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Proposed changes to HSR Form and Instructions would have significant impacts for private equity

July 31, 2023 | Client Update | 9-minute read

Proposed changes to the HSR Form and Instructions would, if adopted, substantially increase the time and cost of compliance for private equity firms. The proposed rules would require more information from a variety of sources and non-parties at these firms—including minority investors, supervisory deal team leads, and all officers/directors/board observers—posing significant challenges for parties with complex corporate structures.

Executive summary

On June 27, 2023, the Federal Trade Commission (FTC) issued a Notice of Proposed Rulemaking (NPRM) to amend the Hart-Scott-Rodino Act (HSR) Form and Instructions. According to FTC Chair Lina Khan's accompanying statement, the NPRM is the result of the antitrust agencies' first "top-to-bottom" review of the HSR Form in 45 years and seeks to fill "gaps" in the HSR Form, which she states currently hinder FTC staff's ability to understand and assess the competitive impact of reportable transactions within the initial waiting period.

Davis Polk has previously provided a general analysis of these proposed changes. This alert focuses more specifically on the implications for private equity.

As explained below, the proposed changes are likely to have a significant and direct impact on private equity firms. In particular, new disclosure requirements for officers and directors of portfolio companies as well as for limited partners/minority investors at both the fund and portfolio level are likely not only to result in significant compliance costs, but also to erode privacy protections for investors. Additionally, private equity firms are likely to be impacted disproportionately by a number of other generally applicable requirements. Such requirements include the provision of ordinary course agreements, listing more prior acquisitions, and expansion of transaction related documents—all of which are likely to magnify cost of compliance and lengthen timelines for transactions, whether or not a particular transaction raises substantive antitrust concerns.

The FTC's proposed changes to the HSR Form and Instructions are unlikely to go into effect for many months, as they are subject to a 60-day public comment period, which would be followed by a period of additional antitrust agency review before a final review is published. It is also likely that various interested parties will bring legal challenges to the new rules in federal court. These changes are therefore unlikely to affect deals during 2023. Because they impose significant information demands on the public, the changes must also undergo review by the Office of Management and Budget (OMB) under the Paperwork Reduction Act. Nevertheless, by 2024, there is a substantial risk that some version of these new rules will go into effect, with significant implications for private equity.

Provisions directly targeting private equity firms

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Providing information on minority investors and interest holders

Under current rules, Item 6(b) of the HSR Form requires the identification of minority holders between 5% and 50% of the ultimate parent entity (UPE), with the notable exception that limited partnerships are required to identify only the general partner. This exception obviously has signficant benefits for private equity funds, which are typically organized as limited partnership. Under the NPRM, however, acquiring persons must identify (1) all 5-49% minority holders—including limited partners—of the acquiring entity; (2) any entity that either controls or is controlled by the acquiring entity; and (3) any entity within the acquiring person that has been or would be created in contemplation of, or for the purposes of, effectuating the transaction. Minority holders are defined as "all entities or individuals, including limited partners, that hold 5% or more of the voting securities or non-corporate interests of one of the identified entities." Acquired persons must identify minority holders of the acquired entity(s) that will retain an interest in the acquired entity(s) or will acquire interests in any of the acquiring person's entity(s) due to the transaction, i.e., rollover shareholders.

In effect, the NPRM imposes the requirement that all new minority investors in a transaction would need to be identified, which could have significant implications for private equity firms. As the Commission acknowledges:

> [T]hese proposed requirements may require significant additional information from investment entities, such as funds and master limited partnerships, for which organizational structures are often more complex. In particular, there is some risk that limited partners, who often by agreement are required to remain passive, may forgo investment to avoid disclosing their identity to federal antitrust authorities.

Providing an organizational chart of all associates

The Commission proposed that "[f]or transactions where a fund or master limited partnership is the UPE, also provide an organizational chart sufficient to identify and show the relationship of all entities that are affiliates or associates." Because private equity entities typically have many affiliates and associates, and their ownership participation levels are subject to fluctuation, producing an organizational chart would be time-consuming and costly to prepare and update, and would be of questionable benefit to the agencies in their antitrust review.

Provisions likely to result in more significant impact for private equity firms

Extending production of transaction-specific assessments of competition to provide drafts and to supervisory deal team leads

The NPRM expands the requirement to produce transaction-specific assessments of competition under items 4(c) in two meaningful ways:

First, the NPRM proposes to add "supervisory deal team lead(s)" to "officers or directors" of individuals from whom documents need to be produced. The NPRM defines "supervisory deal team lead(s)" as the "individual or individuals who functionally lead or coordinate the day-to-day process for the transaction at issue." This new emphasis on "functional" leadership poses novel challenges for firms with complex or fast-changing leadership structures.

