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M&A Communications in a Web 2.0 World

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It used to be that once a merger or acquisition agreement was signed, communicating the deal's merits to shareholders was a mechanical process with a pre-ordained outcome. That is no longer the case. While the SEC liberalized the ability of corporations to talk about their pending transactions almost 15 years ago, the explosive growth in online technologies in the past few years has opened up new channels of communication for anyone with an opinion on a pending deal.

As a result, a company can not only count on commentary on the merits of its deal from traditional sources, but also from new voices, including activist investors who may be strongly motivated to defeat a transaction in favor of a preferred alternative, and who are sophisticated in using new communications channels to organize shareholder opposition. Furthermore, as technology fuels social media and other highly-interactive "Web 2.0" websites, various corporate constituencies, including investors, have come to expect an unprecedented degree of online engagement from businesses.

While companies have embraced social media in other areas of corporate communications, most have been reluctant to do so when it comes to M&A communications. Using social media in the M&A context presents dealmakers with significant compliance challenges that are only likely to grow as technology advances. Nevertheless, the use of social media by activists and the demand for engagement by investors makes it apparent that ignoring social media will not be a viable option for dealmakers very much longer.

The Rules of the Road: The SEC's Regulatory Framework for M&A Communications

Until 2000, the federal securities laws sharply restricted public companies' ability to communicate with the market about their deals. Virtually any communications about a pending deal beyond a very limited factual announcement could be deemed to involve an "offer" under the Securities Act of 1933 (in the case of a transaction involving stock consideration), or a "solicitation" of proxies or "commencement" of a tender offer under the Securities Exchange Act of 1934.[1]

[1] Section 2(a)(3) of the Securities Act defines the term "offer" broadly to "include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." 15 USC §78(b)(a)(3). Rule 14a-1 defines "solicitation" to encompass providing any "communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy." 17 CFR §14a-1(l)(iii).

TABLE OF CONTENTS

– M&A Communications in a Web 2.0 World 1

– That Grant Could Cost More Than You Think: HSR Application to Officer & Director Compensation 6

– Traps to Consider: Delaware's Merger Statute & Ratification Amendments 9

– New Reg D: Implications for Offering Publicly-Traded Securities as Consideration in Private Acquisitions 11

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The SEC eased these restrictions significantly in 2000.[2] In essence, the SEC's new approach was to tell companies that they could say whatever they wanted about their pending deals, but they had to assume responsibility for those communications by filing them with the SEC as either a "prospectus" subject to liability under Section 12 of the Securities Act, or as "soliciting material" subject to liability under Rule 14a-9 of the Exchange Act.[3]

At around the same time, the SEC also addressed longstanding concerns about selective disclosure by adopting Regulation FD. Regulation FD, which became effective in October 2000, requires that whenever a company discloses material nonpublic information to securities market professionals or investors, it must simultaneously (for intentional disclosures) and "promptly" (for unintentional disclosures) provide general public disclosure of that same information.[4]

The Emergence of Web 2.0 & Social Media

The SEC's new communications rules and Regulation FD represented dramatic changes in the regulatory environment for M&A. When it came to pending deals, the general rule had been that companies should speak primarily through their SEC filings (and then only after such filings were made). The new rules allowed companies to say anything they wanted to about their deals, so long as they were willing to assume liability for those statements, file them the SEC, and make sure that they appropriately shared that information with everybody if they shared it with anybody.

The new regime worked pretty well until Mark Zuckerberg showed up. As everyone knows, Mr. Zuckerberg is the co-founder of, and prime mover behind, Facebook, the world's leading social media site and a prime example of the "Web 2.0" phenomenon: the interactive and collaborative websites that are becoming the dominant voices on the Internet, as they replace the passive websites which characterized the Internet's first generation.

While there was a lot of excitement about the Internet during the 1990s and the first decade of the 21st century, first generation websites shared many of the characteristics of traditional media. Static screens, a limited number of content creators (all of whom were affiliated with the site), and few if any opportunities for interaction made these sites essentially online versions of newspapers. So while the Internet created a lot of new media voices, issuers could interact with these voices in much the same way as they had done in the past with their print or broadcast counterparts.

Web 2.0 fundamentally changed the game for corporate communications in general, and is rapidly transforming the way that interested parties communicate about M&A transactions. Instead of a handful of individuals speaking through traditional media and newer online outlets, the explosive growth of sites like Facebook, Twitter, Linked-In, YouTube, Vine, Instagram, Google+ and other social media or interactive sites means that hundreds or even thousands of people may share opinions about a proposed deal on a real time basis.

Activist investors have been quick to realize the benefits of social media, and have incorporated it into their campaigns. Activists are using a variety of social media outlets to broadcast their message to investors as widely as possible, and to help ensure that small investors can cast their votes on an expeditious basis.[5] Use of social media has become so central to activist strategies that *The Wall Street Journal's MoneyBeat* blog recently described noted activist Carl Icahn as having "three key weapons in his armory—money, opinions and a Twitter account. . ."[6]

Many businesses view social media as a tool that provides them with unprecedented opportunities for marketing and overall customer engagement. What's more, key constituents have come to expect that companies will interact with them through social media, and the failure to do so can create significant

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[2] *Regulation of Takeovers and Security Holder Communications*, Release No. 33-7760 (effective January 24, 2000).

[3] *See generally*, Rule 165, 17 CFR §239.165 and Rule 14a-12, 17 CFR §240.14a-12. Communications relating to tender offers are somewhat more restricted, with the ability to speak freely generally limited to the period prior to commencement of a tender offer.

[4] Regulation FD, 17 CFR §243.101-103.

