Investment Funds Fined For Violating HSR Act

Two related investments funds have agreed to pay a total of $800,000 in fines to settle charges by the Federal Trade Commission ("FTC") that they failed to comply with the HSR Act's[1] reporting obligations. The FTC enforcement action, *United States v. ESL Partners, L.P and ZAM Holdings, L.P.*,[2] serves as a reminder that substantial fines may be imposed for failure to comply with pre-merger notification regulations, regardless of the lack of any apparent impact on competition. In addition, this action provides yet another indication of the federal antitrust agencies' continued scrutiny of investment firms such as hedge funds and private equity firms.

Under the HSR Act, certain transactions cannot be closed unless the parties have notified the FTC and the Department of Justice and observed the statutory waiting period. Parties to a proposed acquisition of voting securities that results in the buyer holding over $63.1 million (a threshold which is adjusted annually) of the acquired person's voting securities may be required to comply with HSR report and wait obligations before closing the transaction, unless one of the various exemptions applies.[3] All shares held by the buyer as a result of an acquisition, including shares held as a result of prior acquisitions, must be aggregated with holdings by all entities within the same "ultimate parent entity." Thus, for example, an acquisition of $12 million of Company A's voting securities by itself would not be reportable, but if the buyer, or an entity controlled by the buyer, already holds $59 million of Company A's voting securities the transaction would likely be reportable, unless it is subject to an exemption.

In its December 15, 2008 announcement of this enforcement action and civil complaint,[4] the FTC stated that in 2004 each investment fund, ESL Partners, L.P. and ZAM Holdings, L.P., purchased voting securities of AutoZone, Inc. ("AutoZone"), when the investment funds already held a substantial amount of that corporation's stock. The complaint (filed by the DOJ on behalf of the FTC) alleged that as a result of these purchases, ESL Partners held, in aggregate, over $775 million of AutoZone's voting securities and that its 1999 HSR filing did not cover the 2004 acquisition.[5] The complaint also alleged that following its 2004 acquisitions, ZAM (as the "ultimate parent entity" of another investment firm) held, in aggregate, over $270 million and that it did not qualify for the investment-only exemption because it had indirect representation on the corporation's board.[6] The complaint further alleges that neither transaction should have been consummated without making an HSR filing and observing the waiting period.

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1 The Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, 15 U.S.C. § 18a.

2 No. 1:08-cv-02175 (D.D.C. Dec.15, 2008), Complaint available at http://www.ftc.gov/os/caselist/0510091/081215eslcmpt.PDF.

3 The HSR Act also applies to certain acquisitions of assets and interests in non-corporate entities, such as partnerships or limited liability companies.

4 "ESL Partners and ZAM Holdings Agree to Pay $800,000 in Civil Penalties for Premerger Filing Violations" (Dec. 15, 2008) available at http://www.ftc.gov/opa/2008/12/esl.shtm.

5 See Complaint ¶16.

6 See Complaint ¶9.

Some important points raised by this enforcement action:

- Individuals and businesses should consider the applicability of the HSR Act to their investments and other acquisitions, even if the acquisition is of a minority position or the amount paid, on its face, does not exceed the HSR threshold.

- While a previous HSR filing is valid for certain additional purchases of securities for a five year period, a new filing may be required under the HSR Act for additional purchases of a corporation's voting securities.

- An investment fund may not be able to rely on the investment-only exemption from HSR filing requirements for an acquisition of securities if the manager making investment decisions participates in the basic business decisions of the corporation whose securities are being acquired. As illustrated by the case, such participation may be deemed to include the fact that a third party making investment decisions for the investor serves on the board of directors of the company in question. The right to designate an individual to serve in such a capacity is a right significant investors often obtain as a condition to their making an investment.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Laurence T. Sorkin at (212) 701-3209 or lsorkin@cahill.com or Elai Katz at (212) 701-3039 or ekatz@cahill.com.