Antitrust Agencies Reach Settlements in Three HSR Act Cases

February 7, 2017

In waning days of the Obama Administration, the U.S. Antitrust Agencies reached three settlements totaling $1.4 million for violations of the premerger notification and waiting period requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act").

Background

In the United States, the HSR Act requires companies planning acquisitions that meet certain HSR Act thresholds to file a premerger notification with the DOJ and the FTC and to observe the applicable waiting period (typically 30 days, unless extended by a so-called "second request").

During the waiting period, the acquiring company is not permitted to obtain "beneficial ownership" of the assets it plans to acquire. Beneficial ownership of a target can be transferred when the acquiring company assumes certain risks or benefits of changes in the value of the business or exercises control over daily business decisions of the target. In other words, the acquirer cannot "jump the gun" and take control of the target before the HSR period has expired. While some conduct obviously constitutes inappropriate "gun jumping," there are frequently gray areas and difficult judgment calls that arise.

In the three cases discussed below, the first involved a more nuanced and complex "gun jumping" issue, while the other two involved relatively clear and straight-forward HSR Act violations.

Duke Energy Corporation

When parties have entered into a merger agreement, they may sometimes seek to enter into *separate* commercial agreements prior to the termination of the HSR waiting period. When this happens, a question arises as to whether such separate commercial agreements can constitute inappropriate "gun jumping" or can be characterized as "ordinary course" and "arm's length" conduct that is occurring independent of the transaction.

This issue arose in connection with Duke Energy Corporation's ("**Duke's**") proposed acquisition of Osprey Energy Center ("**Osprey**"). In a complaint filed on January 18, 2017, the DOJ took the position that a "tolling agreement" between Duke and Osprey constituted "gun jumping" because it gave Duke effective control over Osprey's business and would not have happened but for the proposed acquisition.

Factual Background

In August 2015, Duke agreed to purchase Osprey from Calpine Corporation ("**Calpine**"), a nationally competing seller of wholesale electricity. According to the complaint, in September 2014, Duke and Calpine executed a "tolling agreement" that would be in effect from October 2014 until the closing of the acquisition. The tolling agreement caused Duke to be responsible for determining the amount of power to be generated by Osprey and for purchasing and delivering all fuel necessary to produce the power generated by Osprey. In return, Duke received all of the electricity generated by Osprey. In testimony to the Florida Public Service Commission, an executive of Duke testified that the tolling agreement was a "mechanism to transfer the acquisition of the plant to [Duke]."

It was further alleged that each day, Duke sent hour-by-hour instructions to Osprey employees instructing them to produce certain amounts of power at the plant. Duke assumed responsibility of additional functions previously performed by Calpine, including arranging the procurement and delivery of natural

gas to Osprey. In essence, Duke was free to make all competitively significant decisions for Osprey based on Duke's own business interests. According to the complaint, during this time, Calpine no longer made any significant competitive decisions for Osprey and the complaint alleged that the tolling agreement effectively granted Duke control over Osprey.

The DOJ's Complaint and Settlement

Based upon these alleged facts, the DOJ's Antitrust Division brought suit alleging that Duke violated the HSR Act by failing to make the required premerger notification and observe the applicable waiting period before obtaining beneficial ownership of Osprey. The complaint alleged that Duke was in violation of the HSR Act from October 1, 2014 (when the tolling agreement became effective) through the termination of the waiting period in February 2015. Contemporaneously with the complaint, the DOJ filed a stipulation between the parties agreeing to settle the matter against Duke provided it pay a $600,000 civil penalty and a final judgment in accordance with the stipulation is entered. Duke did not admit liability in this settlement.

The key issue presented was whether the tolling agreement amounted to gun jumping. The DOJ acknowledged that "tolling agreements are relatively common in the electrical industry." Nevertheless, the DOJ took the position that circumstances surrounding this particular tolling agreement were unusual and suspect:

> Duke said in testimony to the Florida Public Service Commission that there was no separate rationale to enter this tolling agreement independent of the acquisition . . . Duke insisted that it was only willing to enter into a tolling agreement in combination with an acquisition agreement, and only if Duke had the right to terminate the tolling agreement without penalty in the event that [the Federal Energy Regulatory Commission] rejected the acquisition.

In a press release issued contemporaneously with the settlement, Duke insisted that it "sought FTC approval on the correct date, in compliance with the relevant federal statute as it was widely interpreted by most companies at the time."

The takeaway from this enforcement action is that parties to merger agreements need to take care when they enter into separate commercial agreements prior to expiration of the HSR waiting period. At a minimum, these parties should ensure that the commercial agreement is not linked to the merger agreement, but instead can be accurately represented as an "ordinary course" and "arm's length" agreement that was executed independent of the merger agreement.

Ahmet H. Okumus

Another alleged HSR violation involved a hedge fund founder's acquisition of voting securities of the internet services company Web.com Group, Inc. ("**Web.com**") in 2016.

