January 6, 2012

Hart-Scott-Rodino Enforcement: Executive Equity Awards Can Trigger HSR Filing Obligations

The Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act") requires parties intending to acquire voting securities, assets or certain non-corporate interests to notify the Federal Trade Commission ("FTC") and the Department of Justice, Antitrust Division ("DOJ"), and to observe certain waiting periods, if the HSR filing thresholds are met.[1] Acquisitions by corporate officers that meet HSR filing thresholds are not exempt from the HSR rules even if made as part of a routine executive compensation plan. This issue is illustrated by the recent settlement of an enforcement action filed by the DOJ at the request of the FTC.

Enforcement Activity

The FTC and DOJ have brought several enforcement actions over the years for inadvertent failures to file by executives of U.S. companies as a result of acquisitions of shares, option exercises and wrongful application of the investment purpose exemption (which allows purely passive investors to acquire no more than 10% of an issuer's voting shares). The most recent enforcement action was announced in December.

Last month, the Chief Executive Officer of a large public company agreed to pay a $500,000 civil penalty in connection with acquisitions of shares of his company between 2007 and 2009. While the CEO had previously filed a Notification and Report Form in connection with a prior acquisition of voting shares of his company, his five-year exemption to acquire additional shares up to the next reporting threshold expired in 2007. A Notification and Report Form should have been, but was not, submitted prior to vesting and settlement of certain restricted stock units and acquisitions of voting shares through reinvestment of dividends and short-term interest earned by his 401(k) plan. Approximately two years later, the inadvertent failure to file was discovered and a corrective filing submitted. However, the executive, as the company's controlling shareholder, had previously twice failed to submit HSR filings in connection with acquisitions by the company. While there were no penalties imposed for the two prior inadvertent violations, the executive's third failure to file resulted in the $500,000 civil penalty.

[1] Unless an exemption applies, Notification and Report Forms must be submitted by the parties if the value of a transaction exceeds $66 million and, for transactions valued at less than $263.8 million, one party has annual net sales or total assets of $131.9 million or more and the other party has annual net sales or total assets of $13.2 million or more. If transaction value exceeds $263.8 million, and no exemption is available, a filing is required even if the annual net sales/total assets test is not met. The applicable dollar thresholds are adjusted annually in February.

According to the FTC, it reduced the amount of the civil penalty to take account of various factors including that the violation was inadvertent and technical; that it was apparently due to faulty advice from outside counsel; that the executive did not gain financially from the violation; and that he reported the violation promptly after it was discovered.2

This settlement is a reminder for corporate executives and their advisors to consider whether an HSR filing will be triggered by acquisitions of company stock as part of compensation plans. While analyzing the reporting obligations of a company executive, the following considerations should be kept in mind:

Acquisitions of company shares by executives are not exempt from HSR Act reporting. Acquisitions by officers or directors of a company's voting shares are potentially reportable under the HSR Act if the value of shares to be held will exceed $66 million (or a higher HSR filing threshold).[3] Acquisitions made solely for the purpose of investment are exempt if the acquiror's resulting ownership does not exceed 10% and the acquirer does not intend to participate in the formulation, determination or direction of the company's basic business decisions. Under current FTC interpretations of the HSR Act and related rules, the exemption is not available to officers or directors of a company in connection with acquisitions of shares of their company.

Thus, HSR filing obligations may arise when an officer or director acquires voting shares from the company. This is true whether the shares are acquired directly, through vesting of restricted stock units pursuant to an executive compensation plan, by exercise of options or warrants, through routine acquisitions of company shares via reinvesting of dividends or interest earned in 401(k) accounts, or otherwise. The key principle is the acquisition of additional voting rights. A mere vesting of options (not exercised) or grant of restricted stock units, without the present right to vote the underlying shares, would not normally trigger a filing requirement.

Shares to be acquired are aggregated with current holdings. The value of a person's current holdings must generally be aggregated with the value of shares to be acquired to determine whether HSR thresholds will be exceeded. Current holdings must be counted at present value – significant appreciation of holdings could result in HSR obligations even if one were to acquire only a single voting share (e.g., if shares were acquired for $48 million but their value has appreciated to $70 million). As a result of the aggregation principles, an HSR filing obligation could be triggered by acquiring even a very small number of shares.[4]

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[2] For additional information see http://www.ftc.gov/os/caselist/1010034/index.shtm

[3] As of February 2011, the HSR filing thresholds are: (a) $66 million; (b) $131.9 million; (c) $659.5 million; (d) 50% of a company's voting shares if valued in excess of $66 million; or (e) 25% of a company's voting shares if valued in excess of $1,319 million. If one of the filing thresholds would be exceeded as a result of an acquisition, an HSR filing would be required unless an exemption applies.

[4] Note, however, that appreciation alone in excess of an HSR threshold itself would not trigger an HSR filing obligation – filing obligations are triggered only upon an "acquisition."

Once an HSR filing is submitted, acquisitions up to the next HSR Act filing threshold are exempt for five years. If an individual has submitted a Notification and Report Form and observed the waiting period for an applicable HSR threshold, and has crossed that threshold within one year of the expiration of the HSR waiting period, additional voting shares may be acquired for a period of up to five years as long as the next reporting threshold (as adjusted annually) is not exceeded. For example, if one filed for an acquisition of voting securities valued at $70 million, completed such an acquisition within one year of the filing, and the waiting period for the notification expired in January 2012, additional voting shares of the issuer could be acquired until January 2017 as long as the aggregate value would not exceed the next HSR reporting threshold of $131.9 million[5] or 50%.

Partnership or LLC interests – control required. Acquisitions of interests in non-corporate entities (i.e., partnerships and LLCs) need not be notified under the HSR Act unless one acquires control of the entity for HSR purposes, defined as the right to 50% or more of the entity's profits or 50% or more of the entity's assets on dissolution. If an executive is entitled to an interest in a non-corporate entity which holds voting shares of the executive's company, those underlying voting shares would not be deemed held by the executive (or aggregated with the executive's personal holdings) unless the executive controls the non-corporate entity. If the executive's interest in a non-corporate holding company increases, a potential HSR obligation would only arise if the increased interest would result in the executive acquiring control of the non-corporate holding company.

Violations. Violations of the HSR Act can result in civil penalties of up to $16,000 per day. Corrective filings should be submitted upon discovery of an inadvertent failure to file - penalties are generally not imposed by the FTC or DOJ for the first inadvertent violation.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Any questions concerning these changes or the premerger notification requirements of the HSR Act should be addressed to any of the following:

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5 $131.9 million is the current threshold. It is likely the applicable threshold will increase each year as a result of annual adjustments (although in 2010 the thresholds decreased). The acquiring person may take advantage of the adjusted figure.

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