

## Antitrust Law Blog

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### Discovery Executive Fined \$1.4 Million For HSR Act Violations

In June 2009, media executive John Malone agreed to pay \$1.4 million for violating the pre-merger reporting and waiting requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 as amended (HSR Act). The payment settles a [complaint](#) for civil penalties that alleges Malone violated the HSR Act in August 2005, when he acquired voting securities of Discovery Holding Co. (Discovery) without complying with the HSR Act's pre-merger notification and waiting period requirements. The complaint also charges that he continued to violate the HSR Act through July 2008 by acquiring additional voting securities of Discovery without complying with the same requirements.

#### *The HSR Act*

The HSR Act requires certain acquiring persons and certain persons whose voting securities or assets are acquired to file notifications with the federal antitrust agencies and to observe a waiting period before consummating certain acquisitions of voting securities, assets or non-corporate interests. 15 U.S.C. § 18a(a) and (b). These requirements apply to direct and indirect acquisitions that meet the HSR Act's thresholds. The requirements are intended to give the agencies prior notice of and information about proposed transactions. The waiting period is also intended to provide the agencies with an opportunity to investigate a proposed transaction and determine whether to seek to prevent the consummation of a transaction that may violate the antitrust laws.

A set of rules are promulgated under the HSR Act, codified at 16 C.F.R. §§ 801-803 (HSR Rules). An office within the Federal Trade Commission, the Premerger Notification Office (PNO), administers the HSR Act.

#### *Facts in the Case*

Malone is Chairman of the Board Liberty Media Corporation (Liberty). He is also and Chief Executive Officer and Chairman of the Board of Discovery Holding Company (Discovery).

In May 2005, Malone, who already held voting securities of Liberty, made a premerger filing under the HSR Act to acquire additional Liberty voting securities. The waiting period expired without action by the antitrust agencies. In July 2005, Discovery was spun off from Liberty and became its own "Ultimate Parent Entity" within the meaning of the HSR Act. Malone received

voting securities of Discovery in connection with the spin-off. No HSR filing was required for that acquisition because the shares were distributed pro-rata to the holders of Liberty voting securities.

On August 9, 2005 Malone acquired additional Discovery voting securities without making an HSR filing. Section 801.13(a) of the HSR Rules provides that all voting securities of an issuer that will be held after an acquisition, including any held *before* the acquisition, are deemed held “as a result of the acquisition.” Applying this rule, Malone's August 9 acquisition was subject to the HSR Act because the value of the Discovery voting securities Malone held before this acquisition *together* with the value of the additional voting securities he was acquiring were in excess of the HSR's reportability threshold. For the next two-and-a-half years, through April 2008, Malone acquired additional Discovery voting securities, without making any HSR filings.

On June 12, 2008, Malone made a corrective filing for the Discovery voting securities he had acquired in violation of the Act. In the filing, Malone stated that when he acquired voting securities of Discovery on August 9, 2005, he relied on a 2001 PNO informal interpretation that indicated that a filing to acquire voting securities of a parent corporation would also cover acquisitions of voting securities of a subsidiary of that parent corporation. He stated that neither he nor his counsel was aware that in February 2005, the PNO disavowed the 2001 interpretation, or that the FTC had issued a new informal interpretation stating that acquisitions of voting securities of a subsidiary requires a separate filing. Apparently, neither Malone nor his counsel contacted the PNO or checked the database of informal interpretations to verify whether a filing for a parent corporation covered acquisitions of a subsequently-divested subsidiary prior to acquiring additional shares of Discovery.

Malone's June 12, 2008 corrective filing set off a waiting period that expired on July 14, 2008. Just two days after making this corrective filing and while the waiting period was still pending, Malone allegedly again violated the HSR Act. This occurred when he exercised two options to acquire Discovery voting securities through an escrow arrangement. The Statement of Basis and Purpose for the HSR Rules (43 Fed. Reg. 33460 (July 31, 1978) states that an escrow agent does not become the beneficial owner of assets or voting securities held in escrow. In addition, the complaint alleged several indicia that beneficial ownership had transferred from Discovery. The complaint thus asserted that Malone obtained beneficial ownership of the shares upon exercise of the options and that this acquisition also violated the HSR Act.

### *The Settlement*

According to the complaint, Malone was in violation of the HSR Act for nearly three years. At the then-applicable maximum fine of \$11,000 per day, Malone would have been liable for almost \$12 million. The \$1.4 settlement is thus a fraction of what the government technically could have sought.

### *Review of Important Lessons and Points Regarding HSR Act Compliance*

This case involves several lessons regarding the HSR Act and Rules:

- The HSR Act covers a wide variety of transactions. The HSR Act applies to more than acquisitions of a business. It also applies to acquisitions of a minority interest in a corporation. The HSR Act applies as well to certain long term leases, exclusive licenses, formations and contributions to joint ventures and other entities, provided the applicable thresholds are met and no exemption applies.
- Aggregation rule: Even if a person has previously lawfully acquired voting securities of an issuer without having to make an HSR filing, the person may be required to make an HSR filing before acquiring additional voting securities of that issuer. This is because voting securities of the issuer acquired previously must be aggregated with the voting securities to be acquired to determine whether a given transaction meets the HSR reporting threshold.
- HSR penalties are significant. Currently, any entity or individual in violation of the HSR Act after February 9, 2009, may be subject to a civil penalty of up to \$16,000 a day for each day in violation of the HSR Act. A violation that is not discovered for several years can thus render a person liable for a seven digit or more penalty.
- Consult counsel immediately if you believe you may have violated the HSR Act. Parties that discover that a reportable transaction was completed without a filing should notify the FTC and make a corrective filing as soon as possible.
- Verify Authorities Relied Upon: The FTC can and does change its position on how it interprets the HSR Rules. The applicability of the FTC's interpretations to a given transaction should be confirmed.
- HSR definitions are highly technical and require close attention. The HSR Act's definitions of terms such as "control", "hold", "beneficial ownership", and "acquisition price", among others, must be carefully considered in analyzing a transaction. Specific rules may apply to certain mechanisms. Shares transferred through an escrow arrangement, for example, may not prevent a transfer of beneficial ownership.
- HSR analysis is complex; seek qualified counsel. For any transaction, the process of determining whether the transaction is reportable can be complex. The HSR Rules and their exemptions are highly technical and HSR analysis often is fact-specific and multifaceted. Parties should consult qualified counsel for assistance.

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