

CLIENT ALERT

FTC Clarifies "Investment Only" Exception to HSR Reportability

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The Federal Trade Commission (FTC) on September 25 reminded purchasers of equity interests of the importance of ongoing assessment of reportability requirements under the Hart-Scott-Rodino Act. Specifically, equity purchasers should carefully consider both the timing of their equity acquisitions and up-to-the-minute evidence of their intent with respect to the shares when determining whether a filing is necessary under the "investment only" exemption contained in the HSR Act.

The FTC announced that, at its request, the Department of Justice (DOJ) had filed a complaint against Biglari Holdings, Inc., in relation to its purchases of equity in Cracker Barrel Old Country Store, a restaurant chain and famed seller of rocking chairs based in Lebanon, TN. The complaint alleges that Biglari 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 equity beginning on May 24, 2011 and continuing daily through June 13, 2011. On June 8, 2011, the government alleges, the aggregate value of those equity interests exceeded \$66 million, the then-current HSR "size-of-transaction" threshold.

But those 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. Ultimately, Biglari filed an HSR notification on August 26, 2011, and was granted early termination on September 22, 2011, ending regulatory inquiry into the acquisition.

However, the government alleges that Biglari's communications with Cracker Barrel indicate that it 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.

Biglari has agreed to resolve the government's complaint by paying a civil fine of \$850,000. This represents roughly one half of the total potential fine of \$16,000 per day of violation, or approximately \$1.7 million. The 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).

The government's action against Biglari holds a number of lessons for organizations and individuals considering M&A activity:

- **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 are 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, acquirers should carefully consider their potential future strategies with respect to 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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