Cooley

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Proposed HSR changes

The Federal Trade Commission has announced sweeping changes to the Hart-Scott-Rodino ("HSR") Notification and Report Form that parties to mergers and acquisitions must file before they can consummate proposed transactions.

The changes are subject to public comment until October 18, 2010.

Among a long list of proposed changes, many that will streamline preparation of the HSR Form and others which are relatively noncontroversial, there are major additions to the documentary and information burdens placed on parties. If those major changes, relating to the new category of Item "4(d)" documents and the new information requirements tied to "associates" are adopted after FTC review of comments they will constitute the most significant changes to the HSR filing system in decades, with 4(d)'s reach extending to all filers and with the "associates" concept set to fundamentally change the reporting demands imposed on a broad range of funds, including venture funds, private equity funds, and master limited partnerships.

The HSR Act requires parties to proposed mergers and acquisitions that meet certain criteria, based primarily on the size of the parties and size of the transaction, to notify the FTC and the Department of Justice, and to observe a waiting period before closing. The required Notification and Report Form mandates submission of specific information about the parties and transaction, including a description of the transaction, information about the parties parents, subsidiaries and major shareholders, minority interests, revenue data by North American Classification System (NAICS) code, a copy of the parties' agreement, and financial documents.

Often the most time consuming aspect of preparing the HSR Form is the collection and review of "studies, surveys, analyses and reports" prepared "by or for any officer(s) or director(s)" for the purpose of evaluating or analyzing the acquisition with respect to "market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets"—the so called "4(c)" documents. This 4(c) requirement, which is designed to provide regulators with useful substantive background on the transaction and its effect on competition, has been interpreted broadly to include not only formal presentations but all documents, including even email and handwritten notes. The new 4(d) requirements build on the 4(c) category to supply regulators with an even broader range of documents that they believe can assist their understanding of the competitive impact of proposed transactions.

Item 4(d)—Offering memoranda, third party analyses, synergy/efficiency documents

The FTC is proposing a new category of "4(d)" documents comprised of three separate new document demands:

- ***4(d)(i)****—would require submission of "all offering memoranda (or documents that served that function) that reference the acquired entity(s) or assets … produced up to two years before the date of filing."*

Unlike the "4(c)" requirement, this demand is *not* limited to documents created for a particular transaction and is *not* restricted to documents created by or for an officer or director. While the request should be manageable in most cases, additional burdens will be faced by sellers who have not relied on a single selling document but rather have prepared separate presentations for prospective buyers (potentially several for each) over the previous two years. Those sellers could end up needing to collect, review, and submit a large volume of documents (even if unrelated to the transaction for which the HSR Form is being submitted). The burden will be even greater for some companies who have previously shopped portions of their business—since a later filing for the acquisition of the entire company would relate (in part) to these smaller proposed transactions and draw those selling documents in, no matter how small the business or assets previously up for sale.

- ***4(d)(ii)****—would require submission of "all studies, surveys, analyses and reports prepared by investment bankers, consultants or other third party advisors if they were prepared for any officer(s) or director(s) … for the purpose of evaluating analyzing market shares, competition, competitors, markets, potential for sales growth or expansion into geographic markets, and that also reference the acquired entity(s) or assets … produced up to two years before the date of filing."*

  Notably, the FTC proposes that any document found in the files of any officer or director "should be deemed to have been prepared for that individual." This demand could impose a large burden, as it is untethered to the proposed transaction, and may draw in "off-the-shelf" studies and analyst reports containing any competitive analysis, as well as reports prepared specifically for a merging company, which reference the acquired entity or acquired assets. Insofar as the FTC also treats officers and directors of a company's subsidiaries as subject to the requirement, the scope of the required search for and production of documents could be extremely broad.

- ***4(d)(iii)****—would require submission of "all studies, surveys, analyses and reports evaluating or analyzing synergies and/or efficiencies if they were prepared by or for any officer(s) or director(s) … for the purpose of evaluating or analyzing the acquisition."*

  Since this demand is limited to documents related to "the acquisition," it is likely to be the least burdensome of the three new categories, although it will expand the scope of documents currently required to be produced, even in transactions that raise no serious substantive antitrust issue.

While these requests may be narrowed in response to public comments, companies should anticipate the burden of preparing HSR Forms to increase, and may want to start the document collection process sooner in the future, to be able to file promptly after entering an agreement. (On the other hand, some companies may occasionally consider delaying filing to avoid producing certain documents, since the two year window for these new requests will run backwards from the date of filing.)

