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Premerger Notification Fundamentals for Investors

Presentation for The Regulatory Fundamentals Group

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Overview of U.S. Premerger Notification System

The HSR Act – Background

What is the HSR Act?

- HSR Act is simply a **Notice** Statute
 - Enacted in 1976 to Prevent “Midnight Mergers”
 - Not a “Substantive” Antitrust Statute
- Applies Only to Transactions and Parties Above Certain Dollar Thresholds
 - Applies equally to transactions presenting no conceivable antitrust concern
- Prohibits acquiror from “exercising beneficial ownership” prior to expiration of HSR waiting period

The HSR Act – Background (cont.)

Why Should I Care About the HSR Act?

- HSR filings are sometimes required in connection with even relatively minor acquisitions of voting securities
 - Acquiring a single share could trigger a filing (more on that later)

- Penalty for Failure to Comply with the HSR Act
 - Maximum civil penalty of \$16,000 for each day between date of violation and expiration of waiting period
 - No statute of limitations for violations of the HSR Act
 - Fines under the HSR Act are publicized heavily by FTC and can create significant embarrassment

The HSR Act – Background (cont.)

What “Notice” is Required Under the HSR Act?

➤ The HSR Form

- Separate Form for Each Party to the Transaction
- Basic Information about the Transaction
 - Essentially, who is buying what for how much?
- More Detailed Information about the Parties
 - Basic subsidiary, affiliate, and shareholder information
 - Information about other holdings
 - Financial statements and revenue data broken down by NAICS code
- Submission of Certain Deal-Related Documents
- Sworn Certification of Officer or Director

The HSR Act – Background (cont.)

Who Looks at the HSR Form?

- Both DOJ and FTC have jurisdiction to review transactions
 - “Clearance” meetings decide which agency will evaluate
 - “Turf wars” infrequent, but can happen

- Can the public see the form?
 - HSR Materials Exempt from FOIA
 - Even the Fact of Filing Remains Confidential
 - But see, early termination notices...

The HSR Act – Background (cont.)

How Long is this Going to Take?

- Budget Sufficient Time To Prepare Filing
 - Pulling together the information for your first filing may take a couple of weeks
 - Can file on an LOI, no need for final agreement

- Statutory Waiting Periods
 - 30-Day wait for transactions without issues
 - Shorter if request early termination (but see, publicity)
 - Potentially much, much longer for transactions with substantive antitrust issues

The HSR Act – Background (cont.)

How Much Will This Cost?

➤ Attorneys Fees

- Can vary significantly depending on the scope of the information to be gathered and processed

➤ Filing Fees – Based on Size of Transaction

- \$45,000 for transactions \$78.2 million - \$156.3 million
- \$125,000 for transactions \$156.3 million - \$781.5 million
- \$250,000 for transactions > \$781.5 million

The HSR Act – Background (cont.)

Do I Need to File?

Two Basic Reportability Tests (both must be satisfied):

1) Size of Transaction Test:

- Acquiror must hold **assets, voting securities, or unincorporated interests** > \$78.2 million in target as a result of the acquisition

2) Size of Person Test:

- One party must have sales or assets of \geq \$156.3 million and the other must have sales or assets \geq \$15.6 million
- Size of transaction test deemed satisfied for deals > \$312.6 million

The HSR Act – Background (cont.)

What types of acquisitions are covered?

➤ **Voting Securities**

- Convertible securities / debentures that do not give the present right to vote not reportable
- Non-voting securities not reportable

➤ **Assets**

- Several categories of assets may be exempt from filing obligations
- Assumptions of debt counted as consideration in asset deal

➤ **Non-Corporate Interests (e.g., LLP/LLC/LP)**

- Only if confer “control”

The HSR Act – Background (cont.)

So all acquisitions over \$78.2 million are reportable and transactions below that amount are not?

