

Hart-Scott-Rodino Annual Report for Fiscal Year 2016: Increases in Filings and Second Requests, Impact on Executive Stock Options/Restricted Stock Awards

The [Hart-Scott-Rodino Annual Report Fiscal Year 2016](#), published last year by the Federal Trade Commission (FTC) and the U.S. Department of Justice (DOJ), summarizes FTC and DOJ actions conducted under the Hart-Scott-Rodino Antitrust Improvements Act, or HSR Act, in fiscal year 2016, the period from October 1, 2015, through September 30, 2016.

Noteworthy findings of the report published October 4, 2017 include:

- The number of HSR filings increased 1.7% in fiscal 2016, compared to fiscal year 2015. The percentage of transactions investigated decreased 8.7%. The percentage of investigated transactions leading to second requests increased 24.5%, and the percentage of challenges to reported deals increased 10.8%.
- The agencies continue to enforce the HSR Act's notification and waiting period requirements in "failure to file" situations. This is reflected in the record \$11 million civil penalty to be paid by certain ValueAct Capital entities for their failure to make the required HSR filings prior to acquisitions of voting securities of Halliburton Company and Baker Hughes Incorporated, following the November 17, 2014 announcement by Halliburton and Baker Hughes of their intent to merge.

This update provides key highlights of the annual report and offers practical advice.

Increase in Second Requests and Increase in Challenged Deals During 2016

In fiscal 2016, 1,832 transactions were reported under the HSR Act, which is a 1.7% increase over the 1,801 transactions reported in fiscal 2015. In 2016, the FTC and the DOJ investigated about 13% of reported transactions, an 8.7% decrease from those investigated in fiscal 2015. Of the transactions investigated, 23% resulted in the issuance of second requests, an increase from the 18% reported in fiscal 2015. But where second requests were issued, 87% of the transactions, compared to 89% in 2015, resulted in an abandoned or restructured deal, a consent decree requiring the parties to divest assets or litigation in federal district court.

	2012	2013	2014	2015	2016
Transactions Reported	1,429	1,326	1,663	1,801	1,832
Investigated	15%	17%	17%	15%	13%
Investigated - 2nd Request Issued	24%	22%	19%	18%	23%
2nd Requets Resulting in Challenge	90%	81%	65%	89%	87%

Practice Tip: Address antitrust concerns early in the process

A company considering an acquisition that is likely to raise agency concerns should confer with its antitrust counsel early in the negotiation process. To avoid a second request, a company should address potential anti-competitive concerns with counsel during the preparation and filing of reports under the HSR Act and engage

with antitrust authorities as soon as possible in the waiting period.

Corrective Filings. The statistics cited above do not include agency actions taken in connection with post-consummation "corrective filings." During fiscal year 2016, 47 corrective filings for violations were received, and the agencies brought three enforcement actions resulting in \$12.1 million in civil penalties. This is an increase from 2015, when 39 such filings were made and three enforcement actions were brought, resulting in \$4.04 million in civil penalties.

The antitrust agencies examine the circumstances of each violation to determine whether penalties should be sought. Where the agencies are convinced the failure to file was inadvertent and the parties file corrective filings shortly after discovering the missed filing obligation, the agencies have been less likely to seek civil penalties for the violation—this is generally known as the "one free bite of the apple" approach. However, once a party has received its "one free bite," a subsequent failure to file will result in civil penalties being assessed.

Prompt Corrective Filings May Help Companies Avoid Penalties. When the parties inadvertently fail to file, the enforcement agencies generally do not seek penalties if the parties

1. promptly make corrective filings after discovering the failure to file;
2. submit an acceptable explanation for their failure to file; and
3. have not previously violated the HSR Act.

