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HSR Rule Changes: A Look Back (and Ahead)

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I. INTRODUCTION

In August 2011, the Hart-Scott-Rodino premerger rules and form received their second major overhaul since the enactment of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act"). While the rule changes did not impact the reportability of transactions, they altered a filer's necessary disclosures, initially drawing the ire of the private bar which claimed that they would result in a substantial compliance burden. Now, more than one year since the changes became effective, we reflect: How have the rules impacted filers (particularly the intended targets of part of the rule-making, private equity sponsors)? Have other filers faced increased disclosure unnecessarily? And has the agency accomplished its objectives in the rule-making?

Given that the Federal Trade Commission ("FTC") has largely been mum on the successes and short-comings of the rule-making (and specifically declined comment on this article), we describe our experience—as a global law firm "frequent filer"—working through the rule changes with clients. Our opinions on the positive and negative aspects of the rule-making attempt to balance the burden on clients with the FTC's articulated goal of requiring additional "helpful information" upfront in order to aid the federal antitrust authorities in clearing transactions more efficiently.[2]

II. THE CHANGES IN THE 2011 RULES

The HSR Act requires that parties to acquisitions meeting certain jurisdictional thresholds report information about themselves and their transaction to the FTC and the Antitrust Division of the Department of Justice ("DOJ"), and observe a waiting period, prior to consummating such transaction. The 2011 rules altered such disclosures, eliminating several items that, in the FTC's view, provided little useful information. The rules, however, also added three key items:

1. a new documentary disclosure requirement known as "Item 4(d),"
2. an "associates" definition (which may require the disclosure of certain holdings of entities under common management with the filer), and
3. a new revenue reporting requirement for manufacturers.

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[2] Premerger Notification; Reporting and Waiting Period Requirements, 76 Fed. Reg. 42,471 (July 19, 2011).

The FTC touted the merits of these changes indicating that proposed "revisions, deletions and additions [will] streamline the (f)orm and make it easier to prepare while focusing the (f)orm on those categories of information the Agencies consider necessary for their initial review."[3]

A. Dropped Requirements

While there are imperfections and kinks to work out, as with any rule-making, the streamlining changes have undoubtedly reduced the preparation burden substantially. A welcomed change, filers no longer report revenues for a statistical base year (which was, in 2011, still 2002) or provide a list of products that have been added or deleted since such base year. Compiling such information typically proved cumbersome because of the need to obtain information from subsidiaries or business units that, often, were not owned during the year in question. Moreover, the agencies found this information to be of "minimal value" given that the information was several years stale at the time they received it.

As for other stream-lining changes, the FTC also eliminated the requirements to: (i) submit balance sheets for all controlled entities, (ii) provide links to SEC filings, (iii) disclose the full addresses of subsidiaries, and (iv) disclose shareholders of controlled entities (other than those involved in the transaction for which HSR is filed).

With all of the hoopla generated by the rule-making, the burden that has been reduced by these changes—especially the elimination of the need to provide base year revenue data— should not be under-stated. Discussion of the "new" requirements, however, often overshadows this positive result.

B. The First New Requirement: Item 4(D) Documents

The first of the new requirements requires the submission of additional documents, called "Item 4(d) documents." Item 4(d) aims to supplement the existing Item 4(c), which requires the provision of documents that were created or received by directors or officers in connection with evaluation of the transaction and discuss topics such as markets (including market entry), market shares, and competition. The Item 4(d) requirement impacts all filers, regardless of entity type and irrespective of whether the filer is an acquiring or acquired person. Indeed, in roughly 85.5 percent of all the filings we have made after the rule changes, at least one document was submitted in response to Item 4(d).

Officially, Item 4(d) calls for the submission of three "new" categories of documents; unofficially, only the requirement for synergy and/or efficiency documents is new for most filers. The categories of 4(d) documents include: (i) confidential information memoranda ("CIM") prepared within a year of the HSR submission or, where no CIM exist, documents provided to a director or officer (or equivalent, with respect to a non-corporate entity) of the buyer meant to serve the purpose of CIM ("Item 4(d)(i)"); (ii) "banker's books" and third-party consultant materials prepared within a year of the HSR filing for an officer or director (or equivalent) of the filer, if they contain the same type of content as 4(c) documents and specifically relate to the sale of the acquired person's stock or assets ("Item 4(d)(ii)"); and (iii) analyses of synergies and/or efficiencies concerning the notified transaction ("Item 4(d)(iii)").

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[3] Premerger Notification; Reporting and Waiting Period Requirements, 76 Fed. Reg. 42,471 (July 19, 2011).