[5] For a discussion of activists' integrated approach to using social media in their campaigns, see Richard Levick, *The Floodgates Are Open: Shareholder Activists Intensify Social Media Utilization,"* Forbes.com, April 25, 2011, www.forbes.com/sites/richardlevick/2011/04/25/the-floodgates-are-open-shareholder-activists-intensify-social-media-utlization/ (accessed October 15, 2013).

[6] Ben Winkley, *"Icahn Hopes to Bring Good Fortune to Talisman,"* Wall Street Journal MoneyBeat Blog, October 8, 2013 http://blogs.wsj.com/moneybeat/2013/10/08/icahn-hopes-to-bring-good-fortune-to-talisman/ (accessed October 15, 2013).

issues.[7] As a result, businesses are incorporating social media into every aspect of their communications programs with customers, suppliers, employees and, increasingly, shareholders.[8]

Despite its increasing presence in other areas of corporate communications, companies have been slow to embrace the use of social media in M&A communications. According to a recent survey 77% of public company executives said that they do not have a social media strategy specifically for M&A, 65% do not anticipate developing such a strategy, and 74% were "neutral to negative on the importance of having a social media strategy specifically to impact M&A transactions."[9]

Corporate America may be reluctant to embrace social media in M&A communications, but as corporate use of social media expands in other areas, as key constituencies come to expect it, and as potential adversaries continue to use social media as a vital tool in their campaigns, dealmakers may have no choice but to incorporate social media into their own M&A communications strategies:

> A company has a very important decision to make—and that is whether to lead the conversation about its business and industry, or possibly find itself in a defensive and reactionary position where other individuals participating in social media have an opinion, express it, and thereby force the company to respond.[10]

Notwithstanding this apparent business imperative, corporate dealmakers' reluctance to use social media in their communications about pending transactions is understandable. That is because communicating effectively through this medium without running afoul of the SEC's interpretations of Regulation FD and its M&A disclosure rules is a difficult process, with few channel markers.

The SEC & Social Media: The 2008 Release and the Netflix 21(a) Report

While there remains quite a bit of uncharted territory in terms of the securities laws and the Internet, the SEC has actually had quite a bit to say about electronic communications over the years.[11] In general, the SEC's approach toward the Internet has been one of cautious endorsement, coupling recognition of the benefits of electronic distribution of information with concern for potential abuses associated with the ability to access millions of potential investors at one time and the constraints imposed by the statutes in question.

In 2008, the SEC published an interpretive release providing guidance on the use of company websites for investor communications.[12] Among other things, the 2008 release focused on the extent to which company websites could be used for Regulation FD compliance.[13] The SEC stated that the fundamental Regulation FD question was when information on a website should be regarded as being "public" for purposes of the rule. In evaluating that issue, the SEC said that companies must consider whether their site is a recognized channel of distribution for investor information.[14] It then went on to identify a number of factors that companies should take into account in making this assessment.[15]

In its 2008 release, the SEC also addressed Web 2.0-type technologies, including interactive websites such as blogs and electronic shareholder forums. The SEC noted that despite their often informal nature,

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[7] According to a survey conducted by Edison Research, 42% of customers expect a response within an hour when they contact a corporation through social media. http://socialhabit.com/uncategorized/customer-service-expectations/attachment/slide1/ (accessed October 15, 2013).

[8] According to a recent survey by The University of Massachusetts—Dartmouth, 77% of the Fortune 500 have Twitter accounts, 70% are on Facebook, and 69% have Youtube accounts. The survey also noted that these corporate accounts show "current activity and vibrant engagement" with their audiences. Nora Ganim Barnes, Ph.D., Ava M. Lescault, MBA and Stephanie Wright, *2013 Fortune 500 Are Bullish on Social Media: Big Companies Get Excited About Google+, Instagram, Foursquare and Pinterest*, July 2013, http://www.umassd.edu/media/umassdartmouth/cmr/studiesandresearch/2013_Fortune_500.pdf (accessed October 15, 2013).

[9] *Fasken Martineau 2013 Social Media M&A Survey*, http://www.fasken.com/en/social-media-survey-w/ (accessed October 15, 2013).

[10] Jeff Corbin, *IR Communications in the 21st Century: Social Media*, https://www.irmagazine.com/whitepapers/86/ (accessed October 15, 2013).

[11] The SEC's pre-2008 releases on the use of electronic communications and the Internet include *Use of Electronic Media for Delivery Purposes*, Release No. 33-7233 (October 6, 1995); *Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940*, Release No. 33-7288 (May 9, 1996)and *Use of Electronic Media*, Release No. 33-7856 (April 28, 2000).

[12] *Commission Guidance on the Use of Company Websites*, Release No. 34-58288 (August 7, 2008)

[13] *Id.* at 16-26.

[14] *Id.* at 18.

[15] Id. at 20-21. Factors cited by the SEC include use of the website to regularly post material information, the extent to which investors rely on the website, the taken to make the website accessible to investors, and whether other methods of distribution are the predominant means of communicating with investors.

statements made on interactive sites by companies or employees acting on their behalf were subject to Rule 10b-5 to the same extent as statements made in more traditional outlets.[16]

One of the practical problems associated with the SEC's 2008 guidance was the requirement that a particular website be a "recognized channel" for investor information before it could be used to satisfy Regulation FD:

> The 2008 guidance was sometimes observed to have created a "chicken and egg" problem by focusing on whether a company's website was already a "recognized channel of distribution" at the time the information in question was posted. Without a track record of using only its website to release material information, a company would have a hard time knowing whether its website met this standard.[17]

The real world implications of this problem were brought to the forefront with a single Facebook posting by Netflix CEO Reed Hastings. In July 2012, Mr. Hastings wrote a post on his personal Facebook page disclosing that his company's monthly online viewing figures had exceeded one billion hours for the first time. No other disclosure concerning this information was made by Netflix, which had also not disclosed that Mr. Hastings' personal Facebook page might be used to disclose information to investors.[18]

