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Family Dining Meets Value Investing – Proxy Battle Spills Over into Antitrust Arena and Lands Investor $850,000 Penalty

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The Department of Justice's ("DOJ") imposition of an $850,000 penalty against Biglari Holdings, Inc. for violating the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act") illustrates both the agency's view of the limited scope of the passive investor exemption as well as their continued zeal for taking a hard line on HSR violations, even where it does not challenge the underlying *bona fides* of a transaction. HSR enforcement in recent years has included actions not only for failure to file,[1] but also gun-jumping (or failure to properly observe a waiting period after filing)[2] and defective filings for failure to submit required documents.[3]

The Passive Investor Exemption

Under the HSR Act, certain stock and asset acquisitions are subject to notification and waiting period requirements prior to consummation to allow antitrust enforcers to evaluate whether a merger or acquisition would substantially lessen competition. The current initial reporting threshold is $68.2 million, but adjusts annually. Additional reporting thresholds are presently set at $136.4 million and $682.1 million. However, certain stock acquisitions resulting in minority positions of less than 10 percent held by passive investors can be exempt from the filing and waiting period requirements of the HSR Act. The exemption screens out of the merger review process acquisitions of a *de minimis* nature that are unlikely to present significant competitive concerns. Biglari apparently believed it fell within the exemption, but the competition authorities disagreed.

Slipping over the line

The DOJ's complaint[4] against Biglari Holdings alleges that the company, operating the Steak n Shake and Western Sizzlin restaurant chains, began amassing holdings in Cracker Barrel in May and June of 2011, and that the HSR reporting threshold was exceeded on June 8, 2011. Biglari's Form 13D filed with the SEC on June 13, 2011 stated the company's plan was "to communicate with the Issuer's management and members of the Board regarding the business, governance and future plans of the Issuer."

According to the complaint, Sardar Biglari, Chairman and CEO of Biglari Holdings, spoke with the CEO and CFO of Cracker Barrel on June 15, 2011 and shared his "ideas to improve shareholder value at Cracker Barrel." During a subsequent in-person meeting, Mr. Biglari requested that he and Biglari Holdings' Vice Chairman Phil Cooley be appointed to the board of directors of Cracker Barrel. Biglari Holdings subsequently filed under the HSR Act to acquire additional voting securities of Cracker Barrel.

The complaint alleges that Biglari Holdings was in violation of the HSR Act from the time the value of its Cracker Barrel holdings exceeded the HSR threshold, and until the waiting period was terminated on its subsequent HSR filing. Though not raised by the agency, presumably because Cracker Barrel rebuked Biglari's offer, the matter also potentially raises issues under Section 8 of the Clayton Act, which prohibits the simultaneous service on the boards of competing companies.

The agencies construe reliance on the exemption improper where the acquirer has *any* intent other than or in addition to investment. Although merely voting the issuer's stock is not inconsistent with the exemption, the following acts are viewed as inconsistent: nominating a candidate for the board of directors; proposing corporate action requiring shareholder approval; soliciting proxies; or being a competitor of the issuer, and often will make the exemption unavailable. According to the agency, seeking representation on the target company's board of directors, as Biglari did, creates an irrebuttable presumption of intent inconsistent with a passive investment.

Consult Counsel before Relying on the Exemption

While participation in the formulation, determination or direction of basic business decisions is inconsistent with the Passive Investor exemption, it is not always clear at what point suggestions to management cross the line. In investigations relating to the Passive Investor exemption, the agency generally has considered some or all of the following factors:

- the proximity in time of the last purchase to the announcement of the offer for control;

- the dollar size of the investment;

- the adoption of antitakeover defenses by the target;

- approaches to and clearance of conflicts with lenders for financing an acquisition of control;

- preparation of analyses and *pro forma* financials of a business combination.

This case illustrates the fact-sensitive nature of the applicability of the Passive Investor exemption. Counsel should be consulted prior to reliance on this exemption, and on any matters where the HSR Act may be implicated.

[1] Investment Fund Will Pay $1.1 Million Civil Penalty for Increasing its Stake in Portfolio Companies without First Complying with Hart-Scott-Rodino Act Pre-Merger Notification Requirements

[2] Department of Justice Imposes $1.8 Million Fine for Hart-Scott-Rodino Act Violations: Premerger Coordination Cited as "Gun-Jumping"

[3] HSR and Jail Time? The Importance of Being Earnest, and Getting Corporate Internal Investigations Right and U.S. Department of Justice Imposes $550,000 Penalty for Hart-Scott-Rodino Act Violation

[4] The complaint was filed by the Department of Justice because the FTC does not have the authority to impose fines.

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