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# Executives Beware - Option Exercises Can Engender Massive HSR Fines

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The Federal Trade Commission (FTC) recently fined the CEO of Capital One Financial Corp. \$637,950 for completing the acquisition of Capital One voting securities via an option exercise without making a filing under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (HSR). HSR requires persons acquiring voting securities (or assets, or non-corporate interests) of a certain size, and which also meet other thresholds, to file a Premerger Notification Form (HSR Filing) with the FTC and U.S. Department of Justice (DOJ) 30 days before such an acquisition. If the 30-day waiting period expires (or is terminated early), without FTC or DOJ action, the acquisition is free to close.

### What You Need to Know:

- The exercise of stock options can trigger requirements to file a Premerger Notification Form under a key U.S. antitrust law - the Hart-Scott-Rodino Antitrust Improvements Act of 1976.
- The failure to file this form can trigger a fine of \$43,792 per day for every day beyond the date on which the filing should have been made.
- The triggering thresholds apply when an executive with a net worth of \$18.4 million or more seeks to exercise an option in an entity valued at more than \$184 million when it results in the executive holding securities valued at more than \$92 million. These thresholds adjust annually.

In its news release,<sup>[1]</sup> the FTC characterized the CEO, who was merely exercising options that he had earned as part of his board-approved compensation package, as being a “repeat offender with wrongdoing spanning two decades.” To many corporate and securities industry participants, this is a surprising result. This is not the first time that the FTC has levied significant fines for failing to make an HSR Filing against an executive of a large, publicly traded company for the exercise of properly earned options. For example, in 2009, the FTC fined the CEO and Chairman of Discovery Holding Company \$1.4 million relating to a similar set of option exercises. Similar fines have been paid by the CEO of Comcast Corp.,<sup>[2]</sup> the Chairman of the Madison Square Garden Corporation<sup>[3]</sup> and others.

Given the strong language in the FTC’s recent press release, the agency is making it clear that it intends to pursue corporate executives (and, implicitly others) who fail to make an HSR Filing when one is required. As described below, these FTC fines hold several important lessons, including:

- Option exercises and other stock purchases which meet the HSR size-of-transaction threshold (currently \$92 million<sup>[4]</sup>) when the size-of-person (\$18.4 million and \$184 million in total assets or net sales)<sup>[5]</sup> thresholds are also met, must make an HSR Filing. The HSR Filing triggers a 30-day waiting period, during which the acquisition is on hold. If that waiting period expires, or is terminated early, without action by either the FTC or DOJ, the acquisition may be made, but it does not mean that the acquisition has been “approved.” Instead, it means that neither agency has a present intention to challenge the acquisition under the federal antitrust laws.<sup>[6]</sup>
- Even if a person has lawfully made prior acquisitions of an issuer’s voting securities not subject to an HSR Filing, the person may have to make an HSR filing before completing additional incremental acquisitions of shares under relevant HSR aggregation rules.
- The FTC’s enforcement priorities with regard to HSR rules may change over time, and executives should consult with their legal service providers to keep informed of these changes.

## SECURITIES TRANSACTIONS AND REGULATIONS PRACTICE

**BACKGROUND**

HSR requires parties making acquisition of voting securities, assets or non-corporate interests (such as membership interests or units), by merger, acquisition or other combination that exceed jurisdictional thresholds to make filings with the FTC and the DOJ and to observe a waiting period before closing. However, the definition of what might be considered such a transaction is broader than one might think, and includes any acquisition of voting securities – including option exercises.

**HSR TESTS**

Generally, if a transaction meets all of the following HSR threshold tests and no exemption applies, the transaction will require an HSR Filing:

- **Commerce test.** The commerce test is met if the acquiring or acquired entity is engaged in commerce in the United States or in any activity affecting United States commerce. In the context of option exercises, this test is almost certainly always met.
- **Size-of-person test.** The size-of-person test applies only to transactions resulting in the acquiring entity holding voting securities, assets, or non-corporate interests valued at more than \$92 million. However, transactions valued at \$368 million or more are subject to HSR reporting regardless of size-of-person considerations.
- **Size-of-transaction test.** The size-of-transaction measures the value of the assets, voting securities, and non-corporate interests that the acquiring entity will hold as a result of the transaction (or series of related transactions). This test is met if such assets have a value of more than \$92 million.

