June 26, 2013

On June 19, 2013, the Department of Justice, at the request of the Federal Trade Commission, filed a civil antitrust action against the investment firm of MacAndrews & Forbes Holdings, Inc. ("MacAndrews & Forbes") for purchasing additional voting securities of Scientific Games Corporation ("SG") without first filing the required notification under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act") and observing the HSR waiting period before completing its acquisition. The DOJ simultaneously filed a proposed settlement that, if approved by the court, will settle the charges. Under the terms of the proposed settlement, MacAndrews & Forbes will pay a civil penalty of $720,000. In bringing this complaint and levying a significant fine the DOJ and FTC have sent a reminder to companies that failure to file under the HSR Act—especially for second offenses—can result in substantial penalties.

Notification required for acquisition outside five-year period

The HSR Act requires all persons contemplating acquisitions of voting securities or assets that meet or exceed specified size-of-transaction and size-of-person thresholds, and are not otherwise exempt, to first notify the agencies and observe a waiting period before completing the transaction. In accordance with certain HSR Rules and Regulations, the acquirer of voting securities may subsequently acquire additional voting shares of the same issuer during the five-year period following HSR clearance without submitting another filing *as long as* these additional acquisitions do not result in cumulative holdings that meet or exceed a higher notification threshold than the one under which it previously filed.[1] However, after the five-year period has run, this exemption no longer applies to subsequent acquisitions. Effectively, an acquisition of any additional shares of the same issuer can result in a HSR filing obligation if the value of its total holdings crosses *any* HSR threshold (even a smaller one), unless another exemption applies.

MacAndrews & Forbes initially purchased SG voting securities in February 2007. The company filed its HSR Act notification on February 1, and received early termination of the waiting period on February 9, 2007. Accordingly, MacAndrews & Forbes could acquire additional SG voting securities without filing another notification until February 9, 2012, so long as such acquisitions did not cross a higher threshold. On June 4 and 5, 2012, less than four months after the expiration of the five-year exemption period, MacAndrews & Forbes acquired additional SG voting shares. The acquisition resulted in their holding voting securities above the HSR Act's then applicable $68.2 million size-of-transaction threshold. Despite the fact that the transaction required a new HSR Act notification prior to acquiring any shares, the company failed to file one until August 16, 2012, following a review of its portfolio with HSR counsel. The company submitted its corrective HSR filing with a letter acknowledging that these June acquisitions were reportable, but explaining that their failure to file was inadvertent. Nonetheless, MacAndrews & Forbes was fined $720,000 for this HSR Act violation.

MacAndrews & Forbes' prior failure to file

It is significant that this violation was MacAndrews & Forbes *second* offense. The investment fund had previously failed to file a HSR Act notification in connection with an earlier transaction in which it acquired shares of a separate company, SIGA Technologies, Inc. ("SIGA"). Just as with SG, MacAndrews & Forbes already owned shares of the issuer—ones for which it had made a HSR notification in 2010. In January 2011, MacAndrews & Forbes acquired additional shares in SIGA. However, appreciation in the value of its existing SIGA holdings pushed the combined value of the shares it already owned and the newly-acquired shares past the threshold above the one for which the company had originally filed—and so past the HSR safe harbor. The company did not file a corrective notification until May 2011, when it also submitted a letter indicating its failure to file was inadvertent. The FTC did not impose penalties for this first violation.

Under the HSR Act, the maximum penalty for a failure to file is $16,000 per day until the violation is remedied by approval of the transaction. In determining whether to seek civil penalties and at what level, the FTC considers several factors: did the parties fail to file as a result of understandable or simple negligence; did they promptly correct their mistake; have they gained any benefit (e.g., tax, contract or regulatory) by failing to file; and have they now implemented adequate safeguards to protect against future failures. Frequently, most first-time offenders avoid a penalty for failing to file—just as MacAndrews & Forbes had for its first violation. Their second violation, however, resulted in a stiff $720,000 fine. Although this fine represents a discount from the maximum that the agencies could have sought, and may reflect MacAndrews & Forbes' prompt corrective measures, it sends a strong signal to other companies about the risks of even inadvertent failures to file.

Sizeable fines recently imposed for violations of HSR Premerger Notification requirements

The MacAndrews & Forbes matter represents a continuation of the antitrust agencies' assessment of substantial penalties for HSR premerger notification violations. In September 2012, the DOJ fined Biglari Holdings, Inc., a publicly traded holding company ("Biglari") $850,000 for violation of the HSR Act in connection with its June 2011 acquisition of shares of Cracker Barrel Old Country Store, Inc. ("Cracker Barrel"). Biglari claimed that it qualified for the so-called "passive investor" exemption under the HSR Act, and thus was not obligated to file notification prior to acquisition of shares. The "passive investor" exemption permits an investor to acquire voting securities to be held solely for the purpose of investment, regardless of the securities' value, so long as the acquirer will not cumulatively hold more than ten percent of the seller's issued voting securities as a result of the transaction. The DOJ alleged, however, that Biglari's actions following its acquisition demonstrated that the company had no intention of passively holding its Cracker Barrel investment. These actions included efforts of Biglari's Chairman and CEO to meet with Cracker Barrel representatives within a week after Biglari's acquisition to discuss "ideas to improve shareholder value," as well as requests that Biglari officers be appointed to the Cracker Barrel board of directors.

Substantial fines have also been imposed on investors who already owned voting securities of a company but whose subsequent acquisition of shares in the company resulted in them crossing a HSR threshold—just as MacAndrews & Forbes had in their first violation—or for acquiring shares in a reportable acquisition after the five-year exemption period on their prior filing had expired—as MacAndrews & Forbes did in its second offense. These prior enforcement actions include: $500,000 penalty imposed in 2011 on Comcast Corporation's Chief Executive Officer Brian Roberts (acquisition of shares through vesting of restricted stock units, resulting in total value above threshold); a combined $800,000 penalty imposed in 2008 on investment funds ESL Partners, L.P. and ZAM Holdings, L.P (acquisition outside five-year exemption period); $1.1 million penalty imposed in 2007 on investment firm ValueAct Capital Partners, L.P. (acquisition of shares in one entity combined with previously purchased shares in that entity resulting in total value above threshold; also acquired shares in two companies it was not previously invested in, but failed to file notifications for those acquisitions).

The MacAndrews & Forbes enforcement action highlights several key points. First, HSR clearance applies for only five years from the end of the waiting period, and an investor that continues to acquire shares in an issuer over a period of more than five years may need to make multiple HSR filings unless another exemption applies at the time of the subsequent acquisition. Second, each time an investor acquires voting securities of an issuer, the current market value of that investor's existing holdings must be factored into the determination of whether a HSR dollar notification threshold has been crossed. Finally, the civil penalties for unwitting HSR violations can often be mitigated by prompt corrective measures and cooperation with the agency, but second time offenders—no matter how they manage their failure to file—are likely to face substantial fines. n

NOTES

1. See, 16 C.F.R. Section 802.21.

Key Contacts

Howard Morse Washington, DC	hmorse@cooley.com +1 202 842 7852
Sharon Connaughton Washington, DC	sconnaughton@cooley.com +1 202 728 7007