

Recent Cases Serve as a Reminder of the Potential Impact of HSR Reporting Requirements and Other Key Disclosure Rules on Shareholder Activism

Two recent enforcement actions by the Department of Justice and the Federal Trade Commission (the “FTC”) confirm that there is continuing attention in the United States on compliance by investors with the reporting requirements under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the “HSR Act”) in connection with significant acquisitions of voting securities of a public company. On June 19, 2013, the Department of Justice settled with a civil penalty of \$720,000 a civil antitrust action against MacAndrews & Forbes Holdings, Inc. based on MacAndrews having increased its equity stake in Scientific Games Corporation without first filing the required notification under the HSR Act and observing the HSR Act waiting period.¹ In addition, on July 2, 2013, the FTC announced that Barry Diller will pay \$480,000 in civil penalties to settle charges alleging that Mr. Diller violated the notification requirements of the HSR Act as a result of Mr. Diller’s acquisitions of shares of The Coca Cola Company between 2010 and 2012.

While neither one of above-referenced situations involved shareholder activism, both enforcement actions should serve as a reminder to activist investors that antitrust counsel should be consulted before an investor takes a significant position in a public company and in connection with any subsequent stakebuilding effort, and that the government will take action where it finds violations. On the flip side, there may be opportunities for a company that is the target of shareholder activism to use the HSR Act and other legal limitations offensively in dealing with an activist investor. What follows is a short outline of certain key considerations regarding U.S. reporting obligations that a target company should bear in mind when facing an activist investor.

HSR

- Activist funds that cross the HSR Act thresholds generally cannot rely on the “only for investment purposes” exemption (available for passive holdings of less than 10% of the voting securities of target).
- In June 2011, the FTC clarified in its enforcement action against Biglari Holdings (relating to Biglari’s acquisition of shares of Cracker Barrel Old Country Store Inc.) that certain typical activist efforts, including seeking to meet with the board or management of the target to discuss initiatives to improve shareholder value (especially if accompanied by other public activities) and requesting appointment of directors to the board, are inconsistent with the “passive investor” exemption under the HSR Act.
- While a subsequent change in investment purpose following an acquisition that properly qualified for the “passive investor” exemption does not require an immediate HSR Act filing, such a filing would be required before any additional acquisition of shares of the target company by the investor, irrespective of the size of the acquisition.

SECTION 13(d)

- A target company can bring a legal action against an activist investor based on failure by the investor to comply with the beneficial ownership reporting requirements of Section 13(d) of the Securities Exchange Act of 1934 (the “Exchange Act”) and related rules and regulations. Such action can be based on (i) failure by the activist investor to timely file its Schedule 13D or to convert a Schedule 13G to a Schedule 13D or (ii) failure by the activist investor to satisfy the disclosure obligations of Schedule 13D (including failure to disclose the

¹ See our Client Alert discussing the settlement at <http://www.mofo.com/files/Uploads/Images/130624-investment-firm-HSR.pdf>.

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purpose of the activist investor's investment or the existence of a "group" for Rule 13d-5(b) purposes or to file timely amendments when reported information changes materially).

- While target companies cannot sue for monetary damages under Section 13(d), an alleged violation by an activist investor may constitute (i) the basis for fraud claims by other shareholders, (ii) the basis for a preliminary injunction against actions instigated by the activist investor (e.g., a proxy contest) and (iii) ammunition in the public relations campaign against an activist investor on the ground of federal securities laws violations.

SECTION 16(b)

- Section 16(b) of the Exchange Act provides that the issuer of equity securities can recover any "short-swing profits" realized by any director, officer or beneficial owner of more than 10% of such issuer's securities from any purchase and sale, or sale and purchase, of those securities within any period of six months.
- Claims for disgorgement of short-swing profits under Section 16(b) can be brought by a target company against an activist investor that crosses the 10% beneficial ownership threshold and can also be based on formation of a "group" for Section 16 purposes.
- It is also possible that an activist shareholder that has successfully appointed a designee to the board of directors would be subject to Section 16 obligations irrespective of whether its beneficial ownership interest is in excess of the 10% threshold if the shareholder has deputized its designee to serve on the board on the shareholder's behalf.²

OTHER REGULATORY REGIMES

- In addition to the requirements described above, certain federal and state laws relating to specific industries, such as banking, insurance, public utilities, transportation, communications, gaming and defense, have specific ownership limits or other requirements that are triggered by ownership levels. Also, ownership limitations and reporting requirements may exist under applicable foreign laws. These regimes create similar pitfalls for activists and provide similar opportunities for companies.

"POISON PEN" LETTERS

- Irrespective of whether a company that is the target of shareholder activism can or should directly pursue a claim for a breach of the reporting requirements described above, the company has also the option to alert the relevant regulatory authority through "poison pen" letters describing the alleged violation.

While different activists may have significantly different risk tolerances, a finding of a violation of U.S. reporting requirements may have a damaging reputational impact, regardless of the size of the fine. In addition, the institution of an action against an activist investor by the target company or the commencement of an enforcement action by a regulatory authority can have a destabilizing effect on the activist investor's efforts, irrespective of the ultimate outcome of any such action.

² See Peter J. Romeo & Alan L. Dye, *Section 16 Treatise and Reporting Guide*, 3rd ed., §2.04 (2008).

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