Mergers & Acquisitions Group

The HSR Merger Review Process: Basics and Recent Developments

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Materials

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The HSR Merger Review Process: Basics and Recent Developments

Dorsey & Whitney LLP

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What is this "HSR" that you're talking about?

- **"HSR" stands for Hart-Scot-Rodino**
  - Enacted in 1976 and named for senators Philip Hart (D-Ill.) and Hugh Scott Jr. (R-Pa) and representative Peter W. Rodino (D-NJ)
  - Could be worse. Do you really want a "Cobra" to be responsible for interim health benefits?
- **The HSR Act is the U.S. "merger control" law**
  - Parties to certain transactions are require to notify Federal Trade Commission (FTC) and U.S. Department of Justice Antitrust Division (DOJ) before closing on certain acquisitions
- **More than 110 jurisdictions around the globe now have merger control laws**
  - We can help you navigate through these laws, but today we are discussing only the U.S.'s HSR Act

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When does a transactional lawyer need to think about potential HSR reporting obligations?

- **Anytime the transaction value is more than $90 million**
  - Threshold is adjusted annually, so this is good until February 2020
- **In an acquisition of voting securities or LLC interests, "value" is the purchase price or (if determined and greater) the FMV of the securities or interests**
- **In an acquisition of assets, "value" is the purchase price (including any assumed debt)**
- **Value includes noncompete payments to individuals, milestone payments, and earn-out payments**
- **If the value is more than $90mm (or even getting close), or you have any question, call us**

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So if the deal is valued at $90mm, it's reportable?

- **No, not necessarily**
- **If the value is below $359.9 million, there is also a "size of persons" test**
  - Requires a $18mm person on one side and a $180mm person on the other side
  - Annual net sales determined by annual income statement; total assets determined by most recent regularly prepared balance sheet
  - Applies to ultimate parents of parties, not just the parties
- **And there are some exemptions for entire categories of acquisitions**

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Okay, I'll bite – what exemptions?

- **Some exemptions are pretty simple, such as exemptions for acquisitions of**
  - Office buildings and residences
  - Hotels and motels (unless it includes a ski facility)
  - Recreational lands (golf courses, tennis clubs, swimming facilities)
  - Farmland (unless it includes processing facilities)
- **Others (e.g., acquisition of carbon-based minerals or reserves) are subject to a cap**
- **Others (e.g., acquisition of a foreign issuer) require more detailed analysis**

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But there's no antitrust risk if the deal isn't reportable, right?

- **Wrong**
- **Antitrust laws apply whether or not the transaction is reportable**
- **DOJ and FTC can and do challenge nonreportable transactions**

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What does the HSR process entail?

- **Ultimate Parent Entities ("UPEs") of buyer and of seller file notification forms**
  - A UPE is an "entity" that is not controlled by any other "entity"
  - "Control" of a corporation means owning 50% of the voting securities or having the right to appoint 50% of the directors
  - "Control" of an LLC means a 50% economic interest (i.e., in profits or in assets on dissolution)
- **Buyer pays a filing fee ($45k, $125k, or $280k, depending on size of transaction)**
- **Parties wait 30 days to see whether FTC or DOJ objects**
  - Shorter period for all-cash tender offers
  - Option to request "early termination" in any transaction
  - Parties should consider other strategies in potentially problematic transactions

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Is there a deadline for filing the notification?

- **No statutory deadline**
  - But the deal can't close unless the 30-day waiting period expires or early termination is granted
  - Parties *can* file as soon as an LOI or MOU has been signed by both sides (or, in tender offer and other 801.30 transactions, notice given)
  - We recommend counting backward from anticipated closing date, plus cushion for any preparation time
- **Most purchase agreements will address expressly**
  - "as soon as reasonably practicable"
  - within specified number of business days (usually 10)

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What's this "early" termination?

- **Parties can ask for early termination of the waiting period, which is granted if neither agency is interested in the transaction**
- **No additional fee for early termination**
- **Names of UPEs and acquired entity are published on FTC website and elsewhere**
- **ET is requested in about 75-80% of transactions, and about 78-80% of the requests are granted**
  - That is, early termination is granted in about 58-65% of all transactions
- **We've received as early as day 5 and as late as morning of day 30, but our experience is generally day 14-21 of the waiting period**

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Why do you like to be consulted early on?

