insists on increasing the number of HSR filings it receives, it should reduce the burden imposed by delay by allowing for post-closing filings of transactions involving minority acquisitions by VC funds that do not hold a controlling stake in any other actual or potential competitor.

The primary concern with post-closing filings in mergers is that it can be difficult and burdensome to “unscramble the eggs” post-closing once operations have merged. Minority investments, however, do not involve integration of assets and thus do not give rise to the same level of concern.

## **III. The Proposed Addition of § 802.15 as a new De Minimis Exemption is a Step in the Right Direction, but Remains Overly Restrictive**

The Notice proposes adopting an additional de minimis exemption to exempt acquisitions of voting securities if an acquiring person will hold 10% or less of the issuer’s total voting stock and five other conditions are satisfied. NVCA supports the expansion of the de minimis exemption concept and agrees with the Agencies’ aspiration to “use their resources as effectively as possible.”<sup>26</sup> However, the proposed de minimis exemption, as drafted, is unnecessarily restrictive and, as a result, is likely of limited practical applicability given that the mandatory conditions virtually swallow the proposed exemption.

The Notice itself recognizes that “eliminating the application of the notification and waiting requirements to a significant number of transactions that are unlikely to violate the antitrust laws . . . allow[s] the enforcement agencies to focus their resources more effectively on those transactions that present the potential for competitive harm.” As explained below, NVCA urges

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<sup>26</sup> Notice, at 77058.

the FTC to reconsider the proposed restrictions and limitations on the availability of the proposed exemption insofar as they are not aimed at likely to achieve the Agency’s stated goal.

**A. The proposed definition of “Competitor” is overbroad and misuses NAICS codes as a proxy to gauge competition.**

The 802.15 exemption would not be available to any acquiring person that is “a competitor of the issuer (or any entity within the issuer).”<sup>27</sup> The Notice envisions defining competitor broadly to mean “any person that (1) reports revenues in the same six-digit NAICS Industry Group as the issuer, or (2) competes in any line of commerce with the issuer.”<sup>28</sup>

Using NAICS codes as a proxy for competition would not effectuate the FTC’s stated goal for adopting this new exemption. While the NAICS codes allow the Agencies to identify whether an acquiring and acquired person “overlap” in the same industry, that is not the same as concluding that there is in fact a *competitive* overlap between the filing parties. Indeed, the NAICS system was not created to “reveal any indicia of competition.”<sup>29</sup> Instead, “[i]ts purposes are: (1) to facilitate the collection, tabulation, presentation, and analysis of data relating to establishments, and (2) to promote uniformity and comparability in the presentation and analysis of statistical data describing the North American economy.”<sup>30</sup>

NAICS codes are not a reliable proxy for assessing competition for purposes of this exemption. For one, they over-inclusive. Assume Acquiring Person A holds 5% of the voting securities in Company X, which presently develops software to aid individuals in understanding their own data through visual analytics. Acquiring Person A is considering a 5% investment in Company Y, which presently develops software for digital financial solutions. Company X and Y in no way compete, but would likely both report revenues in NAICS code 511210 (Software Publishers). Thus, Acquiring Person A would be required to make an HSR filing notwithstanding the absence of any competitive overlap.

NAICS codes may also be under-inclusive. Entities that report revenues in one or more NAICS codes do so based on a good faith, but subjective, determination. Given that there are thousands of NAICS codes, and several codes may be applicable to describe an entity’s particular business, entities that do compete may—and often do—categorize revenues in non-overlapping six-digit NAICS codes. There are also different wholesales codes for companies that use contract manufacturers and manufacturing codes for companies that manufacture their products in house, which could lead to companies that would compete downstream not being identified as competitors via NAICS codes.

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<sup>27</sup> Notice, at 77061.

<sup>28</sup> *Id.*

<sup>29</sup> Notice, at 77062.

<sup>30</sup> NAICS Update Process Fact Sheet, available at [https://www.census.gov/eos/www/naics/reference\\_files\\_tools/NAICS\\_Update\\_Process\\_Fact\\_Sheet.pdf](https://www.census.gov/eos/www/naics/reference_files_tools/NAICS_Update_Process_Fact_Sheet.pdf).

Using NAICS codes as a proxy for competition is also unnecessary. The second prong of the proposed definition of “competitor” would require parties to “conduct a good faith assessment to determine whether any part of the acquiring person competes with or holds interests in entities that compete with the issuer, in any line of commerce.”<sup>31</sup> Though this approach would create ambiguity and impose a substantial burden on acquiring persons, particularly funds with minority holdings in entities across industries that may not be fully aware of current or future plans of its these entities, this test is a vastly more accurate proxy for potential overlap.

