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Antitrust Alert

FTC Again Warns Investors Against "Abuse" of Investment-Only HSR Exemption

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On September 25, 2012, the Federal Trade Commission (FTC) announced the latest installment in a long line of cases involving the investment-only exemption to the premerger filing requirements established by the Hart-Scott-Rodino Premerger Notification Act of 1976, as amended ("HSR Act").[1] Biglari Holdings, Inc. agreed to pay $850,000 in civil penalties to settle allegations that it violated the HSR Act by failing to report its acquisition of approximately 8.7 percent of the outstanding voting securities of Cracker Barrel Old Country Store, Inc. The HSR Act exempts acquisitions of 10 percent or less of an issuer's voting securities, but only where the acquirer acts with passive investment intent. The complaint[2] accompanying the consent agreement alleged that this exemption did not apply because Biglari intended to actively participate in the management of Cracker Barrel by seeking seats on the company's board and meeting with Cracker Barrel's senior management to propose business changes.

Factual Background

According to the complaint, Biglari acquired Cracker Barrel voting securities on each day the stock market was open from May 24 through June 13, 2011.[3] As of June 8, 2011, Biglari's accumulated shares in Cracker Barrel exceeded $66 million—more than the minimum HSR filing threshold at the time.[4] On June 14 and 15, the chairman and CEO of Biglari Holdings contacted the CEO of Cracker Barrel to request a meeting to discuss "ideas to improve shareholder value."[5] On June 23, the meeting was held, and Mr. Biglari and the vice chairman of Biglari Holdings requested that they "immediately be appointed" to Cracker Barrel's board of directors.[6]

When the request for board seats was denied, Biglari Holdings initiated a proxy contest.[7] On August 26, 2011, Biglari submitted an HSR filing to the FTC and Department of Justice to acquire additional Cracker Barrel voting securities.[8] The FTC granted early termination of the waiting period on September 22, 2011.[9] While Biglari issued a press release (responding to the FTC's announcement of the settlement) stating that Biglari did not actually nominate directors for

[1] 15 U.S.C. § 18a.
[2] *Complaint, United States v. Biglari Holdings Holdings, Inc.*, No. 1:12-cv-01586 (D.D.C. Sept. 25, 2012) (*available at* [here] (hereinafter "Complaint"). The complaint was filed by the Department of Justice at the FTC's request.
[3] *Id*. at 4
[4] *Id*. The current minimum threshold is $68.2 million. Revised Jurisdictional Thresholds for Section 7A of the Clayton Act, 77 Fed. Reg. 4323 (Jan. 27, 2012).
[5] Complaint at 5.
[6] *Id*.
[7] Duane D. Stanford, *Cracker Barrel Proxy Fight Sparked as Biglari Demands Board Seat*, Bloomberg, Sept. 1, 2011, *available at* [here]; Cracker Barrel Old Country Store, Inc., Form 8-K (Dec. 27, 2011) (*available at* [here].
[8] Complaint at 5.
[9] *Id*.

election to the board until **after** the August HSR filing, nonetheless Biglari acknowledged this was a "corrective filing" to address its "inadvertent failure" to file earlier.[10]

"Passive Investment" HSR Filing Exemption Did Not Apply

The HSR Act and accompanying regulations provide an exemption from filing requirements for acquisitions of voting securities "solely for the purpose of investment," and which result in a holding of 10 percent or less of the issuer's outstanding voting securities.[11] Acquisitions of 10 percent or less of an issuer's voting securities have virtually never given rise to a substantive Clayton Act §7 antitrust claim.[12] Nonetheless, the FTC interprets the investment-only exemption very strictly (arguably more strictly than justified by the underlying regulations).[13]

The regulations define "solely for the purpose of investment" to mean that, **at the time of the acquisition**, the acquirer acted with passive investment intent, i.e., the acquirer had "no intention of participating in the formulation, determination or direction of the basic business decisions of the issuer."[14] The regulations explicitly recognize that following a passive-intent acquisition, an acquirer can change its mind and become activist, with the effect that **subsequent** acquisitions are no longer exempt.[15] However, the FTC is typically very skeptical of an acquirer's claim that it acted with passive intent in making an acquisition in circumstances where the acquirer later became an activist.

