ALERT MEMORANDUM

U.S. Antitrust Agencies Propose HSR Rule Changes That Would Increase Filings and Burden

September 24, 2020

On September 21, 2020, the Federal Trade Commission (FTC) and Department of Justice (DOJ) announced proposed changes to the regulations governing when a filing must be made under the Hart-Scott-Rodino (HSR) Act that would likely significantly expand the filing requirements and increase the HSR burden on institutional investors and fund managers. The FTC also invited responses to a set of questions to inform future regulatory changes, suggesting that even more sweeping changes could be coming.

The changes and proposals were announced in two documents (1) a notice of proposed rulemaking (NPRM), which announced two changes to the HSR rules, and (2) an advanced notice of proposed rulemaking (ANPRM), which requested input on a broad variety of topics.

There is a 60-day public comment period for both the NPRM and the ANPRM. After the comment period closes, the FTC and DOJ could issue the new rules proposed in the NPRM at any time. Any proposed rule changes resulting from the ANPRM would need to be announced in a separate NPRM.

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Proposed Rule Change 1: Broadening the Scope of the "Acquiring Party"

The first change proposed in the NPRM is to expand the scope of the term "acquiring party"—which along with its subsidiaries is the party required to submit an HSR filing on the acquiring side—to include the "associates" of the acquiring entity. For HSR purposes, "associates" generally means entities that are under common management or investment control as a party but not common ownership.

Most significantly, this change would mean that fund managers that manage multiple funds that presently are considered separate entities for HSR purposes generally would be required to aggregate all holdings across the entire fund family both for purposes of determining if a filing is required and in terms of what needs to be provided with the filing. The inquiry would no longer be largely limited to the fund itself as is the case today.

This change would have far reaching effects. For example, while at present generally only revenue information about the acquiring fund is required to be reported, under the new proposed rules, all U.S. revenue of the fund, its manager, and all of the funds and other entities the manager manages or owns would need to be reported. Similarly, information on subsidiaries, shareholders, and minority investments would have to be provided for the whole fund family and, if there is an industry overlap in the revenue between any part of the family and the target, more information would be required.

Moreover, this change would alter the analysis of whether an HSR filing is required in the first place. Today, while a filer is required to report certain limited information about associates, the holdings of associates are not considered in determining whether a filing is required in the first instance. Under the new regulations, those holdings would be attributed to the acquiring party.

We expect that these changes would be difficult and burdensome for many parties to implement. Parties often do not have the information about the activities and holdings of their associates that would be needed to determine whether a filing is required or to provide the information required by the HSR form. Indeed, even determining whether a party has "associates" and who those "associates" are is a difficult exercise. The regulatory definition of associates is vague, and it has been the subject of numerous glosses in "informal" interpretations by the FTC, which do not always seem to be consistent with the regulatory definitions and which are not always public. Because the decision to file at all could turn on the activities and holdings of associates, the proposal could create a compliance trap where parties inadvertently fail to file.

Although the FTC and DOJ seem to be primarily concerned about fund families and similar structures, the rules as proposed would not be limited to those structures and all parties would need to carefully consider whether they have any "associates" for HSR purposes and be mindful of the changes.

Proposed Rule Change 2: Creating a New Exemption for Limited Set of "De Minimis" Investments

The other proposed change would create a limited new exemption for acquisitions of 10% or less of the voting securities of a corporate issuer, although the exemption would be subject to numerous exceptions that are likely to limit its usefulness in practice. Under current regulations, acquisitions of 10% or less of an issuer's voting securities are exempt if the investor has "investment only intent." The HSR rules define "investment only intent" as having "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer." This existing "investment only" exception has been interpreted fairly narrowly by the FTC in its informal guidance.

The new proposed exemption would not have a requirement of "investment only intent." However, it would have its own exceptions that would likely limit its usefulness in practice. In particular, the new exemption would not be available where (1) the target is a competitor of the buyer; (2) where the buyer holds a 1% interest in any competitor of the target; (3) where

an individual who is employed by, a principal of, an agent of, or otherwise is acting on behalf of the buyer, is an officer or director of the target or a competitor of the target; or (4) where there is a $10 million or greater "vendor-vendee" relationship between the buyer and the target. Of course, assuming the rule change relating to the definition of "acquiring party" is changed, these tests will be applied using the new definition.

The ANPRM: Seeking Input on a Variety of Topics

In the Advanced Notice of Proposed Rulemaking, the FTC lists seven topics on which it seeks to "gather information … that will help to determine the path for future amendments to the" HSR rules. The topics and the commentary surrounding them suggest that the FTC could attempt to further significantly expand the scope of the HSR Act in terms of both what transactions must be reported and what must be reported with each filing, even beyond what is proposed in the NPRM.

