

October 8, 2015

Recent Enforcement Actions Highlight Importance of Hart-Scott-Rodino Compliance When Acquiring Voting Securities

Three recent enforcement actions by the Federal Trade Commission (“FTC”), in cooperation with the Antitrust Division of the United States Department of Justice (“DOJ”), serve as reminders that certain acquisitions of voting securities must be carefully analyzed to determine whether they are subject to the filing and waiting period requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the “HSR Act”). Failure to comply with the HSR Act may result in substantial fines.

Background

The HSR Act and its implementing regulations (the “HSR Rules”) require, among other things, that parties to a transaction involving the acquisition of voting securities or assets file notifications with the FTC and DOJ and observe a waiting period if the acquisition meets certain thresholds and does not fall within an exemption.¹ Among transactions exempted from the reporting and waiting requirements of the HSR Act are “acquisitions, solely for the purpose of investment, of voting securities, if, as a result of such acquisition, the securities acquired or held do not exceed 10 per centum of the outstanding voting securities of the issuer.” 15 U.S.C. § 18a(c)(9). According to the HSR Rules, “[v]oting securities are held or acquired ‘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 issuer.” 16 C.F.R. § 801.1(i)(1). The agencies have taken a strict interpretation of the provision.

Further, so long as its aggregate holdings would not exceed 15 per cent of the outstanding voting securities of the issuer, an institutional investor (as defined in the HSR Rules) is, subject to certain exceptions, exempt from the notification and waiting period requirements of the HSR Act if it purchases voting securities directly, in the ordinary course of business and solely for the purpose of investment. 16 C.F.R. § 802.64. That exemption itself includes exceptions, including that: “[n]o acquisition of voting securities of an institutional investor of the same type as any entity included within the acquiring person shall be exempt under this section.” *Id.*

¹ For a list of the current reporting thresholds, see Paul, Weiss Client Memorandum, *FTC Announces New Hart-Scott-Rodino and Clayton Act Section 8 Thresholds* (Jan. 21, 2015) available at http://www.paulweiss.com/media/2770923/21-jan-15_alert.pdf.

Recent Enforcement Actions

In one recent enforcement action, the FTC settled with affiliated hedge funds that, according to the FTC's allegations, failed to report acquisitions of voting securities of Yahoo! Inc. that caused the value of the funds' voting securities in Yahoo! to exceed the reporting threshold.² The funds allegedly relied on the "solely for purpose of investment" exemption in deciding not to file an HSR notification. However, according to the government, the funds contacted potential candidates to become the CEO of Yahoo!, worked to put together a proposed slate of directors for Yahoo!, and discussed a possible proxy contest to replace Yahoo!'s board. These steps, according to the FTC, rendered the funds ineligible for the investment-only exemption, and they were required to file an HSR notification and observe the statutory waiting period. To settle the charges the funds agreed that they "are prohibited from relying on the investment-only exemption if they have contacted third parties to gauge their interest in joining the board of the target company, communicated with the target company about proposed candidates for its board, or engaged in other specified conduct in the four months prior to acquiring voting securities above the HSR Act threshold."³ The FTC did not in this instance seek civil fines, but indicated it would do so in appropriate cases.

In another recent action, a holding company agreed to pay a \$240,000 fine to settle allegations that it failed to file an HSR notification and observe the requisite waiting period when its ownership interest in one company was converted to voting shares of a new entity as a result of the original company's consolidation with the other.⁴ According to the government's allegations, the holding company believed that it was exempt from reporting because it was an institutional investor. The FTC, however, maintained that, while the holding company met the threshold criteria for the institutional-investor exemption, it nevertheless was required to report the transaction and observe the waiting period because the transaction fell within an exception to the exemption: the holding company was itself a broker-dealer and acquired the securities from another broker-dealer, thus rendering the exemption unavailable under HSR Rule 802.64(c)(1). The FTC's decision to seek a fine in this matter was predicated in part upon a previous HSR violation by the holding company in 2007.

Finally, and most recently, the government levied a \$656,000 fine on an investor who failed to report and observe the waiting period for an acquisition of voting securities in a technology start-up when that acquisition caused the aggregate value of the investor's shares to exceed the threshold triggering the

² See Debbie Feinstein, Ken Libby and Jennifer Lee, FTC Bureau of Competition, "Investment-only" Means Just That (Aug. 24, 2015) available at <https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just>

³ Press Release, FTC, Aug. 24, 2015.

⁴ Press Release, FTC, Sept. 22, 2015.

application of the HSR Act.⁵ The FTC's fine here too was predicated in part upon the investor's previous violation of the HSR Act and the failure of the investor to conduct an HSR analysis of the acquisition notwithstanding a commitment to the FTC to do so as a result of the previous violation.

Conclusion

These recent enforcement actions underscore the importance of seeking experienced HSR compliance advice. The HSR Act and its implementing regulations are quite technical and navigating the regulatory thicket can pose challenges even for the most experienced and sophisticated investors. Indeed, the government has demonstrated that it will aggressively enforce the HSR process, and will levy substantial fines in cases where it determines they are warranted.

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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. Questions concerning issues addressed in this memorandum should be directed to:

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⁵ Press Release, FTC, Oct. 6, 2015.