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U.S. Antitrust Agencies Announce Proposed Changes to HSR Rules

Changes Would Create New Exemption for Minority Acquisitions and Increase Filing Obligations for Certain Entities

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Antitrust/Competition

Agencies Also Seek Public Comments that Could Lead to Additional Changes to the HSR Rules

The Federal Trade Commission ("FTC") and the Antitrust Division of the Department of Justice ("DOJ") (the "Agencies") announced proposed changes to the premerger notification rules ("Rules") promulgated under the Hart-Scott-Rodino ("HSR") Act on September 21, 2020. Although the Agencies' proposals are extensive, most significantly they would:

1. create a new exemption for certain acquisitions that result in holding 10% or less of the voting securities of a target, so long as the acquirer and target do not "already have a competitively significant relationship;" and
2. expand the definition of "person," creating new filing obligations for certain entities, including many investment entities.

The Agencies' proposed new rules are described in a Notice of Proposed Rulemaking ("NPRM"). The Agencies also released a request for comment, in the form of an Advanced Notice of Proposed Rulemaking ("ANPRM"), regarding a variety of additional filing issues that are under consideration. Comments on the NPRM and the ANPRM will be due sixty days after publication in the Federal Register.

Notably, the NPRM was approved by the FTC by a 3-2 party-line vote. Commissioner Phillips released a statement supporting the proposed 10% exemption, while Commissioners Chopra and Slaughter released dissenting statements. In a press release issued by the DOJ, Assistant Attorney General Delrahim supported the *de minimis* exemption in particular, and specifically asked for commentary on the necessity of the carve-outs in the proposed exemption for officers and directors and vendor-vendees, which is discussed below.

The HSR Act and Rules

The HSR Act requires parties to certain mergers and acquisitions to notify the Agencies and observe a waiting period (usually 30 days) prior to consummating a reportable transaction. The jurisdictional thresholds are adjusted annually. Currently, acquisitions resulting in holdings of voting securities, assets, or controlling interests in non-corporate entities valued at more than $94 million may be reportable.

The HSR Rules further define the requirements of the Act, provide exemptions (some of which are provided in the HSR Act itself), and delineate the information that parties are required to submit in their filings.

Proposed "*De Minimis*" Exemption

The HSR jurisdictional threshold applies not just to controlling acquisitions of corporations, but to minority acquisitions of voting securities as well—no matter how small of a percentage of the voting securities of the acquired issuer a $94 million investment may represent. The HSR Act provides an exemption for acquisitions resulting in holdings of 10% or less of voting securities, but only if they are acquired "solely for the purpose of investment." 15 U.S.C. § 18a(c)(10); 16 C.F.R. § 802.9. The Agencies apply this exemption very narrowly, however.

The Agencies are not proposing to change the "solely for the purpose of investment" exemption. Rather, they are proposing a new *de minimis* exemption, which will apply to acquisitions (1) that result in the acquiring person holding 10% or less of the voting securities of the target, and (2) where the acquiring person:

- is not a competitor of the target;
- does not have a greater than 1% investment in a competitor of the target;
- does not have employees, principals, or agents that serve as officers or directors of the target (or a competitor of the target);
- and does not have a vendor-vendee relationship with the target resulting in annual sales of more than $10 million.

In each case, the "target" (or "competitor of the target") includes controlled entities, such as subsidiaries. The exemption does not apply to minority acquisitions of non-corporate interests (e.g., interests in an LLC), because acquisitions of such interests that do not result in control of the non-corporate entity (as "control" is defined in the Rules) are already not reportable under the Rules.

The proposed *de minimis* exemption could relieve filing burdens in some instances. However, application of the Rule may be complex and qualifying for the exemption may be difficult, given the number of exclusions and the Agencies' proposed broad definition of "competitor."

Proposed New Definition of "Person"

Identifying the relevant "person" for HSR purposes determines the scope of information that must be reported on the form, and can also determine whether a transaction is reportable at all. The definition of "person" has remained unchanged since the original Rules were finalized in 1978, and includes the "ultimate parent entity" ("UPE") of the entity making the acquisition (or of the entity whose assets, voting securities, or non-corporate interests are to be acquired), as well as all of the entities the UPE directly or indirectly controls, with "control" defined for this purpose in the Rules.

