

ALERTS

Investor Fined for Alleged Misuse of HSR Act Passive Investment Exemption

October 8, 2012

On Sept. 25, 2012, the Federal Trade Commission (“FTC”) announced that Biglari Holdings Inc. (“Biglari”) agreed to the payment of an \$850,000 civil penalty in order to settle charges that Biglari acquired shares of Cracker Barrel Old Country Store, Inc. (“Cracker Barrel”) in violation of the premerger reporting and waiting period requirements under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (“HSR Act”).^[1] According to the government’s complaint (the “Complaint”), Biglari’s acquisitions did not qualify for the HSR Act’s exemption for acquisitions made “solely for the purpose of investment” because Biglari’s actions were evidence that it intended to participate actively in the management of Cracker Barrel, a public issuer.

The HSR Act requires parties to transactions meeting certain thresholds^[2] to make a premerger filing with the FTC and the Department of Justice (collectively, the “Agencies”), and to observe a waiting period prior to closing such transactions. The waiting period allows the Agencies time to determine whether a reportable transaction may result in a substantial lessening of competition, and therefore should be investigated or challenged.

The HSR Act also provides for numerous exemptions, including for acquisitions made “solely for the purpose of investment” that result in the acquired person holding 10 percent or less of the outstanding voting securities of an issuer (regardless of the value of such investment).^[3] The term “solely for the purpose of investment” means that the person holding or acquiring such voting securities has no intention of participating in the

formulation, determination or direction of the basic business decisions of the issuer. The intent of an acquiring person seeking to claim the passive investment exemption is to be assessed at the time of the acquisition. While the facts and circumstances of each situation are to be taken into consideration, certain types of conduct will be viewed by the Agencies as inconsistent with an intent to acquire solely for the purpose of investment:

- Nominating a candidate for the board of directors of the issuer;
- Proposing corporate action requiring shareholder approval (although the mere voting of stock is not inconsistent with an investment intent);
- Soliciting proxies;
- Having a controlling shareholder, director, officer or employee simultaneously serving as an officer or director of the issuer;
- Being a competitor of the issuer; or
- Doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer.[4]

According to the Complaint, in May and June 2011, Biglari acquired approximately 8.7 percent of the outstanding voting securities of Cracker Barrel. On June 8, 2011, Biglari acquired Cracker Barrel voting securities that resulted in Biglari exceeding the HSR Act's size-of-transaction threshold. Biglari then continued to make additional acquisitions through June 13, 2011, all without making a filing under the HSR Act.

The Complaint stated that, following the June 8 through June 13 acquisitions:

- Biglari filed a Form 13D with the Securities and Exchange Commission, disclosing its Cracker Barrel holdings on June 13;
- Biglari's Chairman and CEO, Sardar Biglari, called Cracker Barrel's CEO on June 14;
- Mr. Biglari had a phone call with the CEO and CFO of Cracker Barrel, during which he said "he had ideas to improve shareholder value and requested an in-person meeting"[5] on June 15; and
- Mr. Biglari and another Biglari executive had a meeting with the CEO and CFO of Cracker Barrel, during which Mr. Biglari said that he had

ideas to improve customer traffic at Cracker Barrel and requested that he and the other Biglari executive immediately be appointed to the Cracker Barrel board of directors on June 23.

While the Agencies acknowledge that investors' intent may change over time from passive to active,[6] the allegations in this matter show the Agencies' willingness to question and challenge an investor's reliance on the passive investment exemption. In an FTC press release, Chairman Jon Leibowitz stated: "The passive investment exemption is a narrow one, and we will not hesitate to seek civil penalties against companies that try to abuse it." Here, only 15 days separated the initial acquisition that exceeded the HSR threshold (on June 8) and the meeting during which Biglari requested board seats (on June 23). The government concluded, based on Biglari's actions, that Biglari's intent at the time of the June 8 through June 13 acquisitions was to participate in the formulation, determination or direction of the basic business decisions of Cracker Barrel.

There are many complex and technical aspects of the HSR Act's requirements and exemptions, including (but not limited to) the passive investment exemption. Accordingly, the advice of counsel should be sought as early as possible in order to determine whether the HSR Act's filing requirements may apply to particular situations.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] See <http://www.ftc.gov/opa/2012/09/biglari.shtm>. Complaint available at <http://www.ftc.gov/os/caselist/1110224/120925biglaricmpt.pdf>.

[2] The HSR Act applies to acquisitions of voting securities, interests in unincorporated entities and assets. The minimum size-of-transaction threshold is currently \$68.2 million. Furthermore, transactions valued at \$272.8 million or less are only reportable to the extent that the parties also satisfy certain size-of-person thresholds (currently, either the acquiring or acquired person must have annual net sales or total assets of \$13.6 million or more, and the other person must have annual net sales or total assets of \$136.4 million or more). The dollar thresholds are adjusted annually.

[3] 15 U.S.C. § 18(c)(9); 16 C.F.R. § 802.9.

[4] 43 Fed. Reg. 33,450, 33,465 (July 31, 1978).

[5] Complaint, at ¶ 17.

[6] In fact, the Complaint states that Biglari made an HSR Act filing on Aug. 26, 2011 “to acquire additional voting securities,” and that early termination was granted on Sept. 22, 2011. However, following the announcement of the settlement, Biglari stated to the media that, while Biglari did not actually nominate directors until after the August filing and had “no intention of becoming actively involved in day-to-day management or in seeking control of the Board of Cracker Barrel,” the August filing was in fact intended to be a corrective filing relating to the previously unreported acquisitions, and that it was not relying on the passive investment exemption for such prior acquisitions. See <http://www.prnewswire.com/news-releases/biglari-holdings-responds-to-ftc-allegations-171247081.html>.

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