FTC Proposes Rule Changes and Issues Updated Guidance for Hart-Scott-Rodino Filings

September 29, 2020

On September 21, 2020, the Federal Trade Commission published a Notice of Proposed Rulemaking ("NPRM") pertaining to pre-merger notification rules under the Hart-Scott-Rodino Act that was supported by the Department of Justice. The FTC proposes changing the definition of "person" under the HSR rules to include "associates," and adding a new "*de minimis*" exemption to cover investments up to 10% where the acquiring person does not already have a "competitively significant relationship" with the issuer, such as being a competitor, officer or director, or vendor of the acquired person. The FTC additionally published a blog post on September 23 modifying their guidance regarding the issuance of special dividends as an HSR avoidance mechanism. The Agencies are requesting comments on the proposed new rules, but the new guidance on avoidance mechanisms is effective immediately.

We have briefly summarized each proposed changes below, and offer a high-level analysis of the respective impact of each. At this point, the proposals have not been adopted and they are not binding. It is notable that the two Democratic FTC Commissioners dissented from the NPRM; Commissioner Slaughter highlighted potential effects on corporate governance as the rationale for opposing rule changes that increase the number of HSR-exempt transactions. Accordingly, the pending Presidential election may add some uncertainty as to the ultimate outcome of the rulemaking process.

Rule Change Regarding Associate Reporting

The FTC and DOJ propose to redefine the term "person" for the purposes of HSR filing to include "associates." The term "associate" is already defined under HSR rules to include generally any entity that has the direct or indirect right to manage or control the acquiring entity. The FTC press release indicated that their goal is to acquire a more complete picture of the antitrust implications of pending transactions by requiring private equity groups and master limited partnerships to provide significantly more information about associated non-corporate entities not involved in a transaction.

This proposed rule change, if enacted, could create a significant new burden for some private equity and other fund families, which would be required to provide detailed information in their HSR Form on associated entities that may not be readily available nor easily acquired. Perhaps most significantly, certain acquisitions made by a non-corporate ultimate parent may result in an HSR filing where one would not have been required previously. This filing scenario would arise where:

- multiple related funds each acquired less than $94 million in an issuer; or where
- each fund in one family has the right to less than 50% of the profits or assets of a LP or LLC, but where the funds together have a right to more than 50%.

Acquiring parties would be required to disclose controlling or minority interests in entities that report revenue in overlapping NAICS codes with the acquired entity, and would also be required to provide the following information for all entities under common management:

- financial statements;
- revenue by industry codes;
- 4(c) and (d) documents; and

- details of prior transactions in the industry for all entities under common management.

Proposed Addition of a "De Minimis" Exemption

The FTC's proposed new § 802.15 would exempt acquisitions of less than 10% or less of an issuer's voting securities unless the acquirer already has a "competitively significant relationship" with the issuer. This proposal is meant to complement the current § 802.9 exemption, which currently exempts from HSR reporting acquisitions of voting securities made solely for the purpose of investment, provided that the acquirer would hold no more than 10% of the issuer's voting securities. The FTC notes in its press release that "solely the purpose of investment" has long been difficult to interpret.

If adopted, this new rule would likely expand the ability of activists and other investors to acquire significant stakes in issuers without making HSR filings so long as the investor does not have a 1% or greater position in a competitor of the issuer, or propose to put a director on the issuer's board.

The NPRM defines "competitively significant relationship" in the context of this new proposed exemption to include situations "where the acquiring person operates competing lines of business, has an existing vertical relationship with the issuer, or employs or is otherwise represented by an individual who is an officer or director of the issuer or a competitor."

The first prong of the new exemption provides a new definition of competitor that includes entities that report in the same NAICS industry code, as well as entities that compete "in any line of commerce." The second prong of the proposed competitor definition would require filing parties to conduct a good faith assessment to determine whether any entity controlled by the buyer competes with or holds interests in entities that compete with the target. Notably, the FTC acknowledges that this proposed two-prong definition of "competitor" is broad, and the agencies have specifically asked for feedback from the public on this facet of the proposed rule.