After initially indicating that it intended to pursue a Regulation FD enforcement action against Mr. Hastings, the SEC opted instead to issue a Section 21(a) Report clarifying that its 2008 release applied to social media as well.[19] However, instead of focusing on whether the site is a recognized channel of distribution for information, the SEC focused on whether investors were provided with adequate notice that the site would be used for that purpose.[20] The SEC's emphasis on adequate notice is a very helpful development. As one commentator observed, "[b]y focusing on notice rather than on whether a company's disclosure channels have become 'recognized' in the eyes of third parties, the Section 21(a) report provides a concrete step a company can take to establish a particular channel as a Regulation FD compliance tool."[21]

Emerging Best (Or at Least Relatively Safe) Practices for Using Social Media in M&A

While Netflix provides very helpful guidance on Regulation FD and social media, that is only half the equation when it comes to many M&A communications. These communications also must conform to the requirements imposed by the SEC's M&A communications rules. Unfortunately, this is an area where the SEC has not provided guidance; fortunately, there are some third party commentators who have addressed these issues, as well as some intrepid souls who have used social media as part of their M&A communications strategies.[22] Dealmakers can draw from these sources and precedent to begin to derive some best practices (or at least relatively safe practices) for using social media in M&A Communications.

- *Herd the cats*. My mother has 10 grandchildren, is not fond of ATMs and did not know how to turn a computer on until 2011. She's now on Facebook every day. What's the lesson? If my mom is on social media, *everybody's* on social media—and if you don't do something about it, people for whom the SEC says you're responsible will talk about your deal on social media. That can create very big problems unless you reach out to your client's employees and raise their consciousness on these issues.[23] For the private online activities of most employees, it may enough to remind them that

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[16] *Id*. at 42-43.

[17] DavisPolk Client Memorandum, *SEC Explains How to Use Social Media for Regulation FD Compliance,* April 4, 2013.

[18] *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings*, Release No. 34-69279 (April 3, 2013) at 4.

[19] *Id*. at 5.

[20] *Id*. at 6-7.

[21] DavisPolk Client Memorandum, note 17, *supra*, at 2.

[22] Two particularly useful sources on the use of social media in M&A communications are Eddie Best and Jenn Carlson, *Tweeting Transactions: Social Media, Business Combinations and the Federal Securities Laws*, 5 Deal Lawyers 4 (July-August 2011) ("*Tweeting Transactions*"), and a recent DealLawyers.com webcast on using social media in deals**.** Mary Korby, Lissa Pearlman and Cedric Powell, panelists, *"The Use of Social Media in Deals,"* DealLawyers.com webcast, http://www.deallawyers.com/member/Programs/Webcast/2013/09_12/transcript.htm (accessed October 15, 2013) (the "*Social Media Webcast*").

[23] See *Tweeting Transactions*, note 22, *supra*, at 4: "The need for employee education is even more important for companies evaluating a business combination. Statements on company blogs, tweeted by authorized personnel or posted on the company's or an employee's Facebook page are subject to the requirements of the federal securities laws, and company policies should treat such social media communications similar to all other company communications."

when it comes to talking about your transaction, Tyler Durden had the right idea in *Fight Club*.[24] However, if social media is going to play any role in your communications strategy, it is important that any company personnel who will be involved in implementing that strategy understand the rules of the road and the compliance policies that you are implementing.

- *Identify an M&A communications compliance team.* This is pretty basic stuff, but that does not mean it is not also critical. If you are going to establish review and preclearance procedures, avoid Regulation FD and Rule 10b-5 problems and comply with applicable filing and disclosure requirements, you need to pull together a team with representatives from each of your key groups: corporate communications, investor relations, finance and legal. This group should work closely with their counterparts on the other side of the transaction, because compliance is generally an issue for both sides, and because most merger agreements provide for some right of review and approval of statements that one side proposes to make about the deal.

- *Develop deal-specific social media policies and procedures*. One size fits all does not work here, because the compliance requirements may differ for different deals. A deal that does not require shareholder approval or involve the issuance of securities may not implicate the SEC's M&A communications rules at all, but Regulation FD compliance may be necessary. Communications about a small acquisition may not be material enough from the buyer's perspective to worry about Regulation FD, but may raise FD concerns with the seller and trigger a need for both parties to comply with the disclosure and filing requirements of Rule 165 or Rule 14a-12. A particular communication may not be material (and therefore not raise any Regulation FD concerns), but may still fall within the definition of an "offer" or "soliciting material" and thus subject to Rule 165 or 14a-12. The policies and procedures you put in place must reflect the unique compliance posture of your transaction.

- *Pre-clear all communications.* Pre-clearance of social media communications should be a component of any social media policies and procedures, for at least three reasons. First, as the SEC made clear in the 2008 Release, Rule 10b-5 applies to everything that you say about your deal, regardless of the channel you use to say it or the degree of formality of the statement. If you don't stop a problematic communication before it goes out, it may be very difficult to undo the damage in the event of significant movement in the stock price of one of the parties to the deal.

  Second, pre-clearance gives you a chance to engage in a little regulatory jujitsu in many situations where both Regulation FD and the M&A communications rules are in play. You will have to file your blog, tweet or Facebook post in order to comply with Rule 165 or Rule 14a-12 anyway, so why not file it prior to or simultaneously with its release under cover of Form 8-K?[25] That way, instead of wringing your hands over whether your tweet or Facebook posting is FD compliant, you will have already taken advantage of the 8-K safe harbor contained in Regulation FD itself.

