

FTC Targets Activist Abuse of the HSR Act's "Passive Investor" Exemption

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Earlier this week³, the Federal Trade Commission announced that Biglari Holdings, Inc. has agreed to pay an \$850,000 civil penalty to resolve allegations that it violated the premerger notification and waiting period requirements of the Hart-Scott-Rodino Act in connection with its 2011 acquisition of stock of Cracker Barrel Old Country Store, Inc.

The HSR Act and its rules require that parties to certain mergers and acquisitions notify the federal antitrust agencies of their proposed transactions and observe a waiting period before consummation. Acquisitions of up to 10% of the stock of a company are exempt from the notification and waiting requirements, but only if they are made solely for the purpose of investment and "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." Buyers who intend to be involved in the management of the target company or to seek representation on its board of directors are not eligible for the passive investment exemption. Failure to comply with the HSR Act's requirements may result in civil penalties of up to \$16,000 for each day during which a person is in violation.

According to the FTC's complaint, on June 8, 2011, Biglari Holdings acquired voting securities of Cracker Barrel in excess of the HSR Act's notification threshold, and it continued to acquire voting securities through June 13, 2011, when it filed a Form 13D with the SEC. The 13D disclosed a 9.7% stake in Cracker Barrel valued at \$100 million. Biglari Holdings did not file and observe the waiting period under the HSR Act prior to making those acquisitions, apparently maintaining that, at the time the acquisitions occurred, they were made "solely for the purpose of investment." One day after the last purchase, however, Sardar Biglari, the Chairman and CEO of Biglari Holdings, contacted Cracker Barrel's CEO to request a meeting at which he and Biglari Holdings' Vice Chairman asked to be appointed immediately to Cracker Barrel's board of

directors. The FTC's complaint and press release allege that Biglari Holdings' actions, including the request for two board seats, were inconsistent with investment-only intent, and that Biglari Holdings "intended to actively participate in the management of Cracker Barrel" at the time it purchased the stock. As a result, the FTC maintained that Biglari Holdings was not eligible for the passive investor exemption and failed to observe the notification and waiting period requirements in violation of the HSR Act.

While some activist investors may perceive tactical advantages in not reporting their acquisitions under the HSR Act, to claim an "overnight" change of intent is neither credible nor consistent with decades of FTC enforcement. As indicated by the FTC's Chairman in its press release, "the passive investment exemption is a narrow one," and the agency "will not hesitate to seek civil penalties against companies that try to abuse it."

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³ This memo was originally released September 27, 2012.