If the FTC insists on including any restriction on the de minimis test, it should define competitor solely based on the second prong. The Agencies have a strong deterrence mechanism to ensure funds do not abuse this exemption. VCs are keenly aware of the civil penalties for violating the Act, which were just increased to \$43,792 per day, and take compliance with the HSR Act seriously.<sup>32</sup>

Underscoring the reasons why using NAICS codes is not a reliable proxy for evaluating competitors, in fact, the Committee on Foreign Investment in the United States (CFIUS) has made a determination to no longer use NAICS codes when determining whether a mandatory filing is required. CFIUS took this action after usage of NAICS codes proved ineffective because the categories are not clearly defined and many businesses are not clearly in one category or another.<sup>33</sup>

**B. The requirement that the acquiring person not hold voting securities in excess of 1% of another competitor is over restrictive and unsupported by the Notice.**

In order for an acquiring person to rely on the proposed de minimis exemption, the acquiring person must “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).”<sup>34</sup>

The asserted rationale in the Notice for this condition is that the common ownership debate—whether a single entity holding small percentages of voting securities in competitors impacts markets and competition—remains unsettled. Yet, the Notice does not justify the selecting of a 1% threshold in any material way.

The 1% threshold is arbitrary and vastly over restrictive. VCs in particular often invest in startups that may be focused on the same industry. As described above, for example, a VC may invest in multiple companies trying to develop a vaccine, therapeutic, or some other life-saving treatment.

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<sup>31</sup> Notice, at 77061-77062.

<sup>32</sup> FTC Publishes Inflation-Adjusted Civil Penalty Amounts for 2021, FTC (Jan. 11, 2021), available at <https://www.ftc.gov/news-events/press-releases/2021/01/ftc-publishes-inflation-adjusted-civil-penalty-amounts-2021>.

<sup>33</sup> See <https://www.federalregister.gov/documents/2020/09/15/2020-18454/provisions-pertaining-to-certain-investments-in-the-united-states-by-foreign-persons>; <https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-pilot-program>.

<sup>34</sup> Notice, at 77061 (emphasis added).

In other situations, VCs develop investment expertise in a particular area (e.g., cybersecurity or biotechnology) and spend the entirety of their investment career in that discipline. These VCs do not invest in marketplace competitors but given this specialization, investments may be made in companies that resemble each other from the FTC’s perspective and may, therefore, be deemed competitive. Having a threshold as small as 1% severely limits the applicability of the exemption and is not warranted given that the FTC’s examination of over 1,800 10%-or-less filings over a sixteen-year period revealed that not one of those transactions resulted in enforcement action.

Rather than adopting a 1% threshold, NVCA encourages the FTC to continue assessing the common ownership debate and assess what percentage of common ownership, if any, raises a competitive concern.<sup>35</sup> Indeed, the FTC has “place[d] a high priority on determining the merits” of the position that common ownership can have anticompetitive consequences,<sup>36</sup> and should apply those learnings to inform these proposed rules.

**C. The director/officer carve outs should be removed.**

Parts (b)(iii) and (b)(iv) of the proposed de minimis exemption preclude an acquiring person from relying on the exemption if an individual acting on behalf of the acquiring person is a director or officer of the issuer or a director or officer of a competitor of the issuer.

In endorsing the Notice, the DOJ questioned whether the director/officer carve-outs should be excluded. This question makes a lot of sense given that acquisitions by directors and officers almost never result in competitive harm insofar as that individual was already an active participant in the company before the investment.

**D. The vendor/vendee carve-out should be removed because it does not meaningfully increase the likelihood of the Agencies receiving filings that have the potential to raise competition concerns.**

To rely on the proposed de minimis exemption the acquiring person must not have a vendor-vendee relationship with 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.

The DOJ questioned whether the vendor/vendee carve-out should be removed, and the NVCA supports removing it. The Notice does not provide any support for how a vendor/vendee relationship between an acquiring person and an issuer of less than 10% could impact competition. Further, in 2001, the HSR instructions were amended to remove the requirement that reporting parties identify in Item 8 of the HSR Form if a vendor-vendee relationship existed. In removing the requirement, the Agencies acknowledged the burden the old Item 8 placed on vendees,

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<sup>35</sup> Alternatively, if the FTC has evidence regarding the competitive effects of common ownership, NVCA encourages the FTC to cite such evidence.

<sup>36</sup> Bilal Sayed, Prepared Remarks of Bilal Sayyed, Director, Office of Policy Planning, FTC (Sept. 10, 2019), available at [https://www.ftc.gov/system/files/documents/public\\_statements/1544096/sayyad\\_-\\_georgetown\\_university\\_law\\_center\\_remarks\\_9-10-19\\_0.pdf](https://www.ftc.gov/system/files/documents/public_statements/1544096/sayyad_-_georgetown_university_law_center_remarks_9-10-19_0.pdf).

“particularly large diversified persons.”<sup>37</sup> The vendor/vendee condition reintroduces a burden that the Agencies intentionally removed 20 years ago.