1. CIM Documents

Item 4(d)(i) essentially codifies the common practice among most practitioners to submit CIM as Item 4(c) documents. Prior to the rule changes, a few practitioners avoided the submission of such documents using the rationale that a transaction did not exist at the time the documents were created. Now, this fine line argument is, appropriately, unavailable. Given that most filers were already searching for and submitting CIM, in our view, there is no associated burden. In 39.8 percent of filings made by our firm since the rules became effective, CIM were supplied; this is wholly consistent with the percentage of filings made prior to the rule changes, where CIM were submitted in response to Item 4(c). The reason that this figure is not closer to 100 percent is that CIM are not traditionally created for many types of transactions—for example, where the transaction is based on an unsolicited contact by a buyer or is not a traditional M&A transaction (e.g., open market purchase, option/warrant exercise, exclusive license).

Item 4(d)(i) initially caused concern for its requirement that filers supply documents that "served the purpose of" CIM, fearing that it would be too difficult to ascertain what such documents might be or that reams of data room or other ordinary course information would become responsive. In our experience, most clients can readily ascertain whether a particular overview or series of generalized presentations are responsive in the absence of "formal" CIM. Further, in any M&A transaction, the ones most likely to contain CIM, there is significant back-and-forth between counsel for both parties; this can assist with identification of documents that served the purpose of CIM. We have supplied documents serving the purpose of CIM in 54.2 percent of filings since the rule changes; in nearly all cases the document that "served the purpose of" CIM was a management presentation that would otherwise have been responsive to Item 4(d)(ii).

2. Third-Party Documents

The second category of Item 4(d) documents requires the inclusion of documents prepared by third-party consultants during an engagement or for purposes of seeking an engagement, even if unsolicited. In 75.9 percent of filings since the rule changes we have submitted Item 4(d)(ii) documents and, similar to Item 4(d)(i), nearly all of such documents would have been submitted prior to the rule changes in response to Item 4(c).

3. Synergy and/or Efficiency Analyses

Finally, the third category of Item 4(d) truly created a new submission requirement, calling for all synergy and/or efficiency analyses relating to the transaction. This category covers any possible merger-specific synergies. Although the private bar indicated that the agencies were likely to receive voluminous and irrelevant materials in response to Item 4(d)(iii), if our experience is any indication, the Premerger Notification Office ("PNO") of the FTC has not.

Helpfully, the PNO has issued guidance refining the scope of Item 4(d)(iii) indicating, for example, that if there is a final synergy and efficiency model submitted, practitioners need not search for or provide emails otherwise discussing synergies or efficiencies (provided that they are

not also 4(c) responsive).[4] Further, the PNO has indicated that for a document to be responsive to Item 4(d)(iii), it must, at a minimum, have a *quantified* synergy/efficiency[5]—e.g., "property & casualty insurance premiums, $6 million." As a result, documents that speak generally about the "tremendous synergies" that could result from a deal or even identify such synergies generally without assigning numbers to them are not responsive. In 24.1 percent of filings since the rule changes, we have filed documents in response to Item 4(d)(iii).

In our experience, the overall burden of Item 4(d) on most filers is minimal and aided by the congruency—in many material respects—of the PNO's interpretations of Items 4(c) and 4(d). Further, Item 4(d) has arguably—and certainly in the instance of filers who would not have submitted CIM and certain banker materials—provided the agencies with useful information. Although our view is effected by the fact that our clients traditionally filed CIM and management presentations as Item 4(c) documents, we do believe that in approximately 13.3 percent of filings we have made since the rule changes, documents (namely synergy & efficiency materials) which would have otherwise not have been submitted were submitted in response to Item 4(d).

C. The Second New Requirement: Disclosing Associates

The second major addition concerns the creation of a new "entity," an "associate," which potentially triggers disclosures about the associate's holdings of interests in issuers or entities deriving revenue in the same NAICS code as the target. This requirement only applies to acquiring persons and primarily affects private equity funds and oil and gas master limited partnerships. In filings we have made for acquiring persons since the 2011 rule changes, approximately 9.3 percent have included associates disclosures; all of the filings that contained such disclosures were made by funds, though the possible need for associates disclosure has been analyzed in non-fund contexts as well.

The associates aspect of the rule-making is one where many argue the FTC missed its mark. In our experience, it is true that the analysis can initially be labor intensive for some filers (including seemingly unintended targets of the rule-making, corporate filers), virtually non-existent for others, and does not consistently yield the information that agencies purportedly sought. But when an associates disclosure *is* made, however, there is no doubt that the agencies receive additional information that previously would not have been included in the initial filing.

An associate is an entity that is not an affiliate[6] of the filer but that essentially controls, is controlled by, or is under common control with the filer (using a securities law concept which

[4] *See* "PNO Guidance on Item 4(d)" at http://www.ftc.gov/bc/hsr/item4d.shtm and Informal Interpretations 1109010 and 1109008 at http://www.ftc.gov/bc/hsr/informal/opinions/1109010.htm and http://www.ftc.gov/bc/hsr/informal/opinions/1109008.htm.