  The third point also touches on filing requirements—the M&A communications rules require same day filings of any material that might be deemed to be an "offer" or "soliciting material." Anything that has been released during the day but is not filed on EDGAR until after 5:30 pm Eastern Time is not compliant with this requirement. If you do not require pre-clearance, the odds that you will run into a problem with a filing deadline are greatly magnified.

- *Your messaging should be built around what you will disclose in SEC filings*. Regardless of the wide array of new media options in a Web 2.0 world and the increasing willingness of companies to communicate outside of their proxy statements or prospectuses, the parties' SEC filings need to remain the center of any messaging about the transaction.[26] Inconsistencies between the filing and what is said through other channels will at the very least be the source of substantial scrutiny by the SEC's staff during its review process, and are also likely to help the plaintiffs' bar buttress claims made in the lawsuits that inevitably accompany every major transaction.

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[24] "Welcome to Fight Club. The first rule of Fight Club is: you do not talk about Fight Club. The second rule of Fight Club is: *you DO NOT talk about Fight Club!" Fight Club*, Twentieth Century Fox Corp., 1999. http://www.imdb.com/title/tt0137523/quotes?ref_=tt_ql_3.

[25] This does not work as elegantly for tender offers, because post-commencement communications must appear under cover of Schedule TO or Schedule 14d-9, and you cannot simply check a box on Form 8-K as you can for Rule 165 or Rule 14a-12 disclosures.

[26] As one of the panelists in the Social Media Webcast observed, "What's interesting is that it still all begins with the more traditional means of communicating. Recognizing those constraints—Regulation FD and Rule 10b-5—we are very cognizant of the fact that those core messages that we develop about the transaction are consistent with what's coming in the Form S-4 and the proxy statement." Comments of Lissa Perelman, *Social Media Webcast*, note 22, *supra*.

- *Imitate, don't innovate.* This is not an area in which the SEC has provided a lot of guidance, and there are some fundamental questions that simply have not been addressed. For example, you only have 140 characters to work with in a tweet. How do you comply with the legending and other information required by the M&A communications rules when working in this format? Those who have used Twitter have linked to the required language outside the body of the tweet.[27] Nobody is completely sure that this works, although the SEC's positive comments about the "envelope theory" in its electronic communications release provide reason to believe that it does.[28] In this kind of environment, it does not make a lot of sense to venture into uncharted waters. That applies to the SEC's statements in Netflix as well: even if you have notified investors that you will communicate investor information through, the announcement of a significant acquisition is not the time to abandon traditional channels and rely solely on social media to disseminate key information.[29]

Conclusion

The landscape for M&A communications is fundamentally changing. While the changes may have started with SEC's rules, they have accelerated over the past five years as social media and other Web 2.0 sites have transformed the Internet into an interactive arena where a virtually limitless number of voices can be heard. These changes have created unprecedented challenges for dealmakers, and those challenges are likely to increase as corporations find themselves required by the marketplace to incorporate social media into their M&A communications strategies.

Right now, there are very few guidelines from the SEC and many unanswered questions concerning the use of social media in M&A. Companies and their advisors should tread cautiously, devoting significant attention to compliance strategies and, over the short-term at least, looking to precedent as their guide to developing safe practices (if not yet best practices) for M&A communications in a Web 2.0 world.

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[27] See *Tweeting the Deal,* note 22, *supra*, at 4, n. 23 for citations to examples of this practice.

[28] Although it has not addressed its application to social media and the M&A communications rules, the SEC's general endorsement of the "envelope theory" in electronic communications goes back to the mid-1990s: "The 1995 Release provided a number of examples designed to assist issuers and market intermediaries in meeting their delivery obligations through electronic media. One example provided that documents in close proximity on the same website menu are considered delivered together. Other examples confirmed the proposition that documents hyperlinked to each other are considered delivered together as if they were in the same paper envelope. The premise underlying these examples has come to be called the "envelope theory." *Use of Electronic Media*, Release No. 33-7856 (April 28, 2000).

[29] Here again, the comments of one of the panelists on the Social Media Webcast are instructive: "This is not to say that a company should not be active in all manner of media and communications. But when it comes to real, hardcore Regulation FD material information, it makes sense to start with those traditional forms of communication and to make it easy for the investor. That's the bottom line." Comments of Lissa Perelman, *Social Media Webcast*, note 22, *supra*.

That Grant Could Cost More Than You Think: HSR Application to Officer & Director Compensation

By David Beddow, a Partner of O'Melveny & Myers LLP

It is likely that most officers and directors of U.S. public companies never think of the Hart-Scott-Rodino Antitrust Improvements Act of 1976—often referred to as the Hart-Scott-Rodino Act or the HSR Act—outside of its commonly understood application to mergers and acquisitions. These officers and directors need to be aware, however, that it has long been the position of the Federal Trade Commission that the HSR Act is applicable to any acquisition of voting stock—including an acquisition by an individual—that exceeds the Act's jurisdictional thresholds. Due to this broad application of the HSR Act, an acquisition of voting stock by an officer or director of a U.S. company—whether in the open market or as a result of an equity compensation plan—could trigger a filing and waiting period obligation under the Act.

This article provides a general discussion of the pre-closing filing and waiting period provisions of the Hart-Scott-Rodino Act and their application to common types of acquisitions of voting stock by officers and directors of U.S. public companies. It is not our intent to describe every situation in which an acquisition of voting stock would trigger an HSR Act obligation. Of course, because the application of the HSR Act to any acquisition will depend on the particular facts of that transaction, public companies and their officers and directors should consult with counsel before entering into a transaction that could trigger a filing under the Act.