NVCA acknowledges the recent focus and priority the Agencies have placed on vertical transactions, particularly in the merger context. Indeed, NVCA commends the Agencies on the joint issuance of the Vertical Merger Guidelines to provide “transparency of the analytical process underlying the Agencies’ enforcement decisions.”<sup>38</sup> Yet, nothing in these guidelines supports the Notice’s implicit position that acquisitions by acquiring persons of 10% or less where there is a vendor/vendee relationship with the issuer meaningfully increases the likelihood of the Agencies receiving filings that have the potential to raise competition concerns.

#### **IV. Acquisition of a Board Observer Seat is Not Inconsistent with Holding Securities “Solely for the Purpose of Investment”**

While not a focus of the Notice, NVCA wanted to take this opportunity to address a request for comment in the FTC’s ANPR. In the ANPR, the FTC questions the role of a board observer seat and how it should influence availability of exemptions under the HSR Act. The ANPR explains that “it is becoming increasingly common for issuers and NCEs [non-corporate entities] to include board observers as part of their governance structure,” and “even though board observers lack the ability to vote on matters that come before the issuer’s board, they may nevertheless have significant influence over the outcome of matters submitted to the board for approval.”

While NVCA agrees that under certain instances a board observer could have significant influence on matters before the issuer’s board, those instances are the exception to the rule. Because of this, NVCA believes that the current position of the FTC, which requires the investor to evaluate its intended role, if any, within the company is the appropriate policy.

##### **A. “Board Observer” Is Not Synonymous with Director.**

The Statement of Basis and Purpose of the HSR Act (“SBP”) makes clear that, assuming all HSR thresholds have been met, getting a board seat can result in an acquisition becoming reportable.<sup>39</sup> This is because the investor cannot rely on Section 802.9, which exempts certain acquisitions made “solely for the purpose of investment,” so long as the investor will hold 10% or less of the voting securities of an issuer following the transaction. Acquisitions are “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

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<sup>37</sup> Premerger Notification; Reporting and Waiting Period Requirements, 66 Fed. Reg. 8680 (Feb. 2001), available at <https://www.govinfo.gov/content/pkg/FR-2001-02-01/pdf/01-2605.pdf>.

<sup>38</sup> See U.S. Dep’t of Justice & Fed. Trade Comm’n, Vertical Merger Guidelines (2020), available at <https://www.justice.gov/atr/page/file/1290686/download>.

<sup>39</sup> Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33450, 33465 (July 1978), available at [https://www.ftc.gov/sites/default/files/documents/hsr\\_statements/43-fr-33450/780731fr43fr33450.pdf](https://www.ftc.gov/sites/default/files/documents/hsr_statements/43-fr-33450/780731fr43fr33450.pdf) (hereinafter, Statement of Basis and Purpose).

issuer.”<sup>40</sup> Board directors’ activities include helping management develop corporate strategy, analyzing strategic options, appointing the CEO and other officers, determining compensation, and a myriad of other activities that govern a company. Because of these obligations, the SBP has determined that having a director is inconsistent with holding securities “solely for the purpose of investment.”

Holding a director position is only one type of conduct listed in the SBP that *per se* indicates that the acquirer intends to participate in the management of the issuer. While holding a board observer position is not specified, the SBP is also clear that the list provided is not all-inclusive.<sup>41</sup> Prior informal interpretations have addressed the availability of Section 802.9 when the investor obtains a board observer. In Informal Interpretation 1203011, the writer noted that “the request for a board observer seat is similar to a request for information from management, and should be treated in the same manner,” and the PNO confirmed having a board observer was not inconsistent with holding an investment “solely for the purpose of investment.”<sup>42</sup> The PNO subsequently updated the response to this specific informal interpretation, indicating that “802.9 may not be available to board observers, depending on the level of involvement with the Board that the role entails.”

The PNO is correct that the availability of Rule 802.9 for investors that have or will receive a board observer should depend on the “level of involvement with the Board.” Board observers are not directors.<sup>43</sup> Most obviously, they do not have the right to vote, which is the primary means by which directors exercise their management functions.<sup>44</sup> Likewise, board observers do not have a duty of loyalty to the company’s shareholders—their sole obligation is to the investor he or she represents. Board observers may sit silently and just take notes, or they may more actively participate in board discussions. And while it can depend on the terms of the board observer agreement, board observers are often excluded from meetings to preserve the company’s attorney client privilege, particularly when the board is discussing potential litigation or if there is a potential conflict of interest.

Board observer seats may be requested for many reasons. The seat may be requested so that an investor can more closely monitor its investment in the company. It can also be requested so that the investor can maintain or grow its relationship with the company’s management or board members. Companies may request that an investor act as a board observer in order to obtain input

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<sup>40</sup> 16 C.F.R. 801.1(i)(1).