[5] *See* "PNO Guidance on Item 4(d)" at http://www.ftc.gov/bc/hsr/item4d.shtm and Informal Interpretations 1109010 and 1109008 at http://www.ftc.gov/bc/hsr/informal/opinions/1109010.htm and http://www.ftc.gov/bc/hsr/informal/opinions/1109008.htm.

[6] An entity is an affiliate of a person if it is controlled, directly or indirectly, by the ultimate parent entity of such person. See 16 C.F.R. § 801.1(d)(1).

ties to having the possibility of exercising investment discretion or, in the case of a master limited partnership, includes operational control).[7]

In creating the associates definition, the agencies hoped to rectify a perceived gap in the type of disclosures from non-corporate filers without changing the fundamental HSR definition of "control." Although the general partner of a fund may exercise investment discretion over the fund's investments, its interest in the fund does not typically result in "control" of the fund for HSR purposes; seldom does the general partner have an interest in the fund that entitles it to at least 50 percent of the fund's profits or, upon dissolution, assets. Thus, whereas a corporation disclosed information about all of its controlled entities, fund filers only disclosed information about the specific fund making the investment and its controlled entities. There was no disclosure of investments of related funds, even those sharing a common general partner, even though such information could arguably be competitively relevant. Therefore, the agencies sought to close that gap through the associates definition.

Our statistic—which indicates that approximately 9.3 percent of acquiring persons are disclosing associates information—is in contrast to the PNO's statistic of 3.8 percent in the seven months following the rule changes.[8] There may be several reasons for this discrepancy, including the use of a different date range and our high concentration of filings for funds during this time period. Nonetheless, no matter the explanation, neither figure accurately reflects the compliance burden associated with this item the first time that a person files under the new rules.

Every acquiring person—including corporate filers—needs to at least ask about the involvement of an investing arm in its structure and whether there is any portion of the acquiring person exercising investment discretion over the portfolio of another. Accordingly, we have had to vet whether biotechnology companies, bank and trust companies, registered investment advisers, and electronics manufacturers—all with corporate ultimate parents—have associates. In nearly every case the challenge associated with the analysis is gathering the appropriate information—i.e., structure charts, advisory agreements, fund and general partner agreements, management contracts—and finding the right persons within the client's organization to assist. Once a party has identified its associates and the relevant keepers of information, subsequent filings can leverage that information, significantly reducing the time needed to complete the analysis. The investment in the associates analysis is really an "up-front" cost and one that prospective filers can (largely) plan for in advance, if they so choose.

Once associates of a filer are identified, their holdings must be disclosed only if they derive revenue in the same NAICS codes as the target. Determining the NAICS codes of an entity

[7] For purposes of Items 6 and 7 of the Form, an associate of an acquiring person shall be an entity that is not an affiliate of such person but: (A) Has the right, directly or indirectly, to manage the operations or investment decisions of an acquiring entity (a "managing entity"); or (B) Has its operations or investment decisions, directly or indirectly, managed by the acquiring person; or (C) Directly or indirectly controls, is controlled by, or is under common control with a managing entity; or (D) Directly or indirectly manages, is managed by, or is under common operational or investment decision management with a managing entity. See 16 C.F.R. § 801.1(d)(2).

[8] Kathryn E. Walsh, Staff, Premerger Notification Office, Federal Trade Commission, Remarks during the American Bar Association Webinar: "Associates" Under the New HSR Rules (March 22, 2013), *available at* http://www.americanbar.org/groups/antitrust_law/resources/committee_program_audio/committee_program_audio_2013_03.html.

in which an associate holds a minority position (and sometimes even a controlling position) can be a challenge since the associates often do not have day-to-day operational control of such entities. Although the FTC permits a filer to voluntarily list all investments of associates, in our experience, filers feel this results in significant over-disclosure. A filer that does not know the precise NAICS codes is more likely to list the relevant information about entities potentially operating in the same industry as the target, often footnoting that the actual overlap is unconfirmed.

The fact that a filer may make no associates disclosures in a particular filing is not reflective of the leg work that is part of that determination. Where there is no disclosure, it may be the case that associates are limited to co-investment or "friends and family" funds that invest—in small amounts—in the same issuers as the filer. The lack of associates disclosure may also be attributable to the fact that an investment constitutes less than 5 percent of the issued and outstanding voting securities of an issuer or non-corporate interests of an entity; additionally, the issuers or entities may not derive revenues in the same NAICS codes as the target.