Okumus's Prior Violation

According to the complaint, Ahmet H. Okumus was found to have first violated the HSR Act in 2014 for failure to report his acquisition of approximately 13.5% of the voting securities of Web.com due to his improper reliance on the exemption for acquisitions solely for the purpose of investment. That exemption was unavailable because the HSR Act only exempts acquisitions of 10% or less of the issuer's voting securities. In response to Okumus's corrective filing, the FTC sent a letter to Okumus indicating that it would not recommend civil penalty for the Web.com acquisition, but advised that Okumus "'still must bear responsibility for compliance with the [HSR] Act"' and was "'accountable for instituting an effective program to ensure full compliance with the [HSR] Act's requirements."'

In his corrective HSR Act filing, Okumus filed at the $50 million threshold, as adjusted. As such, after expiration of the waiting period, Okumus was allowed to acquire additional voting securities of Web.com without making subsequent HSR Act filings, provided that he did not exceed the $100 million threshold, as adjusted.

Okumus's Recent Violation

In 2016, Okumus began acquiring additional voting securities of Web.com. At the time, the adjusted $100 million threshold was $156.3 million. On June 27, 2016, Okumus acquired additional voting securities of Web.com which resulted in him holding voting securities of Web.com valued in excess of the $156.3 million threshold. Okumus failed to file under the HSR Act or observe the waiting period prior to making the June 27, 2016 acquisition.

On July 14, 2016, Okumus sold a portion of his voting securities in Web.com so that he no longer held voting securities of Web.com that was valued over the $156.3 million threshold.

On January 17, 2017, the DOJ filed a civil antitrust lawsuit in the U.S. District Court for the District of Columbia against Okumus alleging that he was in violation of the HSR Act for each day that he held voting securities of Web.com in excess of the $156.3 million threshold from June 27, 2016 through July 14, 2016. Along with the complaint, the DOJ filed a stipulation between the parties agreeing to settle, discharge and release any and all claims against Okumus provided he pay a $180,000 civil penalty and a final judgment in accordance with the stipulation is entered.

Mitchell P. Rales

The DOJ's Antitrust Division, at the request of the FTC, filed a lawsuit against Mitchell P. Rales for violation of the premerger notice and waiting period requirements of the HSR Act with respect to the acquisition of voting securities of two industrial companies—Colfax Corporation ("**Colfax**") and Danaher Corporation ("**Danaher**").

Rales's Prior Violation

According to the complaint, Rales was found to have first violated the HSR Act due to Equity Group Holdings' ("**Equity Group**") failure to file under the HSR Act prior to acquiring voting securities of Interco Inc. in 1988. Since Rales was an ultimate parent entity of Equity Group and controlled Equity Group for purposes of the HSR Act, Equity Group's violations of the HSR Act were attributed to him. In January 1991, the United States brought a suit against Equity Group for its violation of the HSR Act.

Rales's Recent Violations

Before May 7, 2008, Rales held over 50% of the voting securities of Colfax. As such, under the HSR Rules, Rales was exempt from the requirements of the HSR Act for any further acquisitions of Colfax voting securities. However, on May 7, 2008, Colfax made an IPO of voting securities that resulted in the decrease of Rales's holdings in Colfax to approximately 20.8% of the voting securities of Colfax. This decrease caused Rales to no longer be exempt from the requirements of the HSR Act for any subsequent acquisitions of Colfax voting securities. In October 2011, Rales's wife acquired shares of voting securities of Colfax on the open market. Pursuant to 16 C.F.R. § 801.1(c)(2), this acquisition was attributed to Rales and caused Rales to hold voting securities of Colfax valued over the $100 million threshold, as adjusted. Prior to this acquisition, Rales failed to file under the HSR Act. Although not exceeding the next highest HSR filing threshold, Rales continued to acquire voting securities of Colfax through August 2015.

Separately, in January 2008, Rales acquired voting securities of Danaher that caused him to hold a value of approximately $2.3 billion in voting securities of Danaher. This acquisition was in excess of the HSR

Act's $500 million threshold, as adjusted. Prior to making this acquisition, Rales failed to file under the HSR Act.

In February 2016, Rales made corrective filings under the HSR Act for the 2011 Colfax and the 2008 Danaher transactions. In March 2016, the waiting period on the corrective filings expired.

On January 17, 2017 the DOJ filed a complaint against Rales for (1) his continuous violation of the HSR Act from October 2011 (when Rales's wife acquired additional voting securities of Colfax) through the March 2016 (when the waiting period on the corrective filing expired) and (2) his continuous violation of the HSR Act from January 2008 (when he acquired the Danaher voting securities) through March 2016 (when the waiting period on the corrective filing expired). Contemporaneously with the complaint, the DOJ filed a stipulation between the parties agreeing to settle, discharge and release any and all claims against Rales provided he pay a $720,000 civil penalty and a final judgment in accordance with the stipulation is entered.

In its court filings, the government indicated that the fine was substantially lower than the maximum penalty that could have been imposed (currently, approx. $40,000 per day) because the violations were inadvertent and the defendant self-reported the violations. The takeaway from this action is that even plainly inadvertent violations – the facts in each case were unusual and the triggers for the filing requirements likely would not have been obvious to the non-expert - can lead to a significant monetary penalty if the acquiring person had a prior HSR violation, even one that took place 25 years earlier.

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