- **Make early determination of whether transaction is likely to be reportable**
  - And whether likely to be investigated
- **Help board choose between competing bidders (by assessing relative antitrust risk)**
- **Advise on drafting of "4c/4d" documents that will have to be submitted with HSR notification form**
- **Advise on antitrust issues in diligence process**
- **Assist with drafting provisions in definitive agreement**

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Wait, how *do* I address Antitrust and HSR Issues in the Purchase Agreement?

- **Antitrust commitments and risk-allocation provisions**
  - "Efforts" standards
  - Divestiture covenants
  - Closing conditions
  - Termination triggers
    - Termination fee?
- **Examples:**
  - AT&T/Time Warner (2018): Multiple extensions of termination date; parties prevail over DOJ on the 10th day before (extended) termination date
  - Halliburton/Baker Hughes (2016): $3.5b termination fee with challenge pending on first day after maximum extended termination date

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Why don't you like us saying "HSR Approval"?

- **The HSR process is not an "approval" process – it is an "absence of objection" process**
  - If DOJ/FTC does object to the deal, they need to get a court order to prevent your closing (or reach a settlement or at least a timing with the parties)
- **DOJ/FTC *can* challenge a deal even after they let the waiting period expire, and even after the deal closes**
- **Private parties can challenge a deal**

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What if we just don't want to file?

- **That's why your counter-party is going to insist on a contractual obligation to file**
  - Converts your statutory obligation into a contractual obligation
- **And there is a daily penalty for failure to file (or submitting an incomplete filing)**
  - Current maximum daily penalty is $42,530

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What are some common errors in reportability analysis?

- **Corporate executive acquires voting securities (or nonvoting securities are converted into voting securities), resulting in crossing of a reporting threshold**
  - New York Knicks owner James Dolan fined $609,810 for failure to file HSR notification when award of restricted stock in Madison Square Garden Corp. caused his total holdings to cross threshold
- **Acquiring person fails to aggregate total holdings**
  - Previously bought 40% of issuer and now buying additional 20% (crossing 50% threshold)
  - Previously bought shares with current FMV of $40mm and now buying additional $45mm of shares in same issuer ($95mm > $90mm)
    - Berkshire Hathaway paid $896k in 2014 for failure to file when it converted Notes into voting securities

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Are there any special rules if the parties are competitors?

- **Reportability is based on tripping dollar-based triggers, regardless of transaction's potential competitive significance**
  - Some exemptions for categories of transactions where competitive risk is very low
- **Likelihood of an investigation (and maybe litigation) increases when transaction is between horizontal competitors**
  - "Hot" documents will further increase the risk (e.g., describing high entry barriers, predicting post-transaction price increases, describing transaction rationale as eliminating competition)
- **Puts a premium on avoiding inappropriate information-sharing in diligence process**
  - Mitigation:
    - Disclosure of competitively sensitive information can be deferred until later in the process
    - Access to competitively sensitive information can be limited to a "clean team"—i.e., individuals not involved in competitive decision-making
      - The clean team may summarize or aggregate data for wider distribution

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What happens after the parties have filed?

- **Both FTC and DOJ will review**
- **In most transactions, the agencies close their files without action**
- **In some transactions, one agency will investigate**
  - Clearance process
- **Investigation can sometimes be completed within 30-day waiting period**
  - Options to “go in early” or to “pull and refile”
- **Very small number receive “second requests”**
  - Extends the waiting period until substantial compliance, plus 30 days
  - Options: negotiate a settlement, abandon transaction, or litigate

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How many transactions get investigated?

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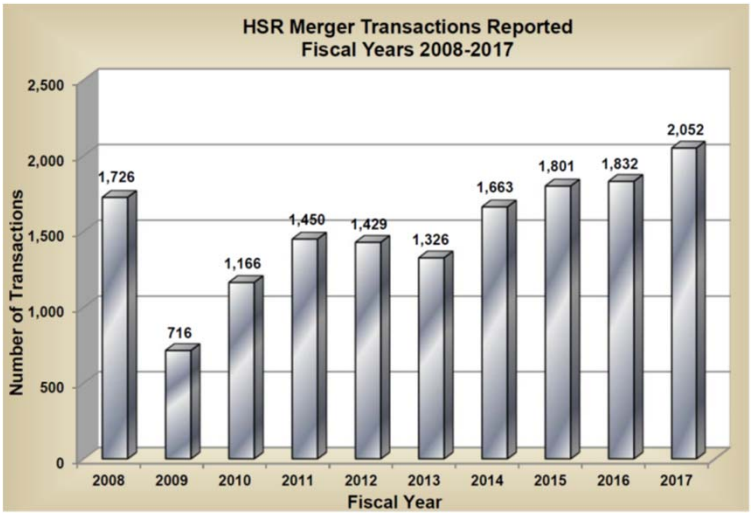
Number of Reported Transactions