Thus, the lack of associates information can sometimes signify the absence of any competitively relevant information. However, sometimes the lack of disclosure can simply be attributed to a particular sponsor's structure (for example, two funds which have separate general partners, the limited partners of which are identical, would not typically be associates and one would not have to disclose the holdings of the other even if such holding were greater than 5 percent of an issuer deriving revenues in the same NAICS codes as the target).

Of the filings we have made that included associates disclosures, all have revealed information about minority, as opposed to controlled, investments of associates; pre-rule changes, such information would not have been disclosed nor would it have been likely to be evident to the agencies otherwise (e.g., no references included in Item 4(c) documents). To our knowledge, based solely on our own filings, the associates disclosures have yet to trigger an investigation into a transaction that we feel would not otherwise have received scrutiny.

D. The Third New Requirement: Revenue Reporting

The final major change to the HSR rules concerns revenue reporting by manufacturers. Specifically, products manufactured outside of the United States by an entity controlled by the filer and sold into the United States must be reported at a more granular, 10-digit product as opposed to 6-digit, NAICS code level.

Explaining its rationale, the FTC indicated that the fact that there is a U.S. sale of a product (regardless of the location of manufacture) suggests a possible impact in the United States;[9] in order to assess such impact, it is necessary to have the specificity conferred by a 10-digit code. For example, assume a company sells its China-made draperies in the United States. Prior to the rule changes, such sales would only have been reported only under a "Home Furnishing Merchant Wholesalers" code. This code covers many types of products, from floor coverings and lamps to cooking utensils and glassware, providing no visibility into what type of product is sold. Post-rule changes the code capturing this sale identifies it as involving a curtain or drapery.

[9] Premerger Notification; Reporting and Waiting Period Requirements, 76 Fed. Reg. 42,471 (July 19, 2011).

As with the associates change, the revenue reporting change affects only a subset of filers—those that manufacture or control a manufacturer. Approximately 47.4 percent of filings we have made since the rule changes have involved a changed disclosure to at least one manufacturing code in Item 5 to account for foreign-manufactured products sold into the United States. As a result, it would appear that the agencies receive more (and in some cases significantly more) detailed information about products that may impact U.S. markets and may be relevant to a competitive analysis.

Although the agencies now have more visibility into the nature of the U.S. sale, the actual numerical code presents only half of the picture. The other half is the corresponding revenue. In order to avoid the "double counting" that sometimes existed under the previous rules when a manufacturer sold a product from a separate distribution facility (and reported the sale twice—the intercompany sale at transfer price and the sale to the ultimate customer at wholesale/retail price), the new rules require each "sale" to be reported only once. The first U.S. sale is reported at the transfer price, if the sale is to a controlled entity; if the sale is to a third party, wholesale/retail pricing is used. Since there is no designation required as to whether (and for which sales) a particular pricing has been used, and since transfer pricing usually represents a small fraction of the price that a customer actually pays, the result may present a skewed picture of the revenue associated with various NAICS codes.

While complying with the new manufacturing disclosures can be time-consuming, most manufacturers only have to go through this extensive exercise as a first time filer or upon adding new products. Beyond the first filing, most filers can simply update the revenues and any changes in ship-to locations. Like the associates change, this change largely represents an "up front" cost that filers can prepare for in advance, if they so choose.

III. CONCLUSION

Overall, we feel that the agencies are receiving more information with the initial filing than they previously did and, from time to time, it seems to be the "helpful" information that they sought. With respect to Item 4(d), they now are guaranteed to receive basic documents like CIM and management presentations that are critical in describing a target's product and geographic markets. Additionally, they receive synergy & efficiency documents that may provide some additional insight into the transaction rationale even if the impetus or benefits of a transaction are not competition related.

With respect to associates, because funds are owned and governed differently than corporations, short of changing the fundamental "control" definition, a fund's disclosure will never match a corporation's disclosure. Further, because of the differences in fund structures themselves, the agencies do not have an equal line of sight between different families of funds; for some they will now have a glimpse, however.

And with respect to manufacturing operations, the agencies now have a more accurate picture of what is being sold into the U.S., even if the transfer pricing issue sometimes muddies the waters.

Ultimately because of—or perhaps in spite of—the new 4(d), associates, and revenue disclosures, we have noted a positive clearance trend. Based on filings we have made post-rule

changes, early termination of the HSR waiting period in those transactions where one party requested it has been received an average of one day sooner.

To see a positive shift in the clearance time is particularly notable considering that one would expect some growing pains from the agencies becoming accustomed to a new form and vetting the significance of new disclosures. As the agencies gain more experience with the form and disclosures, it is possible that clearance time may further decrease. In the last six months, we note that early termination has been received two days, on average, more quickly than before the rule changes.

To that end, although the debate will continue as to the usefulness of information that the agencies now receive as a result of the rule changes, the fact that transactions can move to a quicker close is a strikingly positive result, especially in times of evaporating financing and deal uncertainty.