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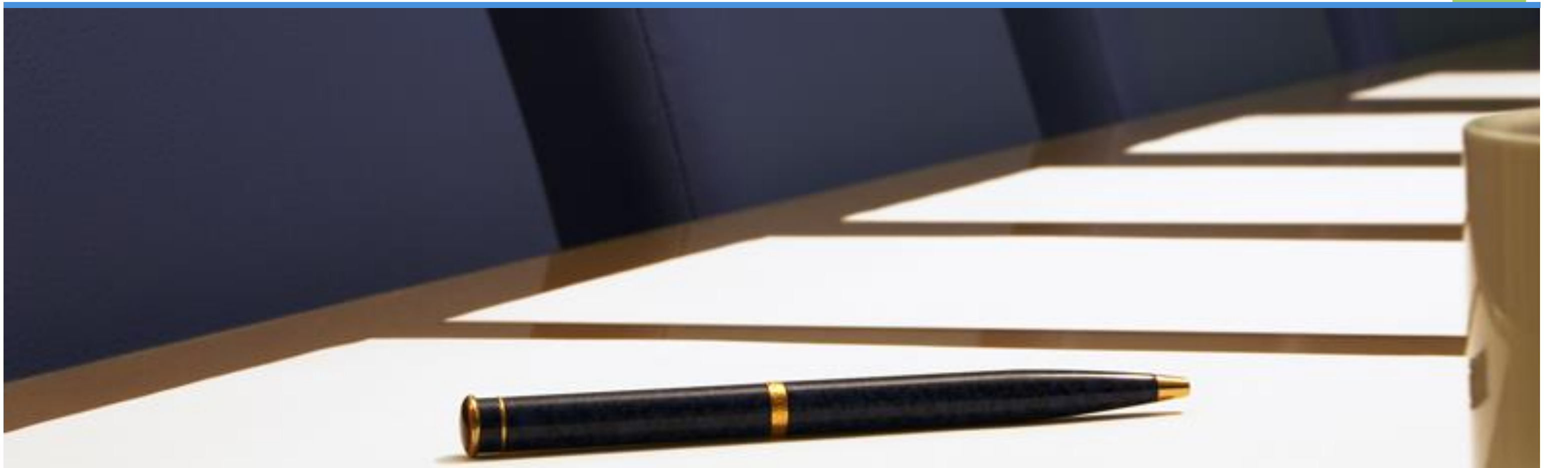

Global Antitrust Litigation & Competition Regulation | Alert

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Board Director Fined for Failure to File Under the HSR Act for Incremental Acquisitions of Stock of Multiple Issuers

On Oct. 28, 2016, the Federal Trade Commission (**FTC**) announced that an investment firm founder (the **Director**) agreed to pay $720,000 in civil penalties in a settlement with the agency to resolve its allegations that he violated the reporting and waiting period requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the **HSR Act**) by failing to report stock acquisitions from two issuers between 2001 and 2012.

The FTC alleged that the Director could not rely on the “investment-only” exemption from filing for certain incremental acquisitions of voting shares of an energy infrastructure company (the **Energy Company**) and an insurance holding company (the **Insurance Company**) because, at the time of each relevant transaction, he was serving as a member of the board of the company.

Background

The HSR Act requires parties – both individuals and companies – with investments that exceed certain jurisdictional thresholds to make filings with the FTC and the DOJ and to observe a waiting period of 30 calendar days before closing. The HSR Act and rules provide numerous exemptions from the reporting and waiting period requirements. One important exemption provides that an acquisition of up to 10 percent of the outstanding voting securities of an issuer is exempt, regardless of value, so long as the acquisition is made “solely for the purpose of investment,” meaning that the holder of voting stock “has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.” The question of intent is assessed at the time of each purchase of voting securities of the issuer.

Individuals who are not, or will not be, officers or directors of an issuer (or directors of a subsidiary) and who can make a good faith determination that they do not seek to influence the management of the issuer, may be considered passive investors. However, the FTC has consistently taken the position that the "investment-only" exemption is not applicable to officers of the issuer or to directors of the issuer or its subsidiaries.[1]

In the absence of an exception, the HSR Act requires an acquirer to make a filing before acquiring and holding an aggregate amount of voting securities of an issuer valued in excess of certain monetary thresholds. Prior to Feb. 1, 2001, the HSR Act's reporting and waiting period requirements applied to most transactions where the acquiring person would hold more than $15 million of the issuer's voting securities. As of Feb. 1, 2001, the HSR Act was amended to provide for a monetary threshold of $50 million. At the same time, the HSR Act was amended to require additional notifications for transactions in which the acquirer will hold voting securities in excess of $100 million, and for transactions in which the acquirer will hold voting securities in excess of $500 million. Since 2004, these thresholds have been adjusted annually.

The thresholds apply to a person's holdings of voting securities in the aggregate; in other words, a person who holds $99 million of voting securities and seeks to acquire an additional $2 million of voting stock would be crossing the $100 million threshold.