"Associate" entities, funds, and new reporting requirements

The FTC's proposed revisions explain, at length, the current shortcomings of the HSR Form in capturing the actual competitive impact of investments made by funds. These limitations largely flow from the fact that current reporting focuses on entities within the "control" of the filing party. In particular, the general partners that manage private equity and venture capital funds, which are typically structured as limited partnerships, rarely control the partnership under the HSR rules—which require that one have either a right to 50% or more of the profits of the partnership or a right to 50% or more of its assets upon dissolution.

The FTC is concerned that, under the current system, regulators might miss the fact that funds under common management may have competitively significant overlaps with the entity/assets to be acquired, or that another fund under common management may already have significant shareholdings in the same entity whose voting securities are being acquired.

To get a better picture of the actual competitive dynamics, the FTC proposes to introduce the concept of "associate" and to layer on substantial reporting requirements to associated entities. The rules would define an "associate" (relevant only to acquiring persons) as an entity that is not under common control but:

1. has the right, directly or indirectly, to manage, direct or oversee the affairs and/or the investments of an acquiring entity (a "managing entity"); or
2. has its affairs and/or investments, directly or indirectly, managed, directed or overseen by the acquiring person; or
3. directly or indirectly, controls, is controlled by, or is under common control with a managing entity; or
4. directly or indirectly, manages, directs or oversees, is managed by, directed by or overseen by, or is under common management with a managing entity.

The FTC proposes that filers limit their response on minority holdings—Item 6(c) of the Form—to those which are believed to create overlaps between the acquiring side and the entity whose interests are being acquired. However, in addition to requiring parties to report on the direct overlaps caused by entities they "control", the new rules would now also require the acquiring person to report any overlaps created by the holdings of their

associates.

For fund families with extensive and/or rapidly changing portfolios this could become a significant burden.

As an example, a General Partner managing six limited partnerships, when preparing an HSR filing for one of the funds it manages would have to consider not only whether the minority interests of the fund that is filing has an overlap with the entity it is investing in but also whether the minority interests of the GP or any of the other funds the GP manages has an overlap with the target. The result is even more burdensome given that overlaps are defined based on NAICS codes (or, if NAICS code information is unavailable, "industry" overlaps) either of which is so broad in its scope that the operations of a software company producing encryption software and one that produces wordprocessing software would likely constitute an "overlap".

The proposed rules appear to tacitly acknowledge the difficulty that filers may face in determining the overlaps resulting from their minority holdings by making it "permissible for the acquiring person to list all entities in which its associate(s) has a reportable minority interest." The end result, for many funds, may be exercising this all-in option even if it results in their submitting substantially more information about their minority holdings than the current filing rules require.

The proposed revisions also expand the coverage of Item 7 of the HSR Form, which previously dealt with the geographic scope of a filer's operations in instances in which it overlapped with the other side, to now include corresponding overlap information with respect to that filer's associates as well if it is filing as an acquiring person.

The ultimate shape of the rules can't be known until the comments are received, reviewed, and incorporated into the final rules (with the FTC also then responding publicly to those comments it believes merit discussion). In particular, it is possible that certain of the proposed revisions that are likely to generate significant negative comments—such as the new 4(d) document requirements—may be modified to some degree. However, filing parties should anticipate that the majority of the proposed rules changes, even those raising controversy, may end up being adopted with minimal or no further changes.

Other Significant Proposed Revisions

- Making explicit that noncompete agreements associated with the main transaction agreement must be submitted (even if still only in draft form at that time of filing).
- Eliminating the requirement to supply or reference SEC filed documents and replacing it with a requirement that the Central Index Key number (CIK) be supplied for controlled issuers who submit Form 10-Ks or 20-Fs.
- Eliminating the requirement that parties submit a most recent regularly prepared balance sheet and, for individuals, the need to submit any personal financials whatsoever.
- Adding the requirement that annual financials be supplied for controlled non-corporate entities.
- Eliminating the need to supply any historical revenue information other than for the last completed fiscal year, and changing the nature of the reporting of foreign manufactured goods sold into the United States.
- Requiring parties to list the pre and post holdings in the issuer or non-corporate entity when the filing relates to the acquisition of additional voting securities or non-corporate interests.
- Expanding Item 6(b) to include holdings in non-corporate entities, as well as limiting the response on the acquiring side to just the acquiring entity and (if different) the entity that controls it.
- Expanding Item 6(c)'s listing of minority holdings to encompass non-corporate interests.

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