Hart-Scott-Rodino Act Basics

The HSR Act may require any person (whether an entity or an individual) who proposes to acquire voting securities in a corporation to provide advance notice of that potential acquisition if the transaction exceeds the Act's jurisdictional thresholds. The following points are fundamental to a basic understanding of the operation of the HSR Act:

- *"Voting securities."* The securities acquired must have a present right to vote for the board of directors of the company. The actual ability to vote the stock is essential. An "acquisition" does not occur merely because a person acquires a right to acquire voting securities. As such, a purchase or an award of a warrant or an option to acquire voting securities of the company will not be HSR reportable; rather, the exercise of that option or warrant would be the HSR Act acquisition.
- *"Acquisition."* An acquisition of voting stock may be subject to the HSR Act, regardless of the means of acquisition. Accordingly, acquisitions in the open market, by exercise of options or warrants, through an equity compensation program, or through an employee stock purchase plan must be considered when assessing the applicability of the HSR Act.

  Appreciation in the value of previously held stock, by itself, will not require reporting under the HSR Act. However, if an individual acquired an amount of company voting stock that was significantly less than the HSR Act threshold, but the value of that stock appreciated to just under an HSR Act threshold, then a very small acquisition of additional company voting stock could cause the individual's holdings to exceed the HSR Act threshold and trigger an HSR Act filing obligation.

  In most instances, the FTC will not consider a transaction to be an acquisition of voting stock if no action is taken by the individual (for example, when non-voting stock is forcibly converted to voting stock and the individual does not have sufficient advance notice of the event to allow for a pre-closing filing). It is important to note, however, that the acquisition of voting stock through a grant under a company's compensation plan, such as a grant of restricted stock or the vesting of restricted stock units, may be subject to the HSR Act. As noted above, the HSR Act filing requirement is triggered by the acquisition of "voting securities"; accordingly, the application of the HSR Act generally will depend on when the individual actually receives the right to vote the granted stock.
- *"Aggregation."* Any acquisition of voting stock must be aggregated with all prior holdings of the company's voting stock in determining whether the HSR Act jurisdictional threshold has been exceeded. In other words, if a person is $1 short of the HSR Act threshold, the acquisition of $1 of voting stock will be aggregated with all prior holdings of that person and will trigger the application of the HSR Act. The focus is on the value of all stock held at the time of the acquisition.

  For purposes of the HSR Act, an individual's holdings must be aggregated with the holdings of (a) a spouse; (b) any minor children; and, possibly, (c) any shares held in trust by the individual or his/her spouse or minor children.[1]
- *"Value."* In the case of voting stock, assessment of the HSR Act jurisdictional thresholds will be based on the current total value of the individual's holdings, along with any holdings that must be aggregated with those holdings, at the time of the acquisition. The valuation of publicly traded securities to be acquired is usually determined by the acquisition price but the value of securities already held is determined by applying the lowest closing trading price within 45 days of closing.
- *Penalty for failure to file.* Despite its common application in situations that raise anti-trust concerns, the HSR Act applies equally to *all* acquisitions. This broad application requires individuals to comply with any HSR Act filing requirements. Further, the fine for failure to satisfy HSR Act filing requirements is a maximum of $16,000 *per day, every day, from the date of the acquisition until the HSR waiting period expires after a post-closing filing is made*. Although there are cases where the FTC has assessed large individual fines, it is important to note that the FTC will rarely fine a first-time violator of the HSR Act filing requirement so long as the error was inadvertent and the filing is made promptly after discovery of the error.

The Hart-Scott-Rodino Act Jurisdictional Thresholds

An acquisition of voting securities may require that reports be filed with the FTC prior to closing of the acquisition (for this purpose, it is assumed that an exemption is not available). Whether reports must be filed will depend on the following:[2]

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[1] The value of such a trust must be included only if *either* (a) the trust is revocable or (b) the settlor(s) of the trust retain(s) a reversionary interest.

[2] These thresholds are increased annually by the FTC. The thresholds discussed in this article were established in February 2013.

- *Acquisitions with a value of $70.9 million or less are not reportable:* If, as a result of an acquisition, the acquiring person will hold an aggregate total amount of voting securities of a company with a value of $70.9 million or less, the HSR Act does not apply regardless of the size of the parties involved;
- *Acquisitions with a value of more than $283.6 million are reportable:* If, as a result of an acquisition, the acquiring person will hold an aggregate total amount of voting securities of a company with a value of more than $283.6 million, the HSR Act applies and the parties must file regardless of the size of the parties involved;
- *Acquisitions with a value of more than $70.9 million but not more than $283.6 may be reportable, depending on the size of the company and the individual:* If, as a result of an acquisition, the acquiring person will hold an aggregate total amount of voting securities of a company with a value of more than $70.9 million but not more than $283.6 million, the HSR Act applies if the following tests are met:
  - One party to the transaction (or its parent company) has $141.8 million or more in total assets or annual net sales;[3] and
  - The other party (or its parent company) has $14.2 million or more in total assets or annual net sales.[4] (Where the acquired person is not engaged in manufacturing, and is not a $141.8 million person, one only looks at value of assets.)

Filing Fees & Waiting Periods under the Hart-Scott-Rodino Act

Where the HSR Act thresholds are exceeded (and an exemption is not available), the company and the individual must make a filing with the FTC and the acquiring person must pay a filing fee of:

- $45,000 for transactions of less than $141.8 million;
- $125,000 for transactions of $141.8 million to $709.1 million; or
- $280,000 for transactions of $709.1 or more.

Further, the company and the acquiring person must observe a 30 calendar- day waiting period before closing the acquisition. This 30 calendar-day period may be terminated early by the FTC.