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Source: FTC HSR Annual Report to Congress for FY 2017

Percentage of Reported Transactions Receiving Second Requests

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Source: FTC HSR Annual Report to Congress for FY 2017

Percentage of transactions that are investigated

TABLE I
FISCAL YEAR 2017[1]
ACQUISITIONS BY SIZE OF TRANSACTION (BY SIZE RANGE)[2]

TRANSACTION RANGE ($MILLIONS)	HSR TRANSACTIONS		CLEARANCE GRANTED TO FTC OR DOJ					SECOND REQUEST INVESTIGATIONS[3]				
	NUMBER[4]	PERCENT	NUMBER		PERCENT OF TRANSACTION RANGE GROUP			NUMBER		PERCENT OF TRANSACTION RANGE GROUP		
			FTC	DOJ	FTC	DOJ	TOTAL	FTC	DOJ	FTC	DOJ	TOTAL
Below 50M [5]	1	0.1%	0	0	0.0%	0.0%	0.0%	0	0	0.0%	0.0%	0.0%
50M - 100M	145	7.3%	7	4	4.8%	2.8%	7.6%	0	0	0.0%	0.0%	0.0%
100M - 150M	346	17.4%	26	6	7.5%	1.7%	9.2%	3	1	0.9%	0.3%	1.2%
150M - 200M	271	13.6%	17	3	6.3%	1.1%	7.4%	2	0	0.7%	0.0%	0.7%
200M - 300M	250	12.6%	33	14	13.2%	5.6%	18.8%	4	1	1.6%	0.4%	2.0%
300M - 500M	255	12.8%	23	5	9.0%	2.0%	11.0%	1	2	0.4%	0.8%	1.2%
500M - 1000M	469	23.5%	47	17	10.0%	3.6%	13.6%	6	5	1.3%	1.1%	2.3%
Over 1000M	255	12.8%	52	23	20.4%	9.0%	29.4%	17	9	6.7%	3.5%	10.2%
ALL TRANSACTIONS	1,992	100.0%	205	72	10.3%	3.6%	13.9%	33	18	1.7%	0.9%	2.6%

Source: FTC HSR Annual Report to Congress for FY 2017

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What will happen if my deal goes from "Investigated" to "Challenged"?

- **Negotiate Resolution / Divestiture(s)**
- **Government Loses on Preliminary Injunction**
  - Transaction proceeds, although parties might agree to defer pending government appeal
- **Government Wins on Preliminary Injunction**
- **Parties Abandon Transaction**

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How about this one: what is the New York CLE Code for this program?

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Earlier you mentioned "Gun-Jumping" – what is it?

- **Parties must remain separate and independent businesses until expiration/termination of HSR waiting period**
- **Acquisition of any operational control is a violation of the waiting period**
  - Requiring approval for non-material, ordinary course contracts
  - Prohibiting presentation of business proposals to customers or potential customers
  - Making joint sales calls
    - But some exceptions
  - Allocation of customers
  - Misrepresenting status
    - Issuing Seller business cards to Buyer personnel
- **Substantive antitrust laws also remain in effect**
- **Consider information sharing provisions/obligations in definitive agreement**

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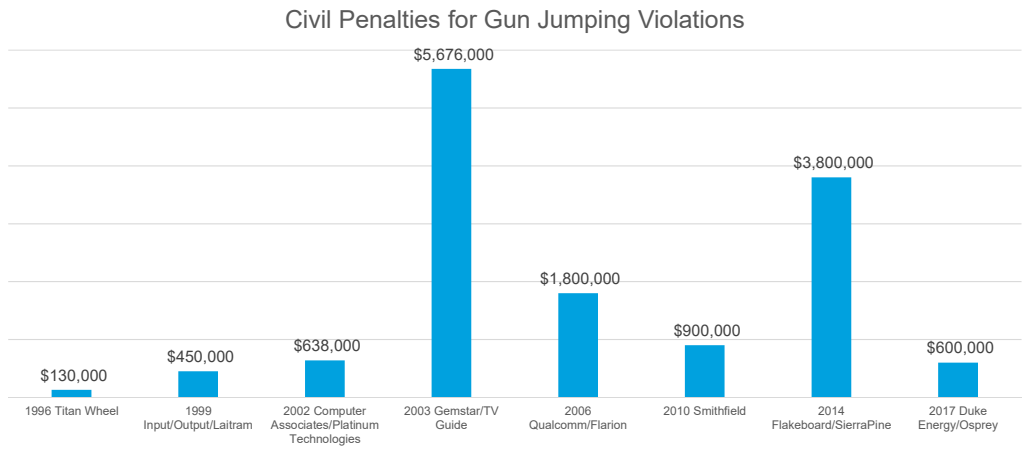
Gun Jumping