While this analysis is generally straightforward for operating companies, it can be quite complex for investment entities, such as private equity funds and master limited partnerships. Under the current Rules, "control" of non-corporate entities such as LLCs and LPs is determined by looking at the rights to profits and assets, not management rights or (strictly speaking)

ownership percentages. Therefore, in many instances, investment groups comprise multiple "persons" for HSR purposes.

Entities that are not commonly "controlled" but are commonly managed, such as by a shared investment manager or general partner, are defined as "associates" under the rules. 16 C.F.R. 801.1(d)(2). The proposed Rules would significantly expand the definition of "person" to include these "associates."

This proposed change to the definition of "person" may sweep additional transactions in under the notification and waiting period requirements of the HSR Act, since investment entities would need to aggregate holdings between associates when determining whether a filing is required.

Additionally, the proposed Rules would require the reporting of extensive new information about associates and their investments in HSR filings. Depending on the complexity of the fund or MLP structure and the number of operating companies involved, compliance with these proposed Rules could require a substantial investment of time and resources, and may require ongoing information collection and updates to the file by "frequent filers" between transactions to facilitate nimble analysis and preparation of necessary filings.

Advanced Notice of Proposed Rulemaking

In addition to releasing proposed Rules, the Agencies issued an ANPRM to request comments on several topics "to help determine the path for potential future amendments" to the Rules. These topics include:

- determination of the acquisition price and fair market value of targets;
- evolution of the structure and operation of Real Estate Investment Trusts (acquisitions by REITs are exempt under the current Rules);
- evolution of the structure and use of non-corporate entities;
- examination of the Rules applicable to investors, including investment funds and institutional investors, and how the Rules relate to rules of the Securities and Exchange Commission;
- influence on management decisions exercised by investors by virtue of their holding non-voting securities or having board observers;
- examination of whether payments of extraordinary dividends (for example, where such payments may reduce the value of assets held by the acquired person) can be used as devices for avoidance of the HSR Act; and
- adequacy of Rules related to subsequent minority acquisitions of voting securities of a target and information gathered regarding prior transactions by the acquired person.

These topics, and the commentary in the ANPRM, indicate that the Agencies are considering further changes to the Rules and informal guidance on such issues as:

- the treatment of debt and transaction expenses in determining whether the value of an acquisition triggers the HSR "size of transaction" threshold;
- the exemption available to REITs for the acquisition of real property;
- how and when acquisitions of non-corporate interests should be reported;

- what type of conduct is consistent with holding voting securities "solely for the purpose of investment";
- the exemption available for the acquisition of non-voting securities when the acquiring person also has the right to appoint a member of the board of directors; and
- the ability to acquire additional voting securities of an issuer within 5 years of filing to acquire shares of the same issuer, so long as such acquisitions do not cross another "size of transaction" threshold.

Next Steps

As of October 2, the NPRM and the ANPRM have not yet been published in the Federal Register. Publication will open a sixty day public comment period. After that time, the FTC and DOJ will consider the comments received and the FTC may (1) issue final Rules, either consistent with the proposed Rules, or altered in response to comments; (2) issue a supplementary notice of proposed rulemaking; or (3) decline to change the current Rules. There is no prescribed timeline for issuing final Rules; historically HSR final Rules have been released in as few as a few months after the close of the comment period, and up to two years later (if at all).

How Covington Can Help

Our antitrust practice group includes attorneys, including several who served at the Federal Trade Commission or the Antitrust Division of the U.S. Department of Justice, with decades of experience in advising on HSR matters. Our team can provide detailed and practical insight into how these complex proposed Rules might apply to various types of entities and transactions.

If you have any questions concerning the material discussed in this client alert, please contact any of the following professionals:

Antitrust and Competition

James Dean	+1 202 662 5651	jdean@cov.com
Ross Demain	+1 202 662 5994	rdemain@cov.com
James O'Connell	+1 202 662 5991	joconnell@cov.com
Kristin Shaffer	+1 202 662 5083	kshaffer@cov.com

Mergers and Acquisitions

Denny Kwon	+1 415 591 7090	dkwon@cov.com
Patrick Manchester	+1 202 662 5570	pmanchester@cov.com
J. D. Weinberg	+1 212 841 1037	jweinberg@cov.com
Amy Wollensack	+1 212 841 1250	awollensack@cov.com