

CLIENT ALERT

Continuing FTC Focus on Investment Funds for Failure to File Timely HSR Notifications

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The Federal Trade Commission (FTC) on September 25, 2012 announced a settlement with Biglari Holdings, Inc. (Biglari), an investment fund, for failure to file timely a notification under the Hart-Scott-Rodino (HSR) Act in connection of its purchases of equity in Cracker Barrel Old Country Store (Cracker Barrel), a restaurant chain and famed seller of rocking chairs based in Lebanon, TN. As part of the settlement, Biglari agreed to pay an \$850,000 fine.

While there is an "investment only" exemption from HSR filing requirements in the HSR Act for passive purchases of less than 10% of a target's voting securities, the FTC alleged that Biglari did not come within this exemption because it had intended to become actively involved in the management of Cracker Barrel.

Although Biglari disputed the FTC's allegations, the FTC's settlement and fine is only the latest in a string of FTC settlements and fines with investment funds and their managers for violations of HSR filing requirements. In 2007, for example, the FTC fined ValueAct and James Dondero \$1.1 million and \$250,000, respectively, for violations of HSR filing requirements. FTC Chairman Jon Leibowitz pointedly noted, "[t]he passive investment exemption is a narrow one, and we will not hesitate to seek civil penalties against companies that try to abuse it." The continuing FTC focus on HSR filing requirements highlights the need for investment funds, their managers and other equity purchasers to carefully consider both the timing of their equity acquisitions and up-to-the-minute evidence of their intent with respect to their equity when determining whether a filing is necessary under the HSR Act or whether the "investment only" exemption is available.

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The background, in a nutshell, is as follows:

At the FTC's request, the Department of Justice filed a complaint against Biglari alleging that Biglari had violated the HSR Act by failing to report purchases of Cracker Barrel voting securities during the summer of 2011. According to the government, Biglari made incremental purchases of Cracker Barrel equity beginning on May 24, 2011 and continuing daily through June 13, 2011. On June 8, 2011, the government alleged, the aggregate value of those equity interests exceeded \$66 million, the then-current HSR "size-of-transaction" threshold. Biglari filed a Form 13D with the SEC on June 13, 2011 but did not file an HSR notification until August 26, 2011. Early termination of the HSR waiting period was granted on September 22, 2011, ending regulatory inquiry into the transaction.

Biglari's purchases would not have triggered Biglari's obligation to file an HSR notification if it had intended to remain a passive investor in Cracker Barrel. The HSR Act provides that notification need not be made if an acquisition is "solely for the purpose of investment" and does not total more than 10 percent of a target's outstanding voting securities. 15 U.S.C. § 18a(c)(9). Under the HSR Rules, a party undertaking an "investment only" purchase of voting securities must have "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).

A week after Biglari's stake in Cracker Barrel crossed the reportability threshold, however, officers from Biglari, including the Chairman/CEO and Vice Chairman, are alleged to have contacted the CEO and CFO of Cracker Barrel seeking to influence just such "basic business decisions." In one call, the Chairman/CEO told Cracker Barrel's leadership that he had ideas about how to improve shareholder value; in another, both Biglari executives said they had ideas about how to drive customer traffic, and suggested they be named to Cracker Barrel's Board of Directors.

No one from Biglari was actually named to Cracker Barrel's Board of Directors, and there is no allegation that Biglari's operational suggestions were accepted by Cracker Barrel. However, the government alleged that Biglari's communications with Cracker Barrel indicate that it had intended to be more than a passive investor and that HSR notification was required as soon as the value of Biglari's shares of Cracker Barrel reached the \$66 million threshold. The DOJ alleged that Biglari was therefore in "continuous violation" of the HSR Act from June 8, 2011 through September 22 of that year (i.e., the date on which the government granted HSR approval).

Biglari agreed to resolve the government's complaint by paying a civil fine of \$850,000 – significantly more than the \$45,000 HSR filing fee Biglari would have paid had it filed the HSR notification on a timely basis on June 8, 2011. The \$850,000 fine represents roughly one half of the total potential fine of \$16,000 per day of violation, or approximately \$1.7 million.

The Biglari matter represents a continuation of the antitrust agencies' pursuit of substantial penalties for HSR violations. These enforcement actions include an unprecedented five month jail sentence imposed on a Korean executive in May for alterations to business documents filed with an HSR notification in Hyosung's abandoned bid to acquire Triton (a Hyosung affiliate paid a criminal fine of \$200,000). In the investment fund context, in 2007, the FTC fined ValueAct \$1.1 million for violations of HSR filing requirements. In the same year, the FTC fined James Dondero \$250,000 for violations of HSR filing requirements. In 2005, the FTC fined Scott Secane, a hedge fund manager \$350,000, for violations of HSR filing requirements.

The government's action against Biglari holds a number of lessons for investment funds, their managers, other organizations and individuals considering investment and other M&A activities:

- **HSR Compliance and a Transaction's Competitive Merits are Separate Issues.** Substantial fines are possible even in a deal like Biglari's, which garnered early termination because it raised no substantial competition issues.
- **Failure to Meet the Requirements of the Investment-Only Exception Does Not Require Actual Influence.** The government did not allege that Biglari was successful in directing Cracker Barrel's strategy, or in seating new members on Cracker Barrel's Board of Directors. Allegations of intent can be sufficient to undermine eligibility under the "investment only" exception and to prompt enforcement action by the agencies.
- **Conduct May Serve as Retrospective Evidence of Intent.** The government relied on Biglari's alleged contacts with Cracker Barrel as evidence of Biglari's intent to participate in basic business decisions as early as the point at which the transaction became reportable, nearly a week before the contacts were alleged to have taken place. When an acquisition is made that would be reportable but for application of the investment-only exception, investment funds, their managers and other acquirers should carefully consider their potential future strategies with respect to the targets and the voting securities acquired, since later conduct may be offered as evidence of the acquirer's intent as of the time of acquisition.

- **Compliance Should Be Assessed on an Ongoing Basis.** Where the parties' strategic goals shift over time, counsel should continuously assess whether its prior interpretations of reportability under the HSR Act and the implementing Rules continue to be supportable. These reassessments can prevent HSR violations or substantially reduce their duration (along with associated penalties).

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