Most Common Hart-Scott-Rodino Act Exemptions for Individuals

- *"Investment Only" Exemption*. Under this exemption, which is often referred to as the "Passive Investor" exemption, an acquisition that would otherwise require HSR Act reporting is exempt if, after the acquisition, the acquiring person will hold ten percent or less of the outstanding voting securities of the company and the acquisition is made "solely for the purpose of investment." This exemption is available regardless of the value of the acquisition. It is important to note, however, that this exemption is *not* available to officers or directors of the company issuing the securities or to any person who has any "intention of participating in the formulation, determination, or direction of the basic business decisions" of the company. As a result, it is possible that the exemption may be unavailable even for individuals who are not officers or directors of the company.
- *"Pro Rata" Exemption*. This exemption is available where "as a result of such acquisition, the voting securities acquired do not increase, directly or indirectly, the acquiring person's per centum share of outstanding voting securities of the issuer." This exemption may be useful for stock dividends or stock splits. In addition, it may be available for an individual's purchase of securities in those situations—including (based on the particular facts) acquisitions pursuant to an employee stock purchase plan—where the acquisition did not increase the individual's percentage ownership of company stock.

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[3] As a general matter, the larger person in this analysis will be the public company. It is important to note that the HSR Act looks to the company's "ultimate parent entity," or "UPE." For this purpose, a UPE is an entity not controlled by any other entity and, in the case of a corporation, "control" means either (a) holding 50% or more of the outstanding voting securities, or (b) having the contractual power to designate 50% or more of the directors. Further, as a general matter, the smaller person in this analysis will be the individual. For this purpose, an individual is always his or her UPE.

[4] When applying this test to an individual, the HSR Act looks to the person's financial statements. As an individual generally will not have regularly prepared financial statements, the HSR Act would require the individual to create a *pro forma* balance sheet to determine whether he or she would meet the "size-of- person" test. If the individual in fact does not have a regular balance sheet, in creating such a balance sheet, the individual would not be required to include the value of any voting securities he or she already holds in the company. This may prevent the individual from meeting the size-of-person test. (There are other assets that also can be excluded.)

Some Events That May Result in a Hart-Scott-Rodino Act Filing Requirement

An officer or director may incur an HSR Act filing obligation in any of the following situations:[5]

- an acquisition of voting stock upon exercise of a stock option or warrant;[6]
- a grant of restricted stock where the grantee receives the right to vote the securities at the time of grant;
- the vesting of restricted stock units;
- a purchase of voting stock in an open market transaction;
- a purchase of voting stock pursuant to a dividend reinvestment plan; or
- a purchase of voting stock pursuant to an employee stock purchase plan.[7]

SEC Reporting of Payment of Hart-Scott-Rodino Act Fees

A number of public companies have determined that it is appropriate to reimburse officers or directors for filing fees and legal fees relating to compliance with the HSR Act. This determination appears to be premised on the analysis that the "Passive Investor" exemption would be available to the individual but for their position with the company. In their executive compensation disclosure, public companies generally report these reimbursements as perquisites by providing:

- the dollar amount of the reimbursements in the Summary Compensation Table; and
- an itemized discussion of the amount of the reimbursement, along with a discussion of the nature of the HSR Act obligation, in a footnote to the Summary Compensation Table.

Conclusion

Most officers and directors—and the U.S. companies for which they work—do not consider the HSR Act outside of the antitrust context. The failure to consider the application of the HSR Act to an individual's acquisitions of company voting stock, however, may result in that officer or director failing to comply with the filing and waiting period requirements of the Act and potentially incurring substantial fines. Public companies should consider including in their compensation analysis and their insider trading policies an appropriate process to track the ownership of voting stock by officers and directors and work with them to monitor HSR Act compliance.

[5] This discussion assumes that an exemption is not available and the acquisition causes the officer or director to cross an HSR Act threshold.

[6] In this regard, the HSR Act may not apply to a true cashless, net exercise of an option where the option is exercised and the shares are sold instantaneously. Specifically, an option exercise will not be deemed to be an acquisition if (a) the officer sells all the shares acquired through the option exercise or sells other shares in an amount not less than the number of shares acquired through the option exercise, and (b) the sale is the same day as the exercise.

[7] Recent FTC enforcement actions against officers/directors were filed against Brian Roberts—Comcast (2011) and John Malone—Discovery (2009). While different in that it did not involve stock compensation, note also the more recent FTC case against Barry Diller—Coca Cola (2013).

Traps to Consider: Delaware's Merger Statute & Ratification Amendments

By Ethan Klingsberg, a Partner at Cleary Gottlieb Steen & Hamilton LLP

During its most recent session, the Delaware legislature enacted various amendments to the Delaware General Corporation Law effective August 1, 2013. Two provisions—one relating to defective corporate authorizations and the other to mergers—are of particular interest, as are the potential traps that may arise in connection with the merger statute amendment.

1. DGCL Section 204 formalizes and streamlines a ratification process for curing defective corporate acts (i.e., corporate acts purported to have been validly taken but which turned out to have been defectively authorized, including issuances of shares in excess of the number authorized in the charter and equity issued where the acquirer or grantee believes the issuance to be valid but there was a defect in the authorization process). One important qualification: Stockholders must receive notice of all Section 204 ratifications and thereafter would be permitted to bring actions in Chancery Court to challenge Section 204 ratifications as inequitable.
2. Paragraph (h) of DGCL Section 251 (the merger statute) permits an immediate second-step merger (no stockholder vote, no proxy statement, no need for a top-up option; just the quick filing of a certificate of merger) immediately following any negotiated tender offer or exchange offer for a public company's shares that results in the bidder owning at least the number of shares necessary to approve a merger

(typically 50.1%). This provision may well change the landscape of M&A structuring by pushing many more deals to the two-step structure (where, significantly, ISS and Glass Lewis normally do not make recommendations). Three potential traps to consider:

a) **Relationships Between the Bidder and Significant Stockholders May Limit Use of Section 251(h)—** To be eligible for new Section 251(h), the bidder may not be an "interested stockholder" under DGCL Section 203 at the time the target board approves the merger agreement. This restriction is broader than a provision that merely states that the second-step merger may not be with a party that is subject to Section 203. Most insiders that own at least 15% of an issuer's shares are exempt from Section 203 due to the board's pre-approval of their acquisitions of shares. But these 15% holders, notwithstanding their exemption from Section 203, still fall within the definition of "interested stockholder" and therefore would not be entitled to take advantage of Section 251(h). Moreover, most practitioners (due to the dearth of Section 203 case law and the breadth of the statutory language) have typically adopted a broad reading of the concept of "ownership" for purposes of the definition of "interested stockholder" under Section 203. As a result, understandings and arrangements between the bidder and a 15% stockholder may result in the bidder itself being an "interested stockholder."