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Source: U.S. Department of Justice, Antitrust Division Update (Spring 2015) (updated by Dorsey & Whitney)

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Questions?

Thank you!

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February 20, 2019

Increase in HSR Reportability Thresholds and Other HSR Developments

Michael Lindsay, Jaime Stilson, James Nichols and Anthony Badaracco

On February 15, 2019, the Federal Trade Commission (FTC) announced the annual adjustment of the thresholds that trigger premerger reporting obligations (and the mandatory waiting period) under the Hart-Scott Rodino (HSR) Act, which will apply to transactions closing 30 days after publication of the announcement in the Federal Register. The FTC also announced adjusted thresholds that trigger prohibitions on certain interlocking memberships on corporate boards of directors, which will become effective immediately on publication in the Federal Register. Both sets of thresholds will then remain in effect until the 2020 adjustment.

Background

The HSR Act requires parties to give advance notice to the Federal Trade Commission and Department of Justice (DOJ) of any acquisition of voting securities, assets, or non-corporate interests where the value exceeds certain dollar-based size thresholds. If the transaction is reportable, the parties cannot close until after a mandatory waiting period (typically thirty days, subject to early termination if the transaction does not present any antitrust issues). The waiting period allows the agencies to review the proposed transaction and determine whether it raises antitrust issues that require further investigation. Either agency can investigate (although only one agency will do so), and if the investigation is not completed during the initial waiting period, then the waiting period may be extended. Ultimately, the investigating agency must decide whether to challenge the transaction (or, potentially, reach a compromise with the parties that addresses the agency's antitrust concerns but permits the transaction to go forward).

Basic Size Tests

The size thresholds that trigger the reporting obligation, and other dollar-based thresholds in the HSR Act, are adjusted (to reflect annual percentage increases in Gross National Product) each year. The most significant effect of the annual indexing is to increase the "size of transaction"[1] and "size of persons"[2] tests:

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[1] The test includes the value of all of the voting securities (and certain assets) of the acquired person that the acquiring person will hold after the transaction is complete, including voting securities of the acquired person that the acquiring person already owns.

[2] "Person" means the ultimate parent of the legal party to a transaction (including all entities controlled by the ultimate parent).

- Transactions resulting in holdings valued at or below $90.0 million[3] in voting securities and/or assets of the seller are not reportable (subject to the rules on aggregation).

- Transactions resulting in holdings valued at more than $359.9 million are reportable (unless exempted) regardless of the size of persons.

- Transactions resulting in holdings valued at more than $90.0 million but less than $359.9 million are reportable (unless exempted) if the "size of persons" test is satisfied. ◦A person with $180.0 million in total assets or annual net sales acquires (or acquires from) a manufacturing person with $18.0 million in total assets or annual net sales; or

    - A person with $180.0 million in total assets or annual net sales acquires (or acquires from) a non-manufacturing person with $18.0 million in total assets; or

    - A person with $18.0 million in total assets or annual net sales acquires (or acquires from) a person with $180.0 million in total assets or annual net sales.

Notification Thresholds

In addition to these basic tests, the HSR Act provides five separate "notification thresholds," with a new report required before completing an acquisition that would result in crossing the next threshold. With the indexing, the notification thresholds will be:

- An aggregate total amount of voting securities of the acquired person valued at greater than $90.0 million but less than $180.0 million;

- An aggregate total amount of voting securities of the acquired person valued at $180 million or greater but less than $899.8 million;

- An aggregate total amount of voting securities of the acquired person valued at $899.8 million or greater;

- Twenty-five percent of the outstanding voting securities of an issuer if valued at greater than $1.7995 billion; or

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[3] The thresholds typically have not been round numbers, and we have retained the decimal designation to avoid any confusion as to whether the threshold really is exactly $90 million (or, for the size of persons test, exactly $18 million and $180 million).

