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Merger Woes for Hedge Fund as Obscure HSR Rule Spells Trouble and $600K Penalty

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According to a complaint filed by the Department of Justice[1], several funds affiliated with Third Point Management failed to file and observe the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act") prior to acquiring shares in the merged DowDuPont Inc. as a result of the merger of Dow and DuPont. Though the funds had each filed under the HSR Act for their prior share acquisitions of Dow Inc. and observed the applicable waiting periods, those prior filings did not permit the funds to acquire the shares of the merged DowDuPont. The complaint alleges that Section 802.21 of the HSR Rules, which permits certain follow-on stock acquisitions in an issuer where an HSR filing was previously made in the last 5 years, did not exempt the funds acquisitions of DowDuPont stock because DowDuPont is not the same issuer as the one for which the funds previously filed to acquire stock.

The HSR Act can become a trap for investors – not realizing that filing requirements under the HSR Act may apply in unexpected contexts. The HSR Act requires investors, and their targets, to make a premerger notification filing and observe a 30-day waiting period (15 days in the case of a cash tender offer) prior to making certain voting share acquisitions, including acquisitions of minority holdings. The investor may not acquire the shares prior to observing the full waiting period, or prior to the early termination of the waiting period by the Federal Trade Commission. Effective April 3, 2019, the minimum threshold for reporting under the HSR Act is $90.0 million (the thresholds adjust annually).

Merger partners are accustomed to seeking antitrust advice and thinking about whether premerger filings are required for their transactions. Hedge funds and private equity investors likewise typically engage counsel before completing investments that may trigger reporting requirements. However, shareholders of merging companies may not immediately think to consider that the merger may impose affirmative filing obligations for them.

Direct share acquisitions and M&A transactions, however, are only part of what the HSR Act captures. The filing and waiting period requirements of the Act can also be triggered by, among others, stock conversions, warrant and option exercises, small incremental investments, and stock grants. While counterintuitive, non-volitional share acquisitions sometimes can also trigger HSR filing requirements. Indeed, HSR enforcement extends to company executives acquiring stock in their employers. For instance, the vesting of restricted stock units as part of an executive compensation package can trigger HSR filing requirements – requirements that are sometimes missed. Under the rules, when a company employee or director acquires company stock that results in an aggregate holding that is valued above the HSR reporting threshold, filing obligations can arise. The FTC also said that even dissenting shareholders that receive stock in a stock-for-stock merger, and thus acquire voting securities that were not previously held, can have a filing obligation where the applicable thresholds are met.[2]

Although the maximum potential penalty for the three separate funds that were alleged to be in violation of the HSR Act from the closing of the DowDuPont merger on August 31, 2017 to the end of the funds' waiting period on December 8, 2017 (30 days after the funds submitted corrective filings on November 8, 2017) was $3.6 million[3], the parties agreed to a reduced penalty of $609,810. Third Point was also subject to a prior HSR enforcement action in 2016, for improper reliance on the passive investor exemption. It appears the passive investor exemption, which permits certain share acquisitions exceeding the reporting threshold for investors that are purely passive, was not available in the DowDuPont matter.[4]

In a prior enforcement action also stemming from a conversion transaction in 2016, the FTC agreed to a $240,000 penalty where Leucadia National Corporation acquired voting securities of KCG Holdings through a conversion transaction valued in excess of the HSR reporting threshold.[5] When Knight Capital merged with financial services company GETCO Holding Company, the merger transaction converted Leucadia's ownership interest in Knight Capital into stock of the newly merged company, KCG Holdings, with a valued in excess of the HSR reporting threshold.

The Third Point enforcement action is an important reminder not only that the HSR Act is strictly enforced, with dozens of enforcement actions under the agency's belt[6], but that the application of the HSR rules is not always intuitive or clear-cut. The notification program and rules were developed primarily for the review substantive antitrust of mergers, but other types of transactions are covered by the rules. While the acquisition of shares in a merged entity as a result of a transaction that you are not involved in and between companies that you do not control does not immediately bring HSR reporting obligations to mind, the failure to file led to a substantial penalty for Third Point. Any transactions where shares or other securities are being acquired[7] should be reviewed by antitrust counsel to evaluate potential reporting obligations and ensure strict compliance with the HSR Act.

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[1] Third Point Complaint.

[2] *Premerger Notification Practice Manual*, 5th Edition (2015), Int. 219.

[3] As of January 22, 2018, the maximum penalty amount was increased to $41,484.

[4] Passive Means Passive! Missed HSR Filing Spurs Antitrust Enforcers' Ire – But Change May Be Coming.

[5] HSR Enforcement Continues Swiftly: $240K Settlement Announced with FTC for Failure to File.

[6] FTC Cases and Proceedings.

[7] Though outside the scope of this article, HSR reporting can also be triggered by asset acquisitions, joint ventures and certain types of exclusive licensing agreements.

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