The FTC proposed an additional carve-out from the exemption for vendor-vendee relationships between a buyer and target. The proposed § 802.15 exemption would not be available if the buyer and the target are in a vertical relationship valued at $10 million or greater. The FTC has not historically focused on vertical relationships, but in the proposed rulemaking they noted that there can be "important competitive implications in vertical relationships, and the Agencies have a strong interest in reviewing transactions that create or expand vertical relationships."

Acquisitions of less than 10% by directors and officers of the acquired company are *not* exempt under the existing passive investment exemption, and they are also not exempt under the new exemption. Thus, officers and directors remain subject to the general HSR Act thresholds for acquisitions of their own company's voting securities, even if they hold less than 10% of the issuer's shares. Interestingly, the DOJ, in its press release on the NPRM, specifically asked for comments on whether it makes sense to carve out officers and directors from the new exemption, asking rhetorically "[h]ow does it meaningfully increase the likelihood of receiving filings that have the potential to raise competition concerns?"[1]

Additional Information Sought by Agencies

The FTC and DOJ are also seeking additional information regarding the following seven topics as they pertain to HSR filing rules:

- size of transaction;
- real estate investment trusts;

[1] **https://www.justice.gov/opa/pr/antitrust-division-supports-modernizing-merger-filing-exemptions-certain-investments**

- non-corporate entities;
- acquisitions of small quantities of voting securities;
- influence on an entity outside the scope of ownership of its voting securities;
- transactions or devices structured for avoiding HSR Act requirements; and
- general issues pertaining to the HSR filing process.

The agencies hope to use this requested information to inform future amendments to the HSR rules and the interpretation of those rules.

Guidance Regarding Special Dividends and HSR Avoidance

On September 23 the FTC published a blog post withdrawing guidance (unchanged since 2003) that categorically excluded special dividends from consideration as an HSR avoidance device under Rule 801.90. Under the previous guidance, filing parties could pay special dividends in order to reduce their assets below the relevant size of parties test. The FTC has issued similar guidance since 2003 stating that other forms of accelerated payments (such as paying down accounts payable or early grants of employee bonuses) were not considered HSR avoidance devices.

In the September 23 post, the FTC noted that:

> "Under 801.90, the Commission determines whether there was a purpose to avoid or delay by applying a 'but for' test: but for the requirement to file and observe the waiting period, would the parties have selected this form of transaction? Put another way: was the transaction structure motivated by some benefit from avoiding or delaying filing? If the answer is yes, the structure is an avoidance device under the Rule."

The FTC has consistently advised parties to consult with them regarding the applicability of 801.90 to a given transaction, noting that such determination requires a comprehensive analysis and review of all the facts and circumstances of the transaction and any related transactions, including a consideration of the parties' purpose for the transaction's structure. This blog, which follows a blog from last fall that stated "restructuring a deal to avoid or delay an HSR filing may subject the merging parties to substantial penalties if the restructured transaction still results in an acquisition,"[2] indicates that the agencies are increasingly focusing on identifying transaction structures designed to avoid an HSR filing. Transaction parties should consult with counsel regarding application of the technical HSR Act rules.

Key Takeaways

These proposed rule changes and updated guidance show that the agencies are intent on reviewing transactions that currently are outside the scope of HSR Act jurisdiction, and receiving up front more information about the holdings of related parties that are not under common control, while carving out transactions that are unlikely to raise competitive concerns.

We are considering the potential impact of these proposed amendments on our clients, weighed against the historical rate of challenges to these classes of transactions and the noted benefits expected by the agencies. Anyone with concerns about these proposed rule changes are encouraged to contact one of the Davis Polk attorneys listed below.

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[2] **https://www.ftc.gov/news-events/blogs/competition-matters/2020/09/seeing-whole-picture-avoidance-devices**

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

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