<sup>41</sup> Statement of Basis and Purpose, at 33465.

<sup>42</sup> Informal Interpretation 1203011, FTC (Mar. 26, 2012), available at [ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1203011](https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1203011).

<sup>43</sup> *Obasi Investment Ltd. et al v. Tibet Pharmaceuticals, Inc.*, 931 F.3d 179, 183 (3d Cir. 2019).

<sup>44</sup> Daniel E. Wolf, Rights and Obligations of Board Observers, Harvard Law School Forum on Corporate Governance, available at <https://corpgov.law.harvard.edu/2019/08/29/rights-and-obligations-of-board-observers/>; see also Stan Doida, What are Board Observer Rights and How Should They be Structured?, available at <https://www.doidalaw.com/what-are-board-observer-rights-and-how-should-they-be-structured/#:~:text=Board%20observer%20rights%20often%20give,members%20of%20the%20board%20have>.

from an investor not otherwise willing to assume the responsibilities and potential liabilities associated with being a director. In that regard, the board observer acts more as a consultant to the board, “offering structural and operational insights – all with the intent of making the Board more efficient and effective.”<sup>45</sup> None of these reasons are inconsistent with the investor holding its shares “solely for the purpose of investment.”

## **B. FTC’s Concerns Can be Addressed Through Other Mechanism**

In the ANPR, the FTC indicates that at a minimum, board observers may obtain insight into a company’s strategic decision-making, which could be useful to the investor represented by the board observer, and useful to competitors if the same board observers serve as officers or directors of a competitor. The FTC also noted that, by adding board observers, companies can receive “additional investor insight without having to alter the composition or voting balance on the board.”

It is the experience of NVCA members that many times investors without a board observer have information rights that are the same as those with a board observer– the only difference is that the board observer may actually attend the board meetings. While NVCA agrees that a board observer could receive insight into a company’s strategic decision-making process, and that companies can receive investor insight without altering the board, that does *not* mean a board observer will participate “in the formulation, determination, or direction of the basic business decisions of the issuer.” And these activities are not inconsistent with holding securities “solely for the purpose of investment.”

The FTC also expressed concern that a board observer’s insight into a company’s strategic decision making can help competitors “if the same board observers serve as officers or directors of a competitor.”

While that is always possible, it should be noted that board observers are subject to confidentiality agreements, and that while they have no fiduciary obligation to all the shareholders of an issuer, the board observer is subject to the investor which it represents. If an investor receives a board observer seat it is generally because it has invested substantial funds in a company, and its goal is to monitor that investment, not to jeopardize it by advantaging a competitor of the company.

If the concern is that by being a board observer then corporate venture capital (CVC) X is going to have a leg up on its competition in terms of acquiring the startup, then it’s important to note the following: the actual board of directors of the company has a fiduciary obligation to the company and its shareholders to obtain the best outcome possible. So even if CVC X gets wind of a possible acquisition opportunity, that does not mean the parent of CVC X has an advantage. In fact, the startup will shop itself around and consider all options in order to get the best price. Even setting aside the board’s fiduciary obligations, the board has an economic interest in getting the maximum

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<sup>45</sup> Mark A. Pfister, *The Board Architect* (July 25, 2018), reprinted and available at <https://www.linkedin.com/pulse/repackaging-board-observer-mark-a-pfister-the-board-architect-/>; *see also* Todd Hixon, *Get Value From Board Observers*, *Forbes* (Sep. 6, 2012), available at <https://www.forbes.com/sites/toddhixon/2012/09/06/get-value-from-board-observers/?sh=611686121531>.

price given that the board by its nature is almost always comprised of significant shareholders in the company.

While there could be certain instances in which a board observer has “significant influence over the outcome of matters submitted to the board for approval” that is not the reason why NVCA members obtain board observer seats. The primary goals of a board observer is typically to monitor the investment, and to provide insight to the company on topics in which the board observer may be knowledgeable. There is no “one size fits all” to describe the role and rights of a board observer. “Board observer” is not synonymous with a director, and there is a broad spectrum of potential roles for board observers. Because of this, NVCA believes that the current policy of requiring an investor to subjectively assess whether it intends to hold voting securities “solely for the purpose of investment” or if it intends to participate “in the formulation, determination, or direction of the basic business decisions of the issuer” is the most appropriate manner of addressing an investor’s acquisition of a board observer.

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Ultimately, NVCA believes it is important to understand that the U.S. venture capital industry is fuel for startups that challenge incumbents and benefit American consumers. New company formation is what has caused the U.S. economy to be the most dynamic in the world. It is critical that all policymakers enable investment in new technologies and companies so that the U.S. can retain its global leadership position.

NVCA appreciates the opportunity to provide these comments, and the FTC’s time and attention to consideration of our views, and looks forward to further engagement on this and other topics.