

January 2017

Co-Founder Fined for Failure to File Under the HSR Act for Acquisitions of Company Stock Post-IPO

The Federal Trade Commission (**FTC**) announced, on Jan. 17, 2017, that a public company (the **Company**) and its co-founder (the **Co-Founder**) agreed to pay \$720,000 in civil penalties in a settlement with the agency to resolve its allegations that the Co-Founder 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 of the Company's after its initial public offering (**IPO**).

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.

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 exceeding a monetary threshold, if the parties meet certain jurisdictional tests related to the value of the parties' total assets and annual net sales, unless an exemption applies. The minimum monetary threshold was set at \$50 million in 2001. The HSR Act also requires additional notification if the acquirer intends to make an additional acquisition of voting securities of the same issuer, and the acquirer's aggregate holdings of that issuer following that acquisition would meet or exceed the next higher threshold of \$100 million, and further notification before the next higher threshold of \$500 million is met or exceeded. Beginning in 2004, these thresholds have been adjusted upward annually. Once an acquirer holds 50 percent or more of the voting securities of an issuer, subsequent acquisitions of voting securities of that issuer are exempt from HSR reporting.

The thresholds apply to a person's holdings of voting securities of an issue in the aggregate; in other words, a person who holds \$99 million of voting securities and seeks to acquire an additional \$1 million of voting stock would be completing a \$100 million transaction for HSR Act threshold purposes. Additionally, under HSR rules, the holdings of a person, their spouse, and their minor children are aggregated.

The Alleged Violation

The Co-Founder served as a director of the Company since its founding in 1995. Prior to the company's IPO in May 2008, he held approximately 57.9 percent of the voting securities of the Company. At that time, because he held over 50 percent of the Company's voting securities, any subsequent acquisitions by him of the Company's voting securities would be exempt from HSR reporting. However, in May 2008, the Company launched its IPO and, as a result, the Co-Founder's holdings of outstanding voting securities of the company decreased to approximately 20.8 percent.

Because the Co-Founder then held less than 50 percent of the Company's voting securities after the IPO, any subsequent acquisitions by him of the Company's stock would be subject to the HSR Act (assuming that his aggregate holdings following an acquisition would exceed a monetary threshold). According to the complaint, on Oct. 31, 2011, the Co-Founder's wife purchased voting securities of the Company on the open market and neither she nor the Co-Founder submitted any HSR filing or observed any waiting period prior to that purchase. Under HSR Rules, holdings of spouses are attributed to the individual. As a result, the Co-Founder was deemed to have made an acquisition of voting securities of the Company at a point in time in which he both (1) held less than 50 percent of the Company's stock and (2) his aggregate holdings exceeded the \$100 million reporting threshold (as adjusted to \$131.9 million in 2011), without making any HSR Act notification and observing a post-filing waiting period. The Co-Founder himself continued to acquire Company voting securities through 2015, though his holdings, including those of his spouse, did not reach the \$500 million (as adjusted) threshold.

The complaint states that in February 2016, the Co-Founder made a corrective filing for the 2011 acquisition by his wife. The complaint further alleges that beginning with his wife's purchase on Oct. 31, 2011, through March 28, 2016 (the date the waiting period expired on the corrective filing), the Co-Founder was in continuous violation of the HSR Act.

The complaint also alleges a separate violation of the HSR Act by the Co-Founder as a result of a January 2008 acquisition of stock of another public company, which resulted in his holdings of that issuer exceeding the \$500 million (as adjusted) threshold. A corrective filing was made for this transaction at the same time as the corrective filing for the Company acquisition.

Finally, the complaint references a prior HSR Act violation by an entity controlled at the time by the Co-Founder and his brother, originating from a transaction occurring in 1988, which was settled in 1991 for a fine of \$850,000.

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 \$40,654 for each day during which such person is in violation.¹ Because of the length of time during which the Co-Founder was alleged to have been in violation of the HSR Act, the maximum penalties could have technically totaled over \$60 million. In assessing the fine, the FTC noted the Co-Founder's "self-reporting of the violation and willingness to promptly settle this matter."

Implications

This case illustrates that a founder could hold 50 percent or more of his or her company, launch an IPO and fall below 50 percent ownership threshold, and then potentially violate the HSR Act by acquiring shares in the now-public company in the open market (including through one's spouse) at a point in time where aggregate holdings meet or

¹ 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. Further, as required by the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015, the \$40,000 per day penalty was increased to \$40,654 for 2017.

exceed a HSR threshold. While not a new interpretation of HSR rules, this is the first time a complaint and fine was issued for this type of violation. It is important to note, however, that the complaint here also referenced the defendant's prior (unrelated) violations of the HSR Act, following agency precedent to fine an individual for alleged HSR Act violations only after a prior offense by the individual or an entity that he or she controls.

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. Individuals, particularly founders, or officers or directors of large companies, public or private, should carefully track the value of their holdings (and those of spouses and family trusts) 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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