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Why Investment Firms Are Watching HSR Rule Changes

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KEY POINTS:

- **Bright-line tests relating to HSR reporting requirements have been eliminated**
- **HSR reporting will now include certain holdings of the acquiring fund's "Associates," or sister funds**
- **Additional types of transaction related documents must be submitted – may require expanded collection efforts**

The HSR Act requires parties to notify the Federal Trade Commission and the Antitrust Division of the U.S. Department of Justice of certain transactions, and to observe a waiting period prior to closing. The basic reporting threshold is presently $66 million, but adjusts annually. Because the rules historically have limited the information called for in HSR filings to entities in the chain of "control", as the term is narrowly defined by the rules, the antitrust enforcement agencies have lamented not having access to information, for instance, from sister funds within a private equity firm.

New rules will remove that limitation and call for additional reporting relating to investments by "associates" in competing businesses. Also gone are the clean bright-line tests limited to the rules' narrow definition of control, in favor of a more nuanced rule that in some ways mimics the European approach to merger control reporting and its "decisive influence" standard. The FTC's premerger notification office has already made several presentations to practitioners on the changes, but it may be some time before the dust settles and we have established guidance on precisely how to apply the new rules to organizations with complex internal structures.

For now, the days when a private equity firm, though separate funds, could quietly acquire interests in multiple competitors in a given industry and escape the scrutiny of antitrust regulators appear to be a thing of the past. The expanded reporting will most directly impact private equity firms, hedge funds and other firms with broad investment portfolios, as the new rules do not make a distinction between, for instance, private equity funds versus hedge funds or other types of investment vehicles. Reaction to the initial proposed rulemaking did result in a somewhat narrower and more workable final rule, however, the resulting expanded reporting will nevertheless create new burdens.

Who are my “Associates”?

The associate concept introduced by the new rules seeks to bring within its reach all entities “under common operational or investment management” with a filer. This can include, for instance, sister funds within a fund family, master limited partnerships under common management, management companies managed by the same general partners, the general partner of a limited partnership, the managing member of a limited liability company, and the entities that control and are controlled by each of them. In each of these cases, filers on the acquiring side of a deal will be required to report their associates’ holdings of 5% or more in voting stock in companies that compete with the target. The prevailing view appears to be that in many cases the new rule will require the reporting of all interests across a firm of 5% or more in a business that is in the same industry as the target being acquired. However, as the premerger office charts out the boundaries of the rule, it is becoming clearer that not all firm entities will ultimately be deemed to be associates in all cases, depending on how a firm and its various fund businesses are structured.

The assessment of which entities to include as associates will need to be made based on an analysis of the firm's overall structure and the relationships between its entities under management. There are also fund formation implications to consider, as a fund's management structure may have an impact on which other firm entities will be the fund's associates under the new rules. The premerger office has said, for instance, that natural persons that are general partners of partnerships will not be considered associates of the partnership unless the individual has a contract granting him the right to direct the investment decisions of the partnership. Also, though not common, the agency has said that partnerships with multiple general partner entities will not be associates of each other unless the partnerships have 50% or more of their general partners in common. The premerger office has also said that holdings below the 5% threshold are not captured by the new rule, even where they would exceed 5% when aggregated with other associates' holdings.

The FTC has said that the new rule will allow the agency to "analyze the holdings of entities that are under common investment or operational management with the person filing notification," and that the burdens imposed by the new filing requirements are outweighed by the benefit to the antitrust enforcement agencies. While the agencies will have access to more information up front to evaluate transactions with competitive overlap, the legal standards for challenging a transaction remain the same.

Additional Documents Required to be Submitted

The revised Hart-Scott-Rodino rules also call for additional transaction related documents to be submitted to the agencies. Item 4(d), an addition to the notification and report form, requires the submission of transaction offering materials, such as a Confidential Offering Memorandum, investment banker books and certain transaction synergy or efficiency analyses and models. Note though that the premerger office has said unsolicited investment banker/consultant materials unrelated to the transaction that are in the files of the parties are not captured by the new rules, so a change in operating policy with respect to these materials may not be warranted. Some, *but not all*, of these materials were either already required or typically submitted as part of common practice. Existing HSR rules require the submission of certain documents that analyze a transaction with respect to, among other things, competition, competitors, markets and market shares, but the new rules expand these requirements.

For example, an offering memorandum that does not address Item 4(c) elements such as markets or market shares would now be required under the new Item 4(d). Likewise, transaction synergy analyses were not specifically called for in the original Item 4(c), but are now required to be included with the merger notification. Certain pre-existing regular course documents not prepared for the transaction also are now required to be submitted.

Item 4(c), and now 4(d), documents are carefully reviewed by the FTC and DOJ to determine whether to open an investigation or move to challenge a proposed acquisition. As always, to minimize potential exposure to antitrust liability and delay in completion of the transaction, care should be taken when preparing documents that examine the competitive impact of a transaction.

While the new rules include some clarifications over the initial notice of proposed rulemaking first published a year ago, some of the concepts the agency is trying to identify, such as offering materials or fund "Associates," remain subject to differing interpretations. The precise scope of the additional documents and information to be submitted in filings under the new rules will develop as the agency issues informal interpretations relating to these issues.

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