   Even though these understandings and arrangements may be pre-approved by the target board and therefore exempt the bidder from Section 203, the bidder's transaction would still be rendered ineligible for Section 251(h) if any of these understandings or arrangements were to arise before the target board's approval of the merger agreement. Although a support agreement between the bidder and a 15% stockholder (where the stockholder would make undertakings relating to voting, transferring and tendering for the benefit of the bidder) could cause the bidder to itself be an "interested stockholder," Section 251(h) should still be available so long as the support agreement is not signed prior to the target board's approval of the merger agreement and prior to that time there was no understanding between the bidder and the stockholder that resulted in the bidder being deemed an interested stockholder.

b) **Equity Rollovers under Section 251(h)—**In some merger structures, certain stockholders will have their shares converted into different consideration than the other stockholders. This is common, for example, in connection with financial sponsor transactions where all stockholders other than management receive cash consideration and management "rolls over" its equity into shares of the sponsor's acquisition vehicle.

   To avoid risks under the SEC's "best price rule" (which requires that the same consideration per share be paid in tender offers, but not in second-step mergers), rollovers may be done in a second-step merger when a two-step, all-cash tender offer structure is employed. But one of the requirements of the new Section 251(h) is that the second-step merger must squeeze-out the untendered shares for the same per share consideration as paid in the tender offer. Thus, a "best price rule"-compliant exchange or other alternative to a second-step merger will have to be relied upon for implementing rollovers in an otherwise all-cash transaction if the parties are to preserve access to the expedited Section 251(h) structure.

c) **Funding Conditions—**We've seen a number of heavily leveraged acquisitions by relatively small-cap acquirers in recent months. If these acquirers, as well as financial sponsor LBO buyers, are pushed toward the two-step structure as a result of Section 251(h), there may be renewed pressure from the SEC staff, based on recent informal statements, to require bidders to hold tender offers open for five business days after satisfaction of a funding or disbursement condition to the tender offer (which condition is often included in highly leveraged tender offers).

   The staff's purpose in putting forth this position would be to protect those holders who were waiting to see whether this condition would be satisfied before tendering (by giving those holders the opportunity, during these extra five business days, to tender once they have learned that the funding condition to the offer would be satisfied). Despite the good intention of the SEC staff here, such a requirement may not be workable since it would require that the bidder assume the risk that the lending banks would fail to fund the debt financing for some reason that would not also permit the bidder to refuse to close the tender offer. More importantly, given that the non-tendering holders will be cashed out pursuant to the new Section 251(h) promptly after the closing of the tender offer, and at the tender offer price, this requirement is not needed to protect the non-tendering holders. Nonetheless, this is an issue for leveraged acquirers and their targets to consider carefully before committing to a two-step structure using the new Section 251(h).

New Reg D: Implications for Offering Publicly-Traded Securities as Consideration in Private Acquisitions

By Robert Little, Jim Moloney & Anthony Shoemaker of Gibson, Dunn & Crutcher LLP

Two sets of final rules adopted by the SEC in July will impact public companies seeking to use their equity securities as consideration in an M&A transaction. The new rules (i) eliminate the absolute prohibition against "general solicitation" in securities offerings conducted pursuant to Rule 506 of Regulation D under the Securities Act of 1933[1] and (ii) disqualify certain "bad actors" from participating in Rule 506 offerings.[2]

When a target business is privately held and the consideration for the acquisition consists wholly or partially of equity securities of a public acquirer, such acquirer may seek to privately place its equity securities with the owners of the target rather than registering the securities due to the long lead-time that is often associated with the registration process or for other reasons. Such public acquirers generally will desire to comply with a safe harbor from the securities registration requirements under the Securities Act in conducting the offer and sale of its securities to the target's owners. Under the former version of Rule 506, which historically provided a commonly relied-upon safe harbor from the registration requirements, an issuer could sell an unlimited amount of its securities in a private placement to an unlimited number of "accredited investors"[3] and up to 35 non-accredited investors.

Under this rule, each investor that is not an accredited investor, either alone or with his purchaser representative(s), must have such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment. As a result, to confirm satisfaction of the investor suitability standards of Regulation D, the acquirer must determine whether the sellers are accredited investors or meet the financial and business sophistication requirements. The acquirer can make this determination by contacting each seller and requesting that each seller complete and return an investment questionnaire, but such contact must not constitute a general solicitation. If any seller is not an accredited investor and does not meet the sophistication requirements, the acquirer can arrange for the appointment of a purchaser representative for such seller.

Under this Rule 506 regime, an issuer-acquirer that reached out to potential sellers to determine their status as "accredited investors" or as otherwise suitable to evaluate the potential investment risked violating the prohibition against general solicitation, unless the issuer or its agent had a pre-existing substantive relationship with the offerees.[4] It was therefore often difficult for issuers to comply with the rule's investor verification requirements while being restricted from directly contacting certain offerees for fear of violating the ban on general solicitation.