Thus, if an option to acquire voting securities in an entity valued at more than \$184 million is exercised by an executive with a net worth of \$18.4 million that results in the executive holding voting securities valued under HSR rules at more than \$92 million, the executive will likely need to report the transaction under HSR, prior to consummating the option exercise. In addition, the entity whose voting securities are being acquired will make a companion filing, and, the appropriate filing fee will have to be paid to make the filing complete and start the 30-day waiting period clock. Of course, this also means that the executive would need to wait until after the expiration or early termination of the waiting period to file Section 16 reports, as well as any updates to the executive's Schedule 13D filings.

**FILING REQUIREMENTS**

- HSR Premerger Notification Form (HSR Form) – In most HSR Filings, the HSR Form calls for a fair amount of detailed information from all parties required to file. For an option exercise, while the form is less of a daunting task for the filing executive, it remains somewhat of a challenge for the entity whose voting securities are being acquired. Nonetheless, the HSR Form has nuances, and the FTC and DOJ review is very exacting. Mistakes can delay the start of the 30-day waiting period. And, the HSR Form requires a certification and an affidavit, and its content is submitted under oath. Therefore, executives exercising options which meet the HSR thresholds should engage legal counsel familiar with the HSR process, rules and the content required in the HSR Form.
- In addition, since the onset of COVID-19, the FTC has required all filings to be made remotely and via an upload to an FTP site as directed by the agency. The mechanics of those protocols are again very exacting and precise regarding how electronic files are formatted and the form in which they are submitted. Experienced counsel will be able to handle this properly.
- The correct Filing Fee must be paid:
  - \$45,000 for deals between \$92 million - \$184 million,
  - \$125,000 for deals between \$184 million - \$919.9 million, or
  - \$280,000 for deals over \$919.9 million.<sup>[7]</sup>
- Depending on the nature of the transaction and the communication of the parties, certain documents may need to accompany the filing, and again, the advice of experienced HSR counsel is necessary to make sure no required attachments are forgotten or overlooked.
- There should not be any open market purchases during the 30-day HSR waiting period.

**SECURITIES TRANSACTIONS AND REGULATIONS PRACTICE**

- While the waiting period is running, there are rules to follow concerning various matters which will be explained by HSR counsel. The FTC will issue a letter when the filing is complete (both parties file and the fee is paid) which states when the waiting period commenced, and when it expires, which is at 11:59 p.m. on the 30th day. Closing can occur thereafter unless one of the agencies makes contact with questions and an investigation delays expiration.

After the executive has cleared the HSR process, it will then shift its reporting obligation considerations from antitrust counsel to securities counsel, which can assist the executive in filing with the U.S. Securities and Exchange Commission, the appropriate Form 4 (or other Section 16 forms), as well as any updates to the executive's Schedule 13D filings.

**CONCLUSION**

The important takeaway here is that equity/incentive compensation transactions by executives, including the exercise of already-earned options, can trigger HSR filing obligations when the filing thresholds are met, whether by that single purchase or exercise, or when aggregated with prior purchases and exercises. Companies, general counsels and executives should consult with counsel when the size-of-person and size-of-transaction thresholds appear to be triggered, so that the appropriate HSR analysis can be performed. Otherwise, the risk in failing to file is a fine of at least \$43,792/day, not to mention further FTC and DOJ scrutiny of both the relevant executive and the corporation which employs the executive.

1. <https://www.ftc.gov/enforcement/cases-proceedings/2010065/richard-d-fairbank-us-v>
2. <https://www.ftc.gov/enforcement/cases-proceedings/1010034/roberts-brian-l>
3. <https://www.ftc.gov/enforcement/cases-proceedings/181-0077/james-l-dolan>
4. The FTC adjusts these dollar amount thresholds annually.
5. In other words, in addition to there being a deal-value threshold, a deal which exceeds the value-threshold also needs to be engaged in by parties that exceed size thresholds; if any one of those three thresholds is not met, no filing is required.
6. It cannot be overstressed that neither the FTC nor the DOJ "approves" HSR Filings. Acquisitions of voting securities, assets and non-corporate interests (e.g., LLC units) are reviewed under section 7 of the Clayton Act, which prohibits those acquisitions where the effect "may be substantially to lessen competition, or tend to create a monopoly." HSR allows the agencies to test the acquisition's potential harm to competition as an incipient matter and to stop it if that effect can be proved. If the transaction is permitted to close without such a challenge, it remains subject to challenge under the Clayton Act if there can be proved an actual adverse effect on competition, via monopoly or otherwise. In effect, the passage of the HSR waiting period is the functional equivalent of a "no present intent to prosecute" outcome.
7. There is only one filing fee, and its payment is the subject of negotiation between the filing parties. More often than not the fee is paid by the purchaser, but, in option exercise deals, the fee is often split.

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