Second, the NPRM proposes to require the submission of all drafts of a document that were prepared or reviewed by an officer, director, or supervisory deal team lead. Particularly in combination with requiring documents from the "day-to-day" coordinator of the transaction, this requirement could result in an upsurge in the number of documents required to be produced. For large, complex acquisitions, which are often analyzed for months by the deal team, this likely would require a custodial collection and review of email correspondence in order to be compliant for the HSR filing. In addition to driving up transaction costs, this may cause significant delays in the ability to make an HSR filing and delay transactions.

List all officers/directors/board observers of each subsidiary, and all such positions held by each in the two years prior

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The Commission proposed a new section which would require firms to identify (1) the officers, directors, or board observers of all entities (including all portfolio companies) of both parties and (2) the other entities these individuals currently serve, or within two years before filing had served, as an officer, director, or board observer. In effect, this change would require yet another record keeping requirement applicable to each controlled portfolio company. This may be particularly challenging given the complex and always evolving nature of private equity funds and the requirement to provide historical information.

All agreements between parties in effect or in last year

The FTC also proposed that each filing person submit all agreements between any entity within the acquiring person and any entity within the acquired person in effect at the time of filing or within the year prior to the date of filing. As applied to funds, this provision would require not only agreements between the acquiring fund of the acquiring entity and the target, but also the disclosure of all agreements with controlled portfolio companies not involved in the transaction. For the larger funds, this could require extensive document collection that could potentially take weeks.

Expand the disclosure of prior acquisitions

The NPRM extends the obligation to provide information about prior acquisitions in any overlapping area in several respects. First, the NPRM proposes to require both the acquiring and acquired person to disclose prior acquisitions—currently only the acquiring person is required. Second, the NPRM extends the time frame to report on prior acquisitions from five to ten years. Third, the NPRM proposes to eliminate the $10 million threshold—all overlapping prior acquisitions, regardless of size would need to be disclosed.

Taken together, these changes are likely to expand significantly the scope of disclosures regarding prior acquisitions. It would also in effect impose a more rigorous record keeping requirement for private equity firms to track historical information, which is likely to be a significant undertaking.

Identify other interest holders that exert "material influence"

In addition to expanding disclosure requirements regarding limited partners/minority investors (discussed above), the NPRM proposes to require the acquiring person to identify individuals (other than its employees) or entities that hold "material influence on the management or operations of the acquiring person." This includes individuals that

- provide credit totaling 10% or more of the value of the entity;
- hold non-voting securities, options, or warrants whose value is at least 10% of the entity or could be converted to 10% or more of the voting securities or non-corporate interests;
- are board members; or
- have agreements to manage entities related to the transaction.

Again, this expansion may disproportionately impace private equity by (among other things) imposing new burdens on lender-financed transactions.

Subsidies from Foreign Entities or Governments of Concern

The Commission also proposed the introduction of a new section entitled "Subsidies from Foreign Entities or Governments of Concern," which would require both parties to (1) identify and describe subsidies either received or expected to be received by any entity (i.e. including controlled portfolio companies) from a foreign entity or government of concern within two years; and (2) identify any of its products that are produced in North Korea, China, Russia, or Iran and are subject to countervailing duties in any jurisdiction or subject of an investigation for potential countervailing duties. As applied to private equity firms, this would impose yet another investigation and compliance regime applicable to each controlled portfolio company.

Key takeaways

If implemented, these changes would not only increase the burden on transacting parties to prepare HSR filings, but also result in significant new record keeping and compliance regimes and impact the ability to timely engage in transactions.

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In particular, new disclosure requirements would impose significant production obligations applicable to each controlled portfolio company, including production of ordinary course agreements and identification of historical roles of board members. While there may be a theoretical chance that a material antitrust concern may be uncovered by this additional disclosure, in the vast majority of transactions the benefit of such disclosure seems very attenuated.

Similarly, the expansion of the scope of transaction-related document submissions to deal team leads and to include drafts, may require custodial collection and review. In combination, the NPRM may lengthen HSR preparation times by weeks or even months—impeding the ability to enter into some transaction on a timely basis. More fundamentally, the new requirements to disclose limited partners/minority investors and identify key creditors, may make it more difficult to secure additional capital—precluding some deals altogether.

In all, the NPRM proposes sweeping changes that may disrupt acquisitions by private equity firms, burden the government with extensive additional documents and data that would need to be reviewed by agency staff, and impose an additional $350 million or more each year of regulatory burden on dealmaking in America.

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