"Devices for avoidance" don't avoid HSR penalties

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On 10 June 2019 the U.S. Department of Justice (DOJ) Antitrust Division, acting at the request of the Federal Trade Commission (FTC), filed a complaint and proposed final judgment in the U.S. District Court for the District of Columbia, alleging that Canon Inc. (Canon) and Toshiba Corp. (Toshiba) violated the premerger notification and waiting period requirements of the Hart-Scott-Rodino Act (HSR Act), 15 U.S.C. §18a, in connection with Canon's acquisition of Toshiba Medical Systems Corp. (TMSC), a subsidiary of Toshiba.

The final judgment imposed a US$5 million civil penalty, split evenly between Canon and Toshiba. Often, the DOJ and FTC impose penalties on the acquiring person only, but given the parties' intent to circumvent the HSR notification rules, the agencies instead sought penalties against both companies for most of the full amount that could have been levied – approximately US$6.4 million – and required each to institute an HSR Act compliance program, which must include among other things at least two hours of HSR training for all relevant employees.

What is particularly significant about this matter is that, although the parties willfully evaded the HSR Act's notification requirements, their motives for doing so were not anticompetitive. To the contrary, Toshiba was motivated by a desire to shore up its financial statements with the proceeds from selling TMSC, after it incurred a significant accounting charge and was forced to restate its earnings. The HSR Act provides the agencies with an opportunity to evaluate whether a particular transaction will harm competition before the transaction is consummated. However, even where the agencies would have cleared a transaction without issue, parties will still be held accountable for willfully depriving the agencies of the opportunity to investigate.

Transaction background

In Toshiba's case, after discovering long-running accounting irregularities during a 2015 independent investigation and facing financial difficulty, Toshiba determined it would need to sell TMSC and recognize the proceeds of the sale by the end of its fiscal year. Although Toshiba began the sale process in December 2015, it did not resolve the sale process with sufficient time to file premerger notifications and obtain the necessary clearances in various jurisdictions. See *Compl., U.S. v. Canon Inc.*, No. 1:19-cv-01680, ¶ 26 (10 June 2019). In March 2016 as it neared the end of its fiscal year on 31 March, Toshiba and Canon implemented a scheme to consummate the sale of TSMC to Canon while evading the notification and reporting requirements of the HSR Act.

Specifically Toshiba and Canon arranged for the creation of a special purpose company – MS Holding Corp. (MS Holding). Toshiba also created new classes of voting shares for TMSC and a "single non-voting share with rights custom-made for Canon, and options convertible into ordinary shares." Compl. ¶ 6. MS Holding then acquired the newly issued voting shares of TMSC for a nominal amount (US$900) well below the US$50 million (as adjusted) HSR size of transaction threshold (US$78.2 million at the time). Canon acquired both the nonvoting shares and the convertible options – the acquisition of which is generally nonreportable under the HSR Act (which applies to the acquisition of voting shares of corporations) – for US$6.1 billion (the value of TMSC). Canon issued a press release regarding the share acquisition and acknowledging that the acquisition was intended "to make TMSC a Canon subsidiary." Compl. ¶ 29. Approximately nine months later – and after complying with the HSR Act to report an acquisition of TMSC voting shares from MS Holding (not Toshiba) – Canon exercised its options and acquired the TMSC voting shares, thereby obtaining full control of TMSC through what appeared to be two independent transactions.

HSR Act prohibition on "devices for avoidance"

The HSR Act's implementing regulations specifically prohibit the use of "[a]ny transaction(s) or other device(s) entered into or employed for the purpose of avoiding the obligation to comply with the requirements of the [HSR] act." 16 Code of Federal Regulations § 801.90. These are known as devices for avoidance.

When the agencies conclude that a particular transaction structure is being used as a device for avoidance, they determine whether the parties have an HSR reporting obligation by evaluating the substance of the transaction. In this case, the DOJ alleged that there was no independent business reason for the transaction structure and that MS Holding bore neither risk of loss nor benefit of gain associated with TMSC because MS Holding "existed precisely to be bought out after Canon exercise[d] its options" and thus "had no incentive to maintain the long term viability of TMSC." Compl. ¶ 33. In other words, MS Holding was created and used to mask the true nature of the acquisition, which was intended to transfer complete ownership and control of TMSC from Toshiba to Canon. Accordingly, Canon's acquisition of TMSC was subject to the HSR Act's notification requirements, and the parties were noncompliant from the time Canon acquired the nonvoting shares until expiration of the waiting period associated with its HSR notification to report its proposed option exercise and resulting acquisition of TMSC voting shares from MS Holding – a period of approximately five months.

Key takeaways

The risk associated with noncompliance with the HSR Act's notification requirements is significant: the maximum current penalty is US$42,530 per day of noncompliance, and both the acquiring and acquired party alike may face steep penalties even for a first offense if the agencies determine that that offense was not inadvertent. This case highlights the importance of consulting experienced HSR counsel early in the process, even if the transaction does not appear to have any substantive antitrust issues. HSR counsel can advise whether a specific transaction structure could qualify as a device for avoidance (or otherwise constitute the transfer of beneficial ownership over the target) and therefore require the making of HSR filings and the observance of HSR waiting periods before closing. Moreover, if the parties wish to meet tight closing deadlines, and are not able to execute definitive agreements in time to file HSR notifications and observe the HSR waiting period before the desired closing date, parties may still be able to meet the desired closing date by filing HSR notifications off of a nonbinding letter of intent or term sheet before the definitive agreements are executed. In such cases, it is important to involve HSR counsel early in the process.

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