- Fifty percent of the outstanding voting securities of an issuer if valued at greater than $90.0 million.

Exemptions

The increases also affect some of the exemptions from reporting requirements. For example, 16 C.F.R. 802.50 exempts the acquisition of assets located outside the United States "unless the foreign assets the acquiring person would hold as a result of the acquisition generated sales in or into the U.S. exceeding $50 million (*as adjusted*) during the acquired person's most recent fiscal year" (emphasis added). With the most recent adjustment, this exemption applies unless the assets generated sales in or into the U.S. of more than $90.0 million.

Filing Fees

The HSR filing fees have not increased, but the levels that trigger larger filing fees have increased.

- The basic filing fee remains $45,000 and is payable on transactions valued at more than $90.0 million but less than $180.0 million.
- For transactions valued at more than $180.0 million but less than $899.8 million, the filing fee is $125,000.
- For transactions valued at more than $899.8 million, the filing fee is $280,000.

Civil Penalties for HSR Violations

Parties who close on a reportable transaction without having filed complete notifications (including all documents required to be included under Item 4(c) and 4(d) of the notification form) and observing the waiting period are subject to civil penalties. As of February 14, 2019, the annually indexed maximum daily penalty is $42,530.

In December 2018, the FTC demonstrated its seriousness about these penalties when it fined New York Knicks / New York Rangers owner James Dolan $609,810 for HSR violations.[4] Dolan had periodically been awarded restricted stock units of Madison Square Garden Company. Dolan had filed an HSR notification when one of these periodic awards brought his holdings above the first threshold, but he did not file before his holdings crossed the second threshold. Upon discovering the error, he made a corrective filing. Dolan was in noncompliance for about 105 days, and the fine amounted to an effective rate of about $6,800 per day.

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[4] *See* Federal Trade Commission, Press Release, *FTC Charges Executive Whose Company Owns New York Knicks, New York Rangers with Violations of U.S. Premerger Notification Requirements* (Dec. 6, 2018). For further discussion, see our previous *HSR Reminder and Sporting News Update* (Dec. 11, 2018).

Tips on Reportability of Not-For-Profit Combinations

Mergers and other combinations of not-for-profit corporations present their own unique issues because there are no shares to be exchanged or acquired. These transactions are reportable under the HSR Act if the assets or revenues of the combining organizations meet the size tests described above (and if no exemption applies). In October 2018, the FTC's Premerger Notification Office staff announced a change in the way it analyzes these transactions (particularly for hospital affiliations).[5] Historically, the FTC has focused on whether the combination results in a change of "control" (where the "acquiring" entity acquires the right to appoint directors of the "acquired" entity). That analysis will still be relevant, but the FTC will now also consider whether "one party obtains the indicia of beneficial ownership over the assets of another party" through other means. Board control will be one way, but others might include becoming the corporate member of two affiliating hospital entities; having the right to authorize and/or approve the articles, bylaws, and other governance documents of the affiliating hospital entities; having the right to authorize and/or approve the sale or lease of the affiliating hospital assets; having the right to appoint and/or approve the senior officers of the affiliating hospital entities; or having the right to devise and/or approve the strategic plans, capital budgets and expenditures, and significant contracting of the affiliating hospitals.

Reminder on Nonreportable Transactions

The fact that a transaction is not reportable does not mean it is exempt from the antitrust laws. The FTC and DOJ can—and do—investigate nonreportable transactions that raise antitrust concerns and will challenge any transaction that they conclude is anticompetitive, even if the transaction has already closed. Indeed, in December 2017 the FTC underscored this point by filing an administrative complaint challenging Otto Bock's recent acquisition of FIH Group Holdings. The FTC sought to unwind the transaction, which closed in September 2017.[6] That matter went to trial in the fall of 2018, and no decision has yet been announced.

Even when an acquisition is reported, and the 30-day waiting period has expired, the FTC and DOJ can still challenge the transaction. A recent example is the DOJ's September 2017 challenge to Parker-Hannifin's acquisition of CLARCOR, its only U.S. rival for sales of certain aviation fuel filtration products.[7] Parker-Hannifin had publicly announced the deal and made timely HSR filings, and the 30-day statutory waiting period had expired with no investigation before the deal closed. The DOJ later learned of certain documents that Parker-Hannifin had not provided with its HSR filings—no HSR violation was alleged—and challenged the

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[5] See Federal Trade Commission, Press Release, *Control No Longer Controlling for HSR Reporting of Not-for-Profit Combinations* (Oct. 26, 2018).