- Not quite... HSR is full of twists and unexpected pitfalls, to name only a few:
 - Investments in unincorporated entities (e.g., LLC's, LP's) only reportable if acquisition confers *control* (as defined by HSR)
 - Size-of-Transaction test may obviate filings for acquisitions by newly formed special-purpose entities
 - Acquisition of a single share may trigger a filing if the buyer already holds >\$78.2 million in the target's voting securities
 - Acquisitions of voting securities in an entity holding only exempt assets is not reportable

The HSR Act– Common Pitfalls

Pitfall #1 – The Creeping Acquisition

- Mere stock price appreciation cannot trigger a filing obligation
- However, acquiring a single share or exercising a single warrant after a stock's value has appreciated may trigger
- Likewise, acquisition of a single LLC membership share could trigger

Pitfall #2 – Receipt of Stock Consideration in a Merger

- Major individual holders of a seller's stock in a stock-for-stock transaction may have an HSR filing in connection with their receipt of the acquiring person's voting securities

The HSR Act– Common Pitfalls (cont.)

Pitfall #3 – Compensation-Triggered HSR Filing Obligations

- Individuals, like companies, may be obligated to make an HSR filing in the event they acquire (or receive as compensation) voting securities in excess of the size-of-transaction test
- One of the most common reasons for corrective filings

Pitfall #4 – Failing to Take into Account All Shares Held by the Ultimate Parent (e.g., controlled trusts, subsidiary holdings)

Pitfall #5 – Misapplication of the Investment-Only Exception

The HSR Act – The Investment-Only Exception

- Acquisitions by an Investor of more than \$78.2 million in Voting Securities by May Be Exempt from HSR Filing Requirements if...
 - The voting securities do not exceed 10 percent of the outstanding voting securities of the issuer

AND

- 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”

The HSR Act – The Investment-Only Exception (cont.)

- “Institutional Investors,” in certain circumstances, may purchase up to **15%** of the outstanding voting securities of an issuer **“solely for the purpose of investment”**

- Examples of “Institutional Investors” include:
 - Banks
 - Insurance Companies
 - Trust Companies
 - Investment Companies
 - Non-Profit Entities under Sections 501(c)1-4, 6-15, 17-20 or (d)

The HSR Act – The Investment-Only Exception (cont.)

- The antitrust authorities have long interpreted this exception to be a narrow one.

- In 2015, the DOJ sued three affiliated hedge funds and their New York-based management company for acquiring shares in Yahoo in 2011 in excess of the size-of-transaction threshold.
 - The antitrust agencies investigated the hedge funds and concluded, based on their behavior, that they had engaged in activities inconsistent with the investment-only exception and had thus violated the HSR Act.

The HSR Act – The Investment-Only Exception (cont.)

Activities Inconsistent with “Investment-Only Exception”

- Nominating a candidate for the issuer’s board of directors
 - Taking steps to assemble an alternate board of directors slate
 - Communicating with third parties to determine their interest in becoming an officer or director of the issuer
 - Making public statements regarding proposing a slate of directors;
- Soliciting proxies
- Internally deliberating the possible initiation of a proxy battle
- Proposing corporate action requiring shareholder approval

The HSR Act – What if I Already Missed a Filing?

Does this mean I'm on the hook for \$16,000/day if I'm just realizing that I neglected to make a required filing?

➤ Not necessarily

- FTC permits parties to make a corrective filing
- Corrective filing requires full disclosure of reasons for failing to file and protections put into place to ensure no future violations
- Separate filings and fees are required for every missed filing
- FTC usually decides not to impose a fine for the first violation if the failure to file was unintentional or based on a good faith misinterpretation of the rules (the “one bite at the apple” policy)

The HSR Act – What if I Already Missed a Filing? (cont.)

Illustrative HSR Violation Enforcement Actions

- *Leucadia National Corporation (2015)* – Paid \$240,000 fine for failing to report acquisition of shares received as consideration based on mistaken application of institutional investor exemption
- *Berkshire Hathaway (2014)* – Paid \$896,000 fine for failing to report the conversion of convertible notes into voting securities, despite having caught the failure shortly after the conversion
- *Barry Diller (2013)* – Paid \$480,000 fine for failure to report acquisition of Coca Cola shares. Though Diller's holdings were <10%, he was a board member and could not avail himself of the investment-only exemption.

Questions or Comments?

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