The specific questions, which run almost 50 pages, can be found in the ANPRM itself. The seven topics and the themes of the information requests are as follows:

1. Size of transaction. The size-of-transaction test sets the lower limit for when a transaction might be required to be reported under the HSR Act. It is currently $94 million and is subject to annual adjustment to reflect annual changes to the U.S. GNP. While the size-of-transaction itself is set by statute, the FTC's questions relate to HSR regulations on the acquisition price calculation and calculation of fair market value.
    a. Acquisition price. The FTC's questions in this area focus on the treatment of debt in transaction valuation and specifically whether the debt of the acquired entity should be considered to be part of the acquisition price, including when the debt is held by the current owners of the entity and the buyer agrees to retire that debt. Other questions relate to transaction expenses and whether the expenses of a seller should continue to be excluded from the acquisition price even when paid by the buyer.
    b. Fair market value. The FTC's questions relate to how parties calculate fair market value in practice. Among other things, the FTC asks whether parties should be required to use independent valuation experts and whether parties should be required to share the basis for their fair market valuation with the FTC and DOJ with their filing.
2. Real Estate Investment Trusts. Presently, acquisitions by REITs and many transactions involving REITS are exempt from the HSR Act. The FTC's questions regarding REITs relate to the activities of REITs outside the mere buying and holding of real estate. Based on the questions, the FTC might be reconsidering the so-called "REIT exemption" and might conclude that transactions involving REITs should be treated like any other transaction for purposes of the HSR Act.
3. Non-Corporate Entities. Under the HSR Act the acquisition of less than 50% of the interests in non-corporate entities, measured in terms of right to profits or right to assets on dissolution, is exempt from the HSR Act. The FTC's questions seem designed to assess whether that treatment of non-corporate entities should continue or whether minority investments in non-corporate entities should potentially be subject to the HSR Act, which would be a significant change that would require the reporting of many more transactions that are currently exempt.
4. Acquisition of Small Amounts of Voting Securities. As discussed above, the FTC in its companion NPRM has proposed a new exemption for acquisitions of 10% or less of the voting securities of an issuer with certain broad exceptions, including an exception where the acquirer owns 1% in a competitor of the target. This set of questions relates to the existing exemption that applies to acquisitions "solely for the purpose of investment" and the definition of

"institutional investor." The questions suggest that the FTC is reconsidering the scope of these exemptions. While the "solely for the purpose of investment" exception is in the HSR Act itself, the FTC's regulations could significantly change how easy or hard it is to quality for that exception.

a. Solely for Purposes of Investment. The FTC's questions in this area seem to suggest a desire to explore the regulatory definition of "solely for the purpose of investment" and to compare the approach used in the HSR Act with that used by the SEC.

b. Institutional Investors. Currently, many institutional investors can acquire up to 15% of the voting securities of an issuer without an HSR filing if specified conditions are met. The FTC's questions in this area suggest that the FTC is reconsidering whether this exemption continues to be appropriate at all, should be raised or lowered, should be applied to a narrower or broader set of entities, or should be applied based on the characteristics of the entities in a more flexible way.

5. Influence Outside the Scope of Voting Securities. The FTC's questions in this area relate to whether the HSR rules should be changed to require reporting based on "influence" as opposed to ownership of voting securities or majority interests in non-corporate entities. The HSR Act itself is limited to acquisitions of voting securities or assets, and so the FTC would be limited in its ability to adopt an "influence" test untethered to acquisitions, but FTC regulations on what those terms mean could affect the scope of filings. The specific questions relate to two topics, convertible voting securities and board observers.

a. Convertible voting securities. Convertible voting securities are securities that do not have a present right to vote but can be converted into voting securities. The FTC's current regulations require a filing only upon conversion, not upon acquisition. The FTC's questions in this area suggest that the FTC is concerned that convertible voting securities give the holder influence over the issuer that is similar to securities with voting rights. The FTC seems to be particularly interested in scenarios where the convertible voting securities are acquired along with a right to appoint one or more directors of the entity.

b. Board observers. The FTC says it would "like to better understand the role of board observers" and whether they have influence over the boards they observe, apparently with a view toward declaring that having a board observer is not consistent with "investment-only" intent.

6. Transactions or Devices for Avoidance. The HSR rules include a provision to the effect that transactions or devices for avoiding the requirements of the HSR Act are disregarded. The questions in this area focus on the use of techniques, such as paying shareholders dividends, that have the effect of reducing the transaction value. Note that after issuing the ANPRM, the FTC issued a "blog post" to the effect that it no longer considers valid its past interpretation that shareholder dividends that reduce the size of the target below reportable levels are never considered a "device for avoidance." In other words, it opened the door to considering such tactics a "device for avoidance."

7. Filing Issues. The FTC's final set of questions relates to what it calls "filing issues."

a. Acquisitions of Voting Securities That Do Not Cross the Next Threshold. Under current rules, a party that secures HSR clearance for the acquisition of voting securities of an issuer may acquire additional voting securities of that issuer, up to certain thresholds, for up to five years from obtaining clearance. For example, an acquirer that files to acquire over $100 million (as adjusted) in voting securities and obtains HSR clearance can subsequently increase its holdings to up to $500 million (as adjusted) without making a subsequent filing,

provided that does not exceed 50% of the target's voting securities. In this series of questions, the FTC suggests that it believes the five-year period might be too long.

b. Prior Acquisitions. This series of questions relates to Item 8 of the HSR notification and report form, where acquiring parties must disclose any acquisitions in the previous five years of entities or assets that had revenue in the same revenue codes as the current target. The FTC indicates it is considering requiring filing parties to report all acquisitions in the last five years, regardless of overlap, subject to a $10 million limitation. That would impose significant new burden on filers, particularly those that have made acquisitions in areas unrelated to the present acquisition.

We would be happy to discuss any of these issues and how they might affect your organization with you. We encourage you to reach out to any of your usual contacts at the firm or Steve Kaiser (skaiser@cgsh.com) or Ken Reinker (kreinker@cgsh.com) in our Washington office or Dan Culley (dculley@cgsh.com) in our Brussels office for more information.

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