[6] *See* Complaint [redacted public version], *In the Matter of Otto Bock HealthCare North America, Inc.*, FTC Dkt. No. 9378 (filed Dec. 20, 2017). *See also James K. Nichols, United States v. Bazaarvoice, Inc.: What In-House Counsel Need to Know*, THE ANTITRUST COUNSELOR, June 2014, at 4.

[7] *See* U.S. Department of Justice, Press Release, *Justice Department Files Antitrust Lawsuit Against Parker-Hannifin Regarding the Company's Acquisition of CLARCOR's Aviation Fuel Filtration Business* (Sept. 26, 2017).

transaction on that basis. Parker-Hannifin settled three months later by agreeing to divest some of the assets it had acquired.

Furthermore, even where the FTC and DOJ decline to challenge an acquisition, private parties may still do so, even after closing. Six years ago, Jeld-Wen, Inc. (a producer of interior molded doorskins—a necessary component of finished doors) acquired one of its competitors. The parties filed their HSR notifications as required. The DOJ later confirmed that it had investigated the transaction but had not taken action to challenge the acquisition. Four years later, a third company that is both a competitor and a customer of Jeld-Wen filed a lawsuit alleging that the acquisition violated section 7 of the Clayton Act and seeking divestiture of certain assets. In 2018, a jury found that the 2012 acquisition had substantially reduced competition in violation of section 7. The DOJ filed a Statement of Interest regarding remedies. The DOJ took no position on the jury's verdict but expressed a strong preference for a structural remedy (such as divestiture of assets) instead of some other equitable remedy (regulating conduct). In December 2018, the court entered final judgment (a) ordering divestiture of the plant, and (b) alternatively awarding damages if the divestiture order is overturned on appeal.[8] Jeld-Wen has announced that it will appeal.[9]

This decision is remarkable not only because of the amount of time that had passed between closing and the divestiture order but also because it is the first successful challenge brought after the closing under Clayton Act Section 16 by a private plaintiff. It also illustrates the influence on enforcers of customer complaints, which the federal enforcement agencies may take into account both during the HSR review period and afterward.[10]

Interlocking Directorates – Increased Thresholds and Other Issues

In its February 15 announcement, the FTC also updated the thresholds for the Clayton Act Section 8's prohibition on interlocking directorates. The Act prohibits one person from serving as an officer or director of two competing companies when each company has capital, surplus and undivided profits of more than $36,564,000 for Section 8(a)(1) and competitive sales of more than $3,656,400 for Section 8(a)(2)(A). These updated thresholds are effective immediately upon publication.

In January 2017, the then-Director of the FTC's Bureau of Competition published a blog post on compliance with Section 8. The blog post offered some practical pointers on circumstances (such as new product introductions) that might warrant considering whether a company with which a director is affiliated has become a "competitor" for Section 8 purposes. The FTC generally relies on self-policing but occasionally opens investigations (for example, the Apple-Google interlock). And in December 2018, Principal Deputy Assistant Attorney General Andrew

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[8] *See Steves and Sons, Inc. v. Jeld-Wen, Inc.*, No. 3:16-cv-545 (E.D. Va. Dec. 14, 2018).

[9] *JELD-WEN Announces Final Ruling in Steves & Sons Litigation; Appeal of Erroneous Ruling to Commence Imminently*, BusinessWire (Dec. 15, 2018).

[10] *See* U.S. Dep't of Justice & Federal Trade Comm'n, HORIZONTAL MERGER GUIDELINES § 2.2.2 (Aug. 9, 2010).

Finch publicly stated that the DOJ is "looking at common ownership and interlocking directorate issues more closely" and is "currently thinking about" whether Section 8 could apply to corporate forms that did not exist when the Clayton Act was passed in 1914, such as private equity firms or LLCs that may have board appointment rights.[11]

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[11] *See* Andrew C. Finch, *Concentrating on Competition: An Antitrust Perspective on Platforms and Industry Consolidation*, at 13–14, *presented* at Capitol Forum's Fifth Annual Tech, Media & Telecom Competition Conference (December 13, 2018).