

HSR Act Guidance for CEOs, Board Directors, and General Counsel

Unlike so-called “merger control” laws in most countries, the U.S. HSR Act applies to individual executive officers and directors acquiring shares of the employing corporation as part of their compensation if certain jurisdictional thresholds are satisfied.

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Recent enforcement activity by the Antitrust Division of the Department of Justice and the Federal Trade Commission (FTC) imposing a civil fine on a company executive for alleged violations of the premerger notification requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (HSR Act), serves as an opportunity to remind company officers, directors, and general counsel of the many HSR traps for the unwary. An HSR violation can result in fines of \$16,000 per day for each day of the violation. The fines can be substantial (i.e., hundreds of thousands of dollars) because they begin to accrue from the date of closing until the violator makes a corrective filing and obtains HSR Act approval.

HSR Act Is Unique

Unlike so-called “merger control” laws in most countries, the United States’ HSR Act applies to individuals making minority acquisitions. Indeed, with respect to officers and directors of a corporation, a pre-closing HSR filing may be required prior to holding in excess of \$66 million (as adjusted annually) of the voting securities of the issuer. And HSR Act approval may be required **prior** to the exercise of options into voting securities or deposits of voting securities into a 401(k) or other retirement account.

Traps and Lessons Learned

There are a number of key lessons to avoid HSR traps and minimize the pain when an inadvertent violation is discovered:

- **HSR Approval Timing:** An officer or director must obtain HSR Act approval **before** obtaining beneficial ownership of the shares.
- **Remember to Aggregate:** Exercising even a very small number of options can trigger an HSR filing because the value of those converted shares must be aggregated with the value of shares already held. For example, if CEO Jones already holds \$65 million of Corporation XYZ’s voting securities, assuming she has \$13.2 million in nonexempt assets, she will have a filing obligation if she acquires (or exercises options) on merely another \$1 million and one penny of shares.

- **More than One Threshold to Consider:** In general, a new HSR filing may be required prior to exceeding each of the applicable notification thresholds. For example, if CEO Smith makes an HSR filing in connection with the acquisition of \$66 million of Corporation XYZ’s shares and obtains approval, he may not cross the next jurisdictional threshold of \$131.9 million (as adjusted annually) a year later without another HSR filing. And, once again, the CEO must aggregate shares already held with the value of any shares to be acquired to see if the next jurisdictional threshold will be satisfied.
- **Five-Year Window:** An HSR filing approval is valid for only five years. After five years, a new filing may be required for **any** acquisition of voting securities, regardless of size, if the value of shares already held (i.e., shares held plus shares to be acquired) exceeds the applicable threshold. For example, if CEO Tolstoy holds \$170 million of voting securities of Corporation XYZ and obtained HSR approval in 2005, she may need to re-file and obtain HSR approval before acquiring one additional share in 2011.
- **Appreciation of the Value of Voting Securities Alone Does Not Trigger an HSR Filing:** For example, if CEO Alter holds \$50 million of Corporation XYZ’s voting securities that appreciate to a value of \$100 million, there is no HSR filing obligation because the increase in value does not relate to an acquisition of shares.
- **Officers and Directors Are Not Passive Investors:** Although there is an exemption for share acquisitions of 10% or less of a corporation by certain “passive” investors, the exemption does not apply to investments made by the corporation’s officers or directors.
- **Cash-out Option and Other Exemptions:** There are many exemptions that may make it possible to avoid a filing. For example, an officer or director can cash-out shares on the same day they are acquired through the exercise of options in order to avoid HSR filing obligations. A share acquisition in which the percentage of voting power of the acquiring person decreases or stays the same is also exempt.
- **Correcting Mistakes:** The FTC usually will not impose penalties on an individual for an inadvertent first-time failure to file if the individual promptly notifies the antitrust agencies upon discovering the violation and convinces the FTC that the relevant parties have committed no further violations and that an HSR compliance program is in place.

The HSR Act and regulations are complicated; there are numerous possible exemptions and an equal number of traps. Officers or directors who engage in minority acquisitions (even if solely as part of compensation packages) should take care to examine the transactions in advance to determine if they would trigger an HSR filing obligation. When in doubt, they should consult experienced HSR counsel to help them determine when action is necessary.

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