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FTC Charges Two Japanese Corporations with Alleged HSR Avoidance Scheme

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What happened?
Two Japanese corporations each agreed to pay $2.5 million to settle Federal Trade Commission ("FTC") charges of violating the premerger notification and waiting period requirements under the Hart-Scott-Rodino ("HSR") Act.

According to the FTC's complaint (the "Complaint"), the scheme began when an independent investigation in July 2015 (triggered by an earlier investigation by financial regulators) publicly revealed long-running financial irregularities within Toshiba Corporation ("Toshiba") and that Toshiba had been overstating its profits by billions. To strengthen its financial statement for FY 2015, Toshiba attempted to sell its subsidiary Toshiba Medical Systems Corporation ("TMSC"), which conducts substantial business in the United States, before the end of FY 2016 (March 31, 2016). However, Toshiba did not resolve the TMSC sales process in a timely manner and found that, by early 2016, it would be almost impossible to file premerger notifications in several jurisdictions, including the United States, and receive premerger clearances in time.

To complete the acquisition before the end of FY 2016, the Complaint alleges that Toshiba and Canon Inc. ("Canon"), one of the potential bidders, devised a plan to (i) enable Canon to acquire TMSC, (ii) allow Toshiba to recognize proceeds from the sale by the end of FY 2016, and (iii) avoid filing the notification and observing the waiting period required by the HSR Act. In March 2016, the companies completed this multi-step process as follows:

1. Toshiba and Canon created a special purpose company, MS Holding Corporation ("MS Holding"), to use as the alleged HSR avoidance device.
2. Toshiba rearranged the corporate ownership structure of TMSC by creating (i) new classes of voting shares, (ii) a single non-voting share with rights custom-made for Canon, and (iii) options convertible to ordinary shares.

3. Toshiba sold TMSC's non-voting share and newly created options to Canon for $6.1 billion while simultaneously transferring TMSC's voting shares to MS Holding for a nominal payment of $900.
4. Canon later obtained formal control of TMSC's voting shares by exercising its options in December 2016.

The Complaint concluded that the companies were hiding the "true nature of the acquisition" because Canon, and not MS Holding, (i) bore the risks/benefits of TMSC and (ii) became the beneficial owner of TMSC in March 2016 when it paid Toshiba $6.1 billion.

According to the Complaint, the scheme devised by Toshiba and Canon "had no purpose" other than to complete the sale of TMSC prior to March 31, 2016, and avoid the HSR Act's waiting period requirements. The Complaint asked the Court to assess each Defendant a civil penalty of at least $6,360,000.

According to the proposed Final Judgement, each Defendant will pay a civil penalty of $2.5 million. The settlement also requires Defendants to establish and maintain a compliance program to address the alleged violations and comply with inspection and reporting requirements, among other imposed obligations.

Why does this matter?
Unlike most HSR penalty cases, this one did not allege a mistaken filing analysis but rather an alleged HSR Rule 801.90 ("Transactions or devices for avoidance") scheme. A few notable takeaways:

- Investment funds sometimes structure funds such that voting rights are given to the fund manager and economic rights given to the investors. This case stands for the proposition that, in such instances, the FTC will look through the formal division of voting/nonvoting securities to the substance of who has beneficial ownership of the shares (risk of gain and loss, etc.).
- Although the statute says that "no person shall acquire" voting securities or assets without first making the required filing and observing the appropriate waiting period, the government here obtained voluntary civil penalties from the seller as well as from the buyer. When analyzing which party bears the risk of not filing HSR for a transaction, this case may be evidence that both sides bear the risk equally, at least in an 801.90 context.
- Also note that, although the Complaint asks the court to assess each defendant a civil penalty of "at least $6,360,000," the government accepted a settlement of $2.5 million each. Given the parties' apparent decision that paying a potential civil penalty for not fiing an HSR notification was an acceptable cost of doing business, it seems that, with a fine of less than

1% of the $6.1 billion deal value, the regulators may be encouraging rather than discouraging such risk assessments despite having brought this case.

What happens next?

Companies and individuals should carefully determine whether they must observe the HSR Act's notification and waiting period requirements before consummating their transactions in order to avoid fines of up to $42,530 daily (adjusted annually). HSR rules and filing obligations can be complex and may change through amendments to the regulations or through formal and informal interpretations issued by the FTC. Experienced HSR counsel should be consulted to determine if an acquisition may trigger a filing requirement and, if so, if an exemption is available.

How can Cadwalader help?

Cadwalader's antitrust team, located in key jurisdictions in the United States (New York, Washington, DC, Charlotte) and Europe (London, Brussels), is composed of specialists in offering 'end-to-end' advice on compliance, investigations and related litigation. Our practitioners are experienced in implementing effective HSR compliance programs and conducting trainings on regulatory requirements.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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