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HSR alert

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Most people think that Hart-Scott-Rodino (HSR) filings are only for large corporations and market leaders. But that's actually wrong. High net-worth individual are often caught in HSR filing obligations. And when they miss a mandatory filing obligation, the penalty can be over $43,000 per day.

High net-worth individuals who routinely receive stock bonuses or dividends are especially likely to unwittingly fall into the HSR net. Here's why.

The exposure

The HSR Act covers acquisitions of voting securities and most assets, provided just a few basic tests are met. It applies even when individuals are involved and even when there is not the slightest anticompetitive issue.

The tests are:

- 1. one side of the transaction (like a passive investor or corporate executive) has at least $18.8 million in assets;
- 2. the other side (like the company issuing the voting securities) has sales or assets of at least $188 million;
- 3. the transaction size is greater than $94 million (or a second threshold of $376 million).

A hypothetical example

Let's assume that we're dealing with an executive of Company X. her net worth is $20 million. Company X has sales or assets of $1 billion. Two of the three HSR tests are already met.

Let's also assume that the long-time executive, over the years, either regularly bought Company X stock or received stock dividends as part of his compensation package. So she now holds $93 mil-lion of Company X stock.

Company X now issues a stock dividend of $2 million as part of his compensation package.

OK, you say. This is a $2 million transaction, not a $94 million transaction. On a common-sense level, you're right. But in HSR-land, you're wrong.

In fact, the "transaction value" is the total of all the voting stock you would have in the same company after the transaction. By receiving the $2 million stock bonus, our executive crossed the "transaction size" barrier without making a mandatory filing. The daily penalty for this violation is $43,280.

Let's assume that the executive realizes her mistake just two months later. The penalty now technically is already over $2.5 million.

In practice, the FTC waives the penalty for the first violation when the person really did not know about the filing obligation. But the condition of the settlement with the FTC is that the individual promises to set up a ***reliable*** HSR filing system for the future. "Reliable" means one that never fails. If you even inadvertently skip a second filing, you will be fined.

Real life example

Barry Diller is a corporate investor. In 2012, bought 605,000 shares of Coca-Cola voting securities between November 2010 and April 2012, and 264,000 more shares in April 2012. The first purchase pushed him over the lowest HSR threshold and the second set over the second and higher threshold. He did not file for crossing either HSR threshold.

This was total inadvertence, but he made no filing until Coca-Cola called the mistake to his attention. The FTC filed him $480,000. (In those days, the daily penalty was $16,000, not $43,280.) Diller was fined because 15 years earlier, in 1997, he had made a HSR acquisition and inadvertently didn't file then. Because the Coca-Cola incident was not his first violation, the FTC imposed the fine.

Another complication based on "control"

Here's a variation to show you how complicated this is. Suppose our executive doesn't own any voting securities at all in Company X. But she does control a separate company that does hold $93 million of the stock. Company X grants her a $2 million stock dividend. Now, she might think $2 million plus $0 is $2 million. But she would be wrong. You need to combine everything you own in a target, plus everything under your control. Once again, our executive inadvertently crossed the HSR threshold without filing.

This same problem happened to Barry Diller in his earlier case. Diller controlled USA Networks. USA Networks bought voting stock of Citysearch and the value exceeded the HSR threshold. Diller did not file, even though he was the controlling entity. The FTC accepted a corrective filing and imposed no fine because this was the first violation, and because he undertook to be "accountable for instituting an effective program to ensure full compliance with the Act's requirements."

Fines are imposed even without anticompetitive effects

This is important: fines can be imposed when there are only literal violations of the law but absolutely no anticompetitive effect. After the Coca-Cola incident, Diller publicly denounced the FTC, saying that he was "dismayed" for their "tactics" for a "technical" violation of a transaction where it was "inconceivable" that it "could harm competition."

Regardless, there is no question purely non-competitive stock dividends and stock bonuses trigger HSR filing requirements. And there are many enforcement actions and fines levied because people just didn't bother to check with their lawyers.

Checklist

To sum up, you need to consider an HSR filing if you are getting voting securities and:

Your net worth is at least $18.8 million;

- The issuing company's sales or assets are at least $188 million.
- You will hold at least $94 million of voting securities after the transaction.
- Your holdings include your own, plus the holdings of all the companies (Corp. or LLC) that you control.
- When you're valuing the stock you already own, the value is today's market price, not what you paid for it.

If any of this seems like familiar territory for you, please contact your regular Withers attorney.

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