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Equity Part of Your Company's Compensation Plan? Don't Forget About HSR

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Any company that issues stock compensation to executives, board members or employees should be aware of HSR requirements and potential traps for the unwary.

On January 26, 2018, the FTC issued its [annual inflation-adjusted thresholds](#) for determining whether an acquisition of voting securities requires prior notification to the FTC and DOJ under the Hart-Scott-Rodino Act. This year, the size-of-transaction magic number is \$84.4 million, meaning that if any person or entity will hold voting shares that exceed that amount as a result of an acquisition, all such parties must submit an HSR filing and observe a mandatory waiting period *before* acquiring the shares.

The FTC also revised the potential maximum penalty for violations of the HSR Act, including failures to submit required notifications, to \$41,484 per day until the violation is remedied.

Triggering an HSR filing through issuance of equity: the general rule

Acquiring shares through an employment compensation arrangement is a potentially reportable event under the HSR Act if the relevant thresholds are met and no exemption applies. The HSR Act applies to acquisitions of shares that, *aggregated with shares already held*, are valued over the relevant thresholds.

Executives and board members often acquire shares through various equity compensation mechanisms, including option exercises, stock purchases under an employee stock purchase plan, restricted stock grant and settlement of restricted stock units. An HSR filing is required if, among other things, the size of transaction test is met, meaning that the shares and assets held as a result of a transaction, including those already held,¹ are valued over \$84.4 million. Companies that use equity compensation awards therefore must be vigilant to avoid inadvertent HSR violations for executives or board members who own stock valued close to, or above, the current threshold of \$84.4 million. Where an HSR filing is required, the executive must file *and* observe a 30-day waiting period, which can be shortened in some circumstances, *before* making the acquisition.

The following chart summarizes a few common scenarios involving executive compensation and the related HSR implications. As the examples make clear, the key is to focus on the time when the executive receives additional voting rights for directors.

Common scenarios	
Equity compensation hypotheticals	Potential HSR implications

Common scenarios	
Equity compensation hypotheticals	Potential HSR implications
Executive holds shares valued <i>over</i> the threshold and receives an award of RSUs that vest annually for next five years.	No HSR filing is required unless the executive is acquiring shares that have the present right to vote for directors. Therefore, no HSR filing obligation is triggered until the executive receives shares under the agreement.
Executive holds shares valued <i>over</i> the threshold and receives RSUs that were previously promised under an agreement reached three years prior.	The acquisition of RSUs, which do not entitle the executive to vote for the election of directors, similarly does not require an HSR filing.
Executive holds shares valued <i>over</i> the threshold and previously-granted RSUs vest, triggering the immediate issuance of voting shares.	HSR filing may be required before the shares underlying the RSU may be issued.
Executive holds shares valued <i>under</i> the threshold and receives option to acquire shares that would put him or her over the threshold.	Because an option to buy a share does not bestow a present right to vote for directors, no HSR filing is required for the acquisition of an option.
Executive holds shares valued <i>under</i> the threshold and exercises options to acquire shares that would put him or her over the threshold.	HSR filing may be required before the executive can exercise the options.
Executive holds shares valued <i>under</i> the threshold and acquires shares on the open market that would put him or her over the threshold.	HSR filing may be required before the executive can purchase the shares.
Executive holds shares valued <i>under</i> the threshold and previously-granted RSUs vest, triggering the immediate issuance of voting shares that would put him or her over the threshold.	HSR filing may be required before the shares underlying the RSU may be issued.

Common scenarios	
Equity compensation hypotheticals	Potential HSR implications
Executive acquires shares on the open market. At time of acquisition the value of shares acquired are <i>under</i> the threshold; shares then appreciate in value over the threshold.	Appreciation of already-held shares does not trigger an HSR filing. Any acquisition of shares, even just one, may trigger an HSR filing if the value of the executive's holdings remain over the threshold.

Are there any exemptions or exceptions to the general rule?

