

FTC: Investment Funds to Pay \$800,000 in Civil Penalties for HSR Violations

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Two investment funds, ESL Partners, L.P. and ZAM Holdings, L.P., will pay a combined \$800,000 for failing to make HSR filings for their acquisitions of shares in AutoZone, Inc. in September and October 2004.

ESL Partners filed HSR notification for its acquisitions of AutoZone shares in August 1999. However, HSR clearance is only valid for five years from the end of the waiting period, so the acquisitions of AutoZone stock by ESL Partners after September 1, 2004, were made in violation of the HSR Act.

ZAM Holdings is the parent of ESL Investors, a related company that also made repeated investments in AutoZone. Through ESL Investors, ZAM held approximately \$270 million in AutoZone stock as of September 1, 2004, for which it was not required to file notification. However, in October 2004 it purchased additional AutoZone shares without filing notice under the HSR Act.

Neither ESL Partners nor ZAM Holdings was entitled to claim the "investor only" exemption for purely passive investments of up to 10% in a given issuer. They did not qualify for the exemption because they intended to participate in the formulation of AutoZone's basic business decisions through their representative on its board of directors. In addition, ZAM held more than 10% of AutoZone's outstanding voting securities.

FTC staff contacted ESL Partners and ZAM Holdings in late January 2005 about the lack of any HSR filings for their recent acquisitions, and both parties filed promptly upon having the omission brought to their attention. The FTC, however, deemed the HSR violations to have dated from each separate acquisition of AutoZone stock through the ends of the parties' respective HSR waiting periods, 30 days after the corrective filings were made.

Under the HSR Act, the maximum penalty for a failure to file is \$11,000 per day per violation. In determining whether to seek civil penalties and, if so, for how much, the FTC considers several factors: whether the parties failed to file as a result of understandable or simple negligence; promptly corrected their failure; gained any benefit (e.g., tax, contract or regulatory) by failing to file; and implemented adequate safeguards to protect against future failures. In practice, most first-time offenders avoid a penalty altogether; the fact that the agency imposed a penalty here may indicate a

previous failure or other aggregating factor. Nevertheless, the civil penalties of \$525,000 for ESL Partners and \$275,000 for ZAM Holdings actually represent a substantial discount from the maximum and may reflect the parties' prompt corrective measures.

This action highlights several points for HSR practice. First, HSR clearance is good for only five years from the end of the waiting period, and an investor that continues to acquire shares in an issuer over a period of more than five years may need to make multiple HSR filings. Second, the HSR rules applicable to investment funds and partnerships have evolved over time, and exemptions that applied to previous acquisitions may no longer be in force, even if all the other facts and circumstances have remained constant. Third, each time an investor acquires voting securities of an issuer, the current market value of that investor's existing holdings must be factored into the determination of whether an HSR dollar notification threshold has been crossed. Finally, the civil penalties for unwitting HSR violations can often be mitigated by prompt corrective measures and cooperation with the agency.