The facts of the Biglari/Cracker Barrel acquisition presented a particularly easy case for the FTC, because according to the complaint Biglari commenced its activist conduct **only one week** after crossing the HSR filing threshold. Thus, the complaint alleged that Biglari crossed the filing threshold on June 8, 2011, and notified Cracker Barrel's CEO on June 15 of its intent to present proposals for business changes, with a demand for board seats following shortly thereafter.[16]

The complaint alleged that Biglari Holdings was in continuous violation of the HSR Act from June 8, 2011 until September 22, 2011 (when the FTC granted early termination of the HSR waiting period) —a total of 107 days.[17] Simultaneous with the complaint, the government filed a Proposed Stipulation and Final Judgment requiring Biglari Holdings to pay a fine of $850,000.[18] The maximum potential penalty of $16,000 per day[19] would have resulted in a total assessment of $1,712,000, meaning that Biglari settled for approximately half of the potential maximum penalty.

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[10] Biglari Holdings Responds to FTC Allegations, PR Newswire (Sept. 25, 2012), *available at* [here]
[11] 15 U.S.C. § 18a(c)(9), 16 C.F.R. § 802.9.
[12] The FTC once proposed to exempt all less-than-10-percent stock acquisitions. 53 Fed. Reg. 36831(Sept. 22, 1998), *available at* [here] ("The principal proposal would exempt from the premerger notification obligations all acquisitions of 10 percent or less of an issuer's voting securities on the grounds that such acquisitions are unlikely to violate the antitrust laws.") The FTC explanation for the proposal stated, in part, that, "available records indicate neither of the antitrust agencies has ever challenged an acquisition of 10 percent or less of an issuer's voting securities as a violation of section 7." *Id*. at 38636. Without explanation or comment, however, the FTC never acted on this proposal.
[13] For example, the FTC's Statement of Basis and Purpose accompanying the HSR regulations comments only that certain activity "could be" viewed as inconsistent with investment intent, including, "(1) nominating a candidate for the board of directors of the issuer; (2) proposing corporate action requiring shareholder approval; (3) soliciting proxies; (4) having a controlling shareholder simultaneously serving as an officer or director of the issuer . . . The facts and circumstances of each case will be evaluated whenever any of these actions have been taken by a person claiming that voting securities are acquired . . . solely for the purpose of investment." 43 Fed. Reg. 33450, 33465 (July 31, 1978). In practice, however, the FTC treats these four activities as absolute passive-investment-intent disqualifiers.
[14] 16 C.F.R. § 801.1(i)(1).
[15] 16 C.F.R. § 801.1(i)(1), example (recognizing that subsequent acquisitions by an acquirer who, following an initial passive-intent investment, "thereafter decides to influence or participate in management of the issuer," will no longer fall under the passive investment exemption).
[16] Complaint at 5.
[17] *Id*. at 6.
[18] Proposed Stipulation and Final Judgment, United States v. Biglari Holdings, Inc., No. 1:12-cv-01586 (D.D.C. Sept. 25, 2012) (*available at* [here].

Lessons from the *Biglari* Case

In approving the consent agreement, FTC Chairman John Leibowitz stated that, "The passive investment exemption is a narrow one, and we will not hesitate to seek civil penalties against companies that try to abuse it."[20] The Biglari settlement thus serves as yet another warning that minority, less-than-10-percent, voting securities acquisitions that meet applicable HSR Act size tests are **not** automatically exempt from filing requirements. Acquirers need to carefully analyze whether their current and near-future intent, plans, or conduct may be deemed to vitiate reliance on the investment-only exemption.

For example, the FTC views being an officer or director of the issuer in which shares are acquired to be a *per se* disqualification from reliance on the investment-only exemption.[21] Thus, option exercises and other share purchases by a company's officers or directors are potentially subject to HSR filing requirements (assuming applicable HSR size tests are otherwise met). Moreover, as illustrated by the *Biglari* case, the investment-only exemption will not apply where an acquirer proposes significant corporate action or seeks to obtain board seats—even where the corporate action proposal is rejected or the board seats are not in fact obtained.

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[19] Debt Collection Improvement Act of 1996, Pub. L. 104-134, § 31001(s) (amending the Federal Civil Penalties Inflation Adjustment Act of 1990, 28 U.S.C. § 2461 note), Federal Trade Commission Rule 1.98, 16 C.F.R. § 1.98, 74 Fed. Reg. 857 (Jan. 9, 2009).
[20] Press Release, Biglari Holdings, Inc., to Pay $850,000 Penalty to Resolve FTC Allegations That it Violated U.S. Premerger Notification Requirements (Sept. 25, 2012), (*available at* [here].
[21] See, e.g., fn.14, *supra*.