Even if the thresholds are met, an investor may be able to take advantage of several exemptions that apply to minority investments. For example, where an executive exercises stock options and then immediately sells those shares (such as through a same day-sale transaction), the FTC takes the position that there was no acquisition and so no filing is required. In the context of an initial public offering, the FTC has concluded that the conversion of a non-voting security into voting stock at the time of the IPO is not a potentially reportable acquisition so long as the investor acquired the non-voting security before the issuer was in registration. Another common exemption for minority investors, though not one available to employees or board members, is the [investment-only exemption](#), which exempts acquisitions of up to 10% if made "solely for the purpose of investment."

The HSR Act also provides an exemption for ongoing acquisitions. Once an investor has filed under HSR, he or she is able to acquire additional shares for five years up to the next HSR threshold without the need to submit another HSR filing. As mentioned above, the FTC adjusted the first HSR threshold to \$84.4 million, effective February 28, 2018; the FTC adjusted the second threshold to \$168.8 million.

A prominent example of a missed HSR filing for executive compensation is the 2012 enforcement action requiring the CEO of a major telecommunications company to pay \$500,000 in civil penalties. The CEO received shares upon the vesting of several previously granted RSUs and through his 401(k) account via reinvestment of dividends and short-term interest earned by that account. While the FTC concluded that the failure to file was inadvertent, it sought civil penalties because the telecommunications company, while the CEO controlled it for HSR purposes, had previously failed to file for acquisitions of shares in two other companies.

Corrective filings and one free bite at the apple

The FTC has a long-standing, informal "one free bite at the apple" policy, pursuant to which it typically will decline to seek civil penalties for the first inadvertent failure to file if the person self-reports the violation and makes a corrective filing.

The corrective filing requires that the parties to the transaction file with the FTC and DOJ as if the filing had been submitted timely, along with a detailed, written explanation about the violation, describing the circumstances that led to the failure to file.

While not a large percentage of the overall HSR filing count, corrective filings are regularly submitted. In FY16, the latest year for which data is available, parties made 47 corrective filings.

Enforcement actions for failure to file

If a person or company fails to file a second time, even if it is inadvertent, the FTC frequently seeks civil penalties. In 2017, for example, the FTC, through the DOJ, sought civil penalties from two individuals.

- Entrepreneur Mitchell P. Rales agreed to pay \$720,000 to resolve charges that he failed to file for acquisitions of shares on the open market in Colfax and Danaher, one made by him and the other by his wife, whose shares were attributable to Rales. Rales previously made a corrective filing for an acquisition of shares by Equity Group Holdings, an entity that Rales controlled, in Interco Incorporated in 1991.
- Hedge fund founder Ahmet H. Okumus agreed to pay \$180,000 to settle allegations that his acquisition of shares in Web.com without a filing violated the HSR Act. In 2014, Okumus made a corrective filing for his acquisition of 13.5% of the voting securities in Web.com at the lowest HSR threshold, \$50 million, as adjusted for inflation. Okumus had relied on the investment-only exemption, but because he held over 10% of the voting securities, that exemption was not available to him. After making the corrective filing and the FTC declining to seek civil penalties, Okumus continued to acquire shares until he crossed the next higher threshold, which was adjusted to \$156.3 million at the time of the violation. The FTC sought civil penalties for Okumus' second violation.

As these enforcement actions underscore, the HSR Act and its many technicalities can often lay traps for the unwary. It is therefore important for individuals and company counsel to be aware of the HSR Act and to seek advice where holdings may start to approach the \$84.4 million threshold.

Implementing an HSR compliance program

If your company has executives, board members or even investors who have or might in the future have holdings close to the HSR thresholds, implementing an effective HSR compliance program is a good way to avoid inadvertent missed filings. Examples of steps that companies can take in implementing a compliance program include:

- Including HSR on acquisition and investment checklists
- Incorporating HSR into internal trainings on regulatory requirements
- Identifying an individual in the legal or business development group responsible for HSR compliance
- Including HSR compliance in RSU and 401(k) information packages for executives
- Periodically checking the value of holdings of executives against HSR thresholds

For assistance in implementing an effective program, reach out to your Cooley contact or anyone in the Cooley antitrust group.

Notes

1. Shares held by spouses and minor children are also deemed to be "held" by an individual.

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