The Alleged Violations

The Director was an early investor in the Energy Company and, by August 1999, held shares valued at approximately $50 million. The initial acquisitions of these shares were exempt because he was not a board member and was otherwise a passive investor. However, according to the complaint, he became a member of the board in October 1999 and continued to serve as a director through 2014. On Jan. 23, 2001, the Director acquired 237,500 shares of the Energy Company on the open market without making any HSR Act notification and observing a post-filing waiting period. The aggregate value of voting securities he held in the Energy Company following that acquisition necessarily exceeded the then applicable $15 million size of transaction threshold. The FTC alleged that this January 2001 purchase resulted in the first HSR Act violation.

On July 16, 2006, the Director acquired an additional 1,600 shares of the Energy Company as compensation for serving on its board. Following this acquisition, the Director held voting securities valued in excess of $113.4 million, the "adjusted" $100 million threshold in effect at the time of that receipt of shares. The FTC alleged that this receipt of shares resulted in a second HSR Act violation, for failure to notify and observe a waiting period before acquiring voting shares at a time when his aggregate holdings exceeded the next monetary threshold.

Finally, on Oct. 25, 2012, the Director acquired 300,000 shares of the Energy Company on the open market, at a time when his aggregate holdings exceeded the "adjusted" $500 million threshold. Again, the FTC alleged that this purchase of shares prior to filing and observing a waiting period resulted in a third HSR Act violation.

The complaint states that, in November 2014, the Director made a separate corrective filing for each of the three notification thresholds exceeded as a result of the 2001, 2006, and 2012 acquisitions referenced above.

The Director was also an investor in an electronics and technology company that owned the predecessor company to the Insurance Company (the **Predecessor**). In 1990, the Predecessor was spun off from the electronics and technology company, and investors in that company, including the Director, received pro-rata shares of the Predecessor. According to the complaint, the Director joined the Predecessor's board shortly after the spinoff. According to the complaint, he acquired 10,000 shares of the Predecessor on the open market in May 2007 without filing a notification under the HSR Act and, at the time of that transaction, already held voting securities of the Predecessor. The aggregate value of his holdings in the Predecessor at that time exceeded the minimum "adjusted" $50 million threshold. The FTC alleged that this purchase of shares, completed without first filing and observing a waiting period, resulted in a fourth HSR Act violation.

[1] See *United States v. Barry Diller*, Civil Action No. 1:13-cv-01002 (D.D.C. July 3, 2013), https://www.ftc.gov/enforcement/cases-proceedings/121-0179/diller-barry-us.

As described in the FTC's complaint, the Director continued to acquire Predecessor voting securities through various transactions through September 2008, and at all relevant times served on the board of the company. He also made a corrective filing on Nov. 21, 2014 for the aforementioned acquisition of shares of the Predecessor.

The HSR Act provides that "any person, or any officer, director, or partner thereof" who fails to comply with any provision of the HSR Act is liable for a civil penalty of $40,000 for each day during which such person is in violation.[2] Because of the length of time during which the Director was alleged to have been in violation of the HSR Act (in one case spanning more than a decade), the maximum penalty could have technically totaled over $100 million.

Implications

This latest in a series of settlements with the antitrust agencies resulting in fines for failure to notify under the HSR Act as a result of improper reliance on the "investment-only" exemption is noteworthy not because of the fact that the defendant was a director or because he, in part, received shares as compensation for his services as a director. The FTC has not, in enforcing the HSR Act, distinguished between shares acquired in the open market or pursuant to executed agreements and those received as part of a compensation package.[3]

The case is remarkable because it (1) appears to represent the first time that an acquiring person has been fined for failure to file without any reference to a prior HSR violation, and where the acquirer has self-reported the alleged violation, and (2) imposes penalties for alleged violations of the HSR Act occurring as far back as 2001.

In previous settlements, the complaint has described the defendant's prior violations of the HSR Act. No such reference is made here. The FTC may have decided to pursue an action and impose a fine in this instance, without any documented prior violation, because of the number of successive transactions and monetary thresholds exceeded and the length of time during which the Director was alleged to have been in violation of the HSR Act. The Competitive Impact Statement accompanying the settlement states that the government sought a penalty of less than one percent of the maximum permitted because "the violations were inadvertent, the Defendant promptly self-reported the violations after discovery, and the Defendant is willing to resolve the matter by consent decree and avoid prolonged investigation and litigation." It remains to be seen whether the FTC may in the future seek penalties for more recent "first offenses" that are self-reported.

The case serves as an important reminder that the FTC continues to be vigilant in strictly enforcing the requirements of the HSR Act, without regard to competitive significance of individual transactions, and particularly with respect to officers and directors holding sizable amounts of their companies' voting stock. Individuals who serve as officers or directors of large companies, public or private, should consult with counsel to carefully track the value of their holdings to ensure that all transactions involving the receipt of stock of the company are completed only after any applicable requirements of the HSR Act have been satisfied.

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[2] The maximum civil penalty was increased effective Aug. 1, 2016 from $16,000 to $40,000 per day, and such daily maximum applies to violations occurring prior to August 2016.

[3] See *United States v. Brian L. Roberts*, Civil Action No. 111-cv-02240 (D.D.C. December 28, 2011).

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