The Metropolitan Corporate Counsel®
www.metrocorpcounsel.com
Volume 14, No. 1 © 2006 The Metropolitan Corporate Counsel, Inc. January 2006

Hedge Fund Manager Hit With $350,000 In Hart-Scott-Rodino Penalties

FTC Puts Hedge Funds "On Notice" That They Are Not Exempt From HSR Rules

Paul B. Hewitt and Anthony W. Swisher

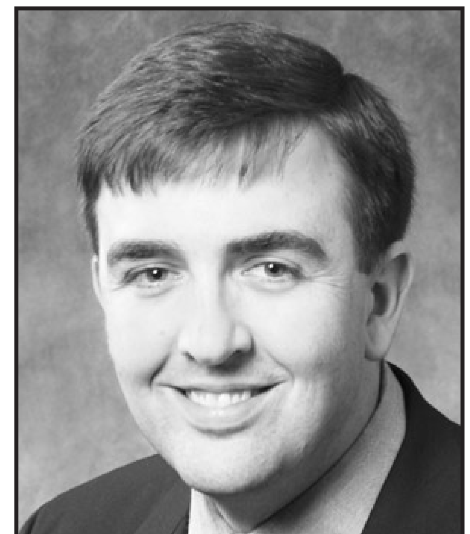
AKIN GUMP STRAUSS HAUER & FELD LLP

The FTC recently announced a $350,000 Hart-Scott-Rodino consent judgment against hedge fund manager Scott R. Sacane. Sacane owns Durus Capital Management (N.A.), LLC. In 2003 a Durus-managed offshore fund (Master Fund) made Hart-Scott reportable acquisitions of voting securities in two U.S. companies, Aksys, Ltd. and Esperion Therapeutics, Inc., but the required Hart-Scott filings were not made. In each instance the acquisition value exceeded the then-$50 million HSR minimum transaction threshold. No Hart-Scott exemption – e.g., the "investment only" exemption – was deemed to apply (presumably based on the high percentage of voting securities acquired and the lack of true investment intent).

The FTC commenced an investigation, perhaps triggered by complaints from one of the targets. In an effort to avoid a Hart-Scott enforcement action, ex post facto Hart-Scott filings were made by the Durus-affiliated entity that owned a majority of the stock of the Master Fund (a Cayman Islands corporation) that made the acquisitions. The FTC later discovered, however, that Scott Sacane should also have filed because he had the power to name more than 50 percent of the fund's directors. Thus, Sacane himself was a Hart-Scott-Rodino "ultimate parent" of the fund. The FTC proceeded against Sacane despite his attempt to "cure" the violation through making ex post facto Hart-Scott filings in 2005.

***Paul B. Hewitt** is a Partner and **Anthony W. Swisher** is Counsel in the Antitrust Practice Group of Akin Gump Strauss Hauer & Feld LLP in Washington, D.C.*

Paul B. Hewitt



Anthony W. Swisher

The FTC press release announcing this action was targeted to the hedge fund industry:

> *'This significant penalty should put hedge funds, their managers, and securities traders on notice that they are not exempt from filing pre-merger notification forms when required to do so,'* said Susan Creighton, Director of the FTC's Bureau of Competition. 'The defendant in this case is an experienced fund manager who should have known and fulfilled his obligations under the HSR Act.' She noted that while the Commission took action only against the individual fund manager in this case, future enforcement actions in other cases resulting from a failure to file could be brought against a fund as well.

(emphasis added). See http://www.ftc.gov/ opa/2005/09/durus.htm (FTC press release, and consent decree papers filed by the Justice Department at the FTC's request).

There are several lessons to be learned from this Hart-Scott-Rodino enforcement action.

First, there is no across-the-board HSR filing exemption for hedge funds. While many fund acquisitions fall within

Please email the authors at phewitt@akingump.com or aswisher@akingump.com with questions about these articles.

specific Hart-Scott exemptions, others do not. One HSR exemption that often applies is the "investment only" exemption. However, fund managers must remember that the FTC interprets this exemption narrowly. It applies *only* to acquisitions by *purely passive* investors of *10 percent or less* of a corporation's voting securities. The exemption is unavailable if *either* (a) the acquiring person will hold more than 10 percent of a corporation's voting securities as a result of an acquisition *or* (b) the acquiring person is not a purely passive investor, but instead intends to influence the target's basic business decisions, for example by seeking representation on the target's board of directors, commencing a proxy contest, etc.

Second, evaluating potential HSR filing obligations requires careful analysis of "control" issues within a family of funds. A fund organized as an *LLC* or *partnership* is an independent Hart-Scott "ultimate parent" if no person (e.g., the fund manager) holds 50 percent or more of the economic interests in the fund (right to profits or right to assets on dissolution). On the other hand, control of a fund organized as a *corporation* is analyzed without regard to economic interests. A fund organized as a corporation is an independent Hart-Scott "ultimate parent" if no person has either (a) 50 percent or more of the fund's voting securities or (b) the right by contract to appoint 50 percent or more of the fund's directors. If a fund is an independent Hart-Scott ultimate parent, the fund's holdings are not aggregated with the holdings of other funds for Hart-Scott purposes. Hart-Scott filing issues are determined based on that fund's holdings alone. On the other hand, if a fund is *not* its own ultimate parent, the fund and its holdings are aggregated with the holdings of other funds controlled by the same ultimate parent. Hart-Scott filing issues are then determined based on the holdings of all these funds collectively.

Third, as illustrated by this FTC enforcement action, the government prosecutes Hart-Scott-Rodino violators without regard to whether the underlying acquisition implicates the substantive antitrust laws. Simply put, the FTC's view is, "The rules are the rules. Period." This enforcement action is another reminder that hedge fund managers must carefully consider the potential applicability of Hart-Scott-Rodino filing requirements *before* making any significant acquisitions.