

Fried Frank Antitrust & Competition Law[®]



Antitrust Agencies Penalize Activist Investor for HSR Violations

Biglari Holdings Inc. has agreed to pay \$850,000 in civil penalties to settle charges that it violated the premerger notification requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the “HSR Act” or “Act”) when it acquired voting stock of Cracker Barrel Old Country Store, Inc. in 2011. Absent an applicable exemption, the HSR Act generally applies to acquisitions of voting stock positions or assets valued in excess of \$68.2 million (the current size-of-transaction threshold), and requires parties to submit notification and report forms to the antitrust authorities and observe a pre-closing waiting period. Violations of the HSR Act are subject to a civil penalty of \$16,000 per day of violation.

This case presents a rare challenge—the first in eight years—by the Department of Justice (“DOJ”) over an investor’s improper reliance on a commonly used exemption to the HSR Act, the “investment only” exemption. The *Biglari* case confirms the agencies’ commitment to aggressively challenge violations of the Act, even for transactions that do not raise competitive concerns. It also highlights the role that the HSR Act can play in hostile transactions.

According to the complaint, activist investor Biglari began acquiring Cracker Barrel voting stock in June 2011, and continued to build its position up to an 8.7% stake through September 2011. Shortly after it began acquiring shares, Sardar Biglari, the Chairman and CEO of Biglari Holdings, initiated a series of communications by phone and in person with Cracker Barrel’s CEO and CFO. Specifically, Biglari sought to propose ideas to improve the business and, most significantly, requested that he be immediately appointed to the board of directors, along with another Biglari executive.

Biglari did not submit an HSR filing prior to the stock purchases in June, July and most of August 2011, but did eventually file notification under the HSR Act on August 26, 2011. From the complaint, it can be inferred that Biglari had exceeded the HSR size-of-transaction threshold prior to its August filing, but had relied upon the investment-only exemption. This exemption applies to acquisitions of voting stock that are made “solely for the purpose of investment,” and where the acquiring person would hold 10% or less (or 15% or less for certain institutional investors) of the outstanding voting securities of the target. However, as reflected in this case and others, the Federal Trade Commission (“FTC”), which has jurisdiction to administer the HSR Act, construes this exemption very narrowly. Thus, voting securities are held “solely for the purpose of investment” *if the acquiring person has no present or future intention of participating in the*

formulation, determination, or direction of the issuer's basic business decisions, including participating in or influencing management." The Statement of Basis and Purpose ("SBP") accompanying the Act states that conduct (or the intention to engage in future conduct) beyond "merely voting" the shares may be inconsistent with investment intent, including, but not limited to: (1) nominating a candidate for the board of directors of the issuer; (2) proposing corporate action requiring shareholder approval; (3) soliciting proxies; (4) having a controlling shareholder, director, officer or employee simultaneously serving as an officer or director of the issuer; (5) being a competitor of the issuer; or (6) doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer.

The principal challenge in applying the exemption is that it turns on subjective intent. Indeed, a party may acquire voting stock in excess of the HSR reporting threshold and rely upon the investment-only exemption, but thereafter change its intent (e.g., decides to take an activist role) without triggering a filing obligation. However, any subsequent acquisition of voting stock after the change in intent would require an HSR filing. Because subjective intent is often difficult to prove and enforce, past enforcement actions involving this exemption have tended to be based on evidence that clearly contradicts passive investment intent.

Because there is relatively limited guidance and precedent, the passive exemption can be difficult to apply as there are gray areas, particularly with respect to communications between investors and management. Depending on the circumstances, communications – particularly with management of the company – suggesting or advocating a course of action or decision-making with respect to the business could be viewed as inconsistent with investment only intent. For example, the FTC previously has taken the position that an intention to make "strong suggestions" to management or the board is inconsistent with passive intent. However, having board observer rights in a private company and/or the right to receive certain financial and other non-public information from the company, likely would be viewed as passive. It can be difficult to distinguish between communications actually seeking to influence business decisions and investors making more passive-oriented statements about a company. It is possible that there would be some circumstances where it is appropriate for an investor to have limited communications with management where it is not seeking to control or influence management. Here, for example, the complaint alleges that Biglari approached Cracker Barrel management with ideas on how to improve customer traffic, but it also alleged that Biglari actively sought two board seats, which is plainly within the type of conduct that would render the exemption inapplicable.

The Biglari action is a compelling reminder that investors should exercise caution before crossing the HSR Act reporting threshold, or acquiring additional shares after the threshold has been crossed. In a statement issued along with the Biglari complaint and settlement, FTC Chairman Jon Leibowitz stated that, "[t]he passive investment exemption is a narrow one, and we will not hesitate to seek civil penalties against companies that try to abuse it." Accordingly, investors should consult counsel before relying upon the passive investment exemption or engaging in communications with a company's management. A potential investigation or enforcement action is more likely in hostile transactions such as this where the adverse target could report potential violations to the FTC as a means to delay or thwart the hostile investor. Indeed, Biglari now holds

a 17.7% stake in Cracker Barrel, and according to public reports, continues to battle for two board seats and push the company to implement changes that would maximize shareholder value. It recently received HSR approval to acquire up to 49.99% of the company.

* * *

Authors:

Barry A. Nigro

Peter Guryan

Alyson Redman

Contacts:

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or the attorneys listed below:

Barry A. Nigro

Partner

+1.202.639.7373

Peter Guryan

Partner

+1.212.859.8477

Richard C. Park

Partner

+1.202.639.7064

Alasdair Balfour

Partner

+44.20.7972.6274

**New York**

One New York Plaza
New York, NY 10004
Tel: +1.212.859.8000
Fax: +1.212.859.4000

Washington, DC

801 17th Street, NW
Washington, DC 20006
Tel: +1.202.639.7000
Fax: +1.202.639.7003

London

99 City Road
London EC1Y 1AX
Tel: +44.20.7972.9600
Fax: +44.20.7972.9602

Paris

5, rue François 1er
75008 Paris
Tel: +33.140.62.22.00
Fax: +33.140.62.22.29

Frankfurt

Taunusanlage 18
60325 Frankfurt am Main
Tel: +49.69.870.030.00
Fax: +49.69.870.030.555

Hong Kong

9th Floor, Gloucester Tower
The Landmark
15 Queen's Road Central
Hong Kong
Tel: +852.3760.3600
Fax: +852.3760.3611

Shanghai

40th Floor, Park Place
1601 Nanjing Road West
Shanghai 200040
Tel: +86.21.6122.5500
Fax: +86.21.6122.5588

A Delaware Limited Liability Partnership

The information and materials offered in this publication are for general informational purposes only; it does not constitute legal advice and is presented without any representation or warranty whatsoever, including as to the accuracy or completeness of the information.

Fried Frank Antitrust & Competition Law Alert® is published by the Antitrust & Competition practice group of, and is a registered trademark and servicemark of Fried, Frank, Harris, Shriver & Jacobson LLP.

Fried Frank Antitrust & Competition Law Alert® is provided free of charge to subscribers. If you would like to subscribe to this email service, please send an email message to Antitrust_Alert@friedfrank.com and include your name, title, organization or company, mail address, telephone and fax numbers, and email address.

To view copies of previous Fried Frank Antitrust & Competition Law Alerts®, please visit our archives on the Fried Frank website.

To view previous Antitrust & Competition To Our Client Memoranda, please visit our archives on the Fried Frank website.

To unsubscribe from all Fried Frank email Alerts and electronic mailings send a blank email to unsubscribe@friedfrank.com.

Attorney Advertising. Prior results do not guarantee a similar outcome.