Post "One Free Bite of the Apple" Failures to File Can Be Costly. Prior to the DOJ's 2016 enforcement action against ValueAct, in 2003, ValueAct filed corrective HSR notifications for three prior acquisitions of voting securities and outlined steps it would take to ensure future compliance with the HSR Act. No enforcement action was taken or penalties assessed at that time, this being ValueAct's "one free bite." However, ValueAct again failed to make required filings with respect to three acquisitions in 2005. Having used up its "one free bite," ValueAct agreed to pay a \$1.1 million civil penalty to settle an HSR Act enforcement action based on these 2005 violations. Among the factors the DOJ considered in determining what penalty would be appropriate in its 2016 case, the fact that ValueAct had previously violated the HSR Act six times by failing to file the required notifications contributed to the DOJ seeking significant civil penalties, with ValueAct ultimately agreeing to pay \$11 million.

Failures to File Often Involve Corporate Executives or Directors Who Exercised Stock Options or Whose Restricted Stock Units Vested. Although there are many different circumstances under which a failure to file may occur, one of the most common scenarios involves corporate executives or members of the company's board of directors acquiring a very small number of their company's stock by exercising options or warrants to purchase their company's stock or by the vesting of restricted stock units (RSUs).

The failure to file often results in such a situation for a reason. Although the purchase price of the stock acquired through the exercise of the option or warrant typically falls well below the size-of-transaction threshold (currently \$80.8 million), or in the case of RSUs, the units simply vest, the executives or directors fail to aggregate the value of those shares with their existing holdings when determining whether an HSR filing is necessary.

An example of how this situation occurs can be seen in the agencies' recent enforcement action against Caledonia Investments plc, in which Caledonia agreed to pay \$480,000 in civil penalties for its failure to make the required HSR filing prior to a 2014 acquisition of voting securities of Bristow Group Inc. Caledonia first acquired voting shares in Bristow in June 2008 and reported its purchase to the FTC and DOJ, as required under the HSR Act. Caledonia continued to invest in Bristow in the following years, making additional purchases that were exempt from reporting under the HSR rules.

During this period, two Caledonia employees were designated to serve on Bristow's board of directors. Bristow awards RSUs to its board members, and, by agreement, it set aside the securities for the two Caledonia board members for purchase by Caledonia. On February 3, 2014, Caledonia acquired 3,650 shares of Bristow voting securities as a result of the vesting of the RSUs awarded to the two Caledonia employees serving on the Bristow board. Although the aggregate value of these 3,650 shares, plus the value of the Bristow voting securities Caledonia already held, was approximately \$111 million, exceeding the HSR size-of-transaction threshold (\$70.9 million at the time of the acquisition), Caledonia did not make the required pre-acquisition HSR filing and wait for the HSR waiting period to expire before acquiring the additional 3,650 shares. Caledonia incorrectly believed the 2008 HSR filing for its initial acquisition of Bristow voting securities allowed it to acquire additional Bristow shares without making a new HSR filing.

Under the HSR Act, a company that has made an HSR filing for an acquisition of voting securities is allowed to acquire additional voting securities of the same issuer during the five-year period following the expiration of the HSR waiting period for the initial transaction, as long as the subsequent purchases of voting securities do not raise the aggregate value of the issuer's voting securities held by the acquiring company above a higher notification threshold.

The five-year period following Caledonia's 2008 acquisition of Bristow stock expired June 13, 2013, nearly eight months before the February 2014 vesting of the Bristow voting securities acquired by Caledonia. On February 4, 2015, Caledonia made a corrective HSR filing, shortly after learning of its obligation to file. Caledonia indicated its failure to make a timely HSR filing was inadvertent based on its belief that the February 2014 acquisition was exempt from the HSR reporting and waiting period requirements. However, since this was not Caledonia's first violation of the HSR Act for failing to make the required filing and observing the waiting period, the agencies sought to have penalties imposed. The final judgment imposes a \$480,000 civil penalty, which reflects a downward adjustment from the maximum permitted because the violation was inadvertent; Caledonia promptly self-reported the violation after discovering it and was willing to resolve the matter by consent decree.

To avoid these problems, companies who offer their executives stock options or restricted stock units should implement an HSR warning system that reminds the company and the executive to confer with counsel about the HSR implications of the acquisition well in advance of the date of exercise or vesting.

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