Under the new rules, the traditional Rule 506 safe harbor described above has been preserved intact as Rule 506(b), and issuers may continue to comply with its conditions, including the prohibition on the use of any form of general solicitation in the offering or sale of securities. The new rules create a new subsection (c) of Rule 506, which permits Rule 506 offerings that employ general solicitation methods if (i) each purchaser in the offering is an accredited investor or the issuer reasonably believes that each purchaser is an accredited investor at the time of the sale of the securities, and (ii) the issuer takes reasonable steps to verify that each purchaser is an accredited investor. Rule 506(c) represents a seismic shift in the nature of allowable advertising and outreach in private offerings—including transactions in which unregistered equity securities may be offered as consideration in an acquisition—but the usefulness of new Rule 506(c) will likely be constrained by the requirement that each offeree receiving unregistered equity securities must be an accredited investor.

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[1] See *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, Release No. 33-9415 (July 10, 2013) (the "General Solicitation Adopting Release"). These rules were mandated by Title II of the Jumpstart Our Business Startups Act and became effective on September 23, 2013.

[2] See *Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings*, Release No. 33-9414 (July 10, 2013) (the "Bad Actor Adopting Release"). These rules implement Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and also became effective on September 23, 2013.

[3] Under Rule 501 of Regulation D, "accredited investor" is defined to include, among others, individuals with a net worth that exceeds $1 million (excluding the value of the person's primary residence); individuals with income exceeding $200,000 (or $300,000 joint income with a spouse); certain businesses or entities with assets exceeding $5 million; and banks, insurance companies and other investment companies.

[4] SEC guidance recognizes the existence of a substantive pre-existing relationship by the issuer or its agent with a prospective investor as evidence that general solicitation was not used to attract such investor to the offering. See, e.g., *Use of Electronic Media*, Release No. 33-7856 (April 28, 2000) (noting that "one method of ensuring that general solicitation is not involved is to establish the existence of a 'pre-existing, substantive relationship'").

Therefore, while an issuer-acquirer may now choose to engage freely in any "solicitation" or other efforts directed toward potential sellers to determine investor suitability, once the issuer has engaged in general solicitation, it may not then rely on Rule 506(c) to issue the equity securities to sellers that are not verified accredited investors. Furthermore, once a general solicitation has commenced, the issuer will no longer have the flexibility to go back and rely on Rule 506(b) or the traditional Securities Act Section 4(a)(2) private placement exemption as an alternative to the Regulation D safe harbor.[5]

As a practical matter, if an acquirer chooses to engage in a general solicitation and cannot verify that each seller is accredited, then the acquirer should be prepared to pay cash consideration to any non-accredited investors. If so desired, the acquirer could also attempt to register the entire issuance of equity securities with the SEC, though the SEC may view the prior general solicitation as an "offer" in violation of the gun-jumping provisions of Section 5 of the Securities Act. A further alternative to registration may be to pursue a fairness hearing under Section 3(a)(10) of the Securities Act, though this option is available only in a handful of states.[6]

If the acquirer suspects that some of the sellers may not be accredited, but it still wants to use its privately-placed equity securities as acquisition currency and is not prepared to cash out any non-accredited sellers, then it will need to follow the traditional model for engaging in such private placements – under Rule 506(b) – and avoid any type of general solicitation. This means that the issuer or its agent will need to have a pre-existing substantive relationship with each seller, and the offering can include no more than 35 non-accredited investors.

Under new Rule 506(d), an issuer will not be able to rely on the Rule 506 exemption if certain "covered persons" have been subject to one or more disqualifying events, such as convictions of securities fraud.[7] In addition to the issuer and its predecessors or affiliated issuers, the list of covered persons includes any director, executive officer, other officer participating in the offering, general partner, or managing member of the issuer, as well as beneficial owners of 20% or more of the issuer's voting equity securities.[8] The new rule also provides for an exception from disqualification for offerings where the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed.[9] In order to satisfy the "reasonable care" standard, issuers conducting a private placement under Rule 506 will need to make "a factual inquiry into whether any disqualifications exist."[10]

These new "bad actor" rules should be added to the list of issues that a public acquirer must consider when it seeks to use its equity as acquisition currency under either Rule 506(b) or Rule 506(c). The acquirer should consider whether it has conducted the appropriate inquiry (whether through the use of questionnaires, certifications and/or undertakings from its directors, officers and large shareholders) to reasonably assure itself of the absence of any disqualifying events or other disclosure obligations in connection with the acquisition transaction.

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[5] See General Solicitation Adopting Release at 12-13 ("This mandate affects only Rule 506, and not Section 4(a)(2) offerings in general, which means that even after the effective date of Rule 506(c), an issuer relying on Section 4(a)(2) outside of the Rule 506(c) exemption will be restricted in its ability to make public communications to solicit investors for its offering because public advertising will continue to be incompatible with a claim of exemption under Section 4(a)(2).").

[6] California, Idaho, North Carolina, Ohio, Oregon and Utah are the only states that currently offer a "fairness hearing" review and approval process.

[7] The disqualifying events detailed in Rule 506(d)(1) include various categories of criminal convictions, court injunctions and orders, final orders of certain regulators, certain SEC disciplinary, cease-and-desist and stop orders, and U.S. Postal Service false representation orders. If the event occurred prior to September 23, 2013, the issuer will not be prevented from relying on Rule 506, but new Rule 506(e) requires disclosure of the information to each purchaser. Because there is no materiality qualifier in the new rules, any violation by a covered person would result in disqualification or mandatory disclosure, as applicable.

[8] See Rule 506(d)(1) for the complete list of covered persons.

[9] Rule 506(d)(2)(iv).

[10] Id.

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