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Kirkland Alert

Proposed Changes to the Hart-Scott-Rodino Act Rules — Public Comments Due February 1, 2021

07 January 2021

The Federal Trade Commission (“FTC”) and the Antitrust Division of the Department of Justice (“DOJ”) have announced a deadline of February 1, 2021, for public comments on proposed changes to the rules promulgated under the Hart-Scott-Rodino Antitrust Improvements Act (the “HSR Act”).

If adopted, the proposed rules would make two significant changes to the HSR reporting regime:

1. expand the definition of HSR “person” to include HSR “associates” (entities under common investment management, but not common HSR control); and
2. add a new de minimis exemption for acquisitions of 10% or less of the voting securities of an issuer provided that the acquiring person does not have a “competitively significant relationship” with that issuer.

As described in greater detail below, the first set of proposed rule changes will subject to HSR reporting certain transactions involving investment funds and master limited partnerships (“MLPs”) that currently are not reportable under HSR. The second set of proposed changes creates an alternative to the current exemption for acquisitions made “solely for the purpose of investment,” as long as an acquiring person falls outside of the stated criteria for having a “competitively significant relationship” with the acquired entity.

Under the current HSR rules, unless an exemption applies, HSR forms must be filed when, as a result of an acquisition, an acquiring person will hold assets, voting securities, and/or non-corporate interests valued in excess of \$94 million¹ and the transaction involves parties with annual net sales or total assets valued at \$18.8

million¹ or more and \$188 million¹ or more, respectively. If the value of the assets, voting securities, and/or non-corporate interests to be held after the acquisition will exceed \$376 million¹, then – again, subject to certain exemptions – HSR forms must be submitted regardless of the size of the parties.

Proposed Expanded Definition of HSR “Person”

The proposed rules would expand significantly the definition of HSR “person” to require investment funds and MLPs to aggregate their holdings across commonly managed funds and entities in determining whether the HSR size of transaction test and size of person test are met. These changes will result in more investment fund transactions being notifiable under the HSR Act.

For example, assume that Funds I-A and I-B are separate ultimate parent entities (“UPEs”) for purposes of the HSR rules (i.e., no one has the right to 50% or more of the profits or assets of each fund on dissolution after payment of debts) and are under common investment management through a common general partner. Fund I-A intends to acquire \$60 million of voting stock in Issuer X and does not currently hold any voting stock in Issuer X. Under the existing HSR rules, in order to determine whether Fund I-A has an HSR reporting obligation, we would look to the value of any voting securities of Issuer X that Fund I-A currently holds and the value of any voting securities of Issuer X that Fund I-A intends to acquire. In this example, Fund I-A currently would not have an HSR reporting obligation for its acquisition of \$60 million in Issuer X voting securities. Under the proposed rules, however, we also would need to look to Fund I-B and aggregate its current and expected holdings. If Fund I-B currently holds \$60 million of voting stock in issuer X (or intends to acquire \$60 million in voting stock of Issuer X), then the size of transaction is \$120 million (\$60 million + \$60 million) and Fund I-A’s acquisition is reportable under HSR.

The proposed rule also would require a significant amount of additional information to be included in the HSR form. For example, the HSR form for the transaction in the example above would need to include information not only from Fund I-A, but also from Fund I-B, as well as any other of Fund I-A’s HSR “associates.” Consequently, we anticipate that it will be more time consuming and more expensive to prepare HSR forms for investment fund and MLP transactions under the proposed rules.

Moreover, first acquisitions by a newly formed fund or special purpose vehicle (“SPV”) that is not controlled for HSR purposes by another entity and does not have a regularly prepared balance sheet at the time of closing will likely be subject to HSR reporting

under the proposed rules. Such acquisitions typically are not reportable if valued at less than \$376 million¹ because the newly formed fund does not meet the HSR size of person test. If the proposed rules are implemented, however, these transactions may now be reportable if the newly formed fund has any “associates,” or if at least 50% of the equity of the SPV is held collectively by funds that are “associates.”

Proposed New De Minimis Exemption

The FTC’s proposed new de minimis exemption would apply to acquisitions of 10% or less of the voting securities of an issuer provided that the acquiring person does not have a “competitively significant relationship” with the issuer (including any entity under the HSR control of the issuer). In order to qualify for the proposed exemption, the acquiring person must:

- not be a competitor of the issuer;
- hold 1% or less of the voting securities or non-corporate interests of any competitor of the issuer;
- not have an employee, principal, agent, or anyone acting on its behalf, serve as a director or officer of the issuer or any competitor of the issuer; and
- not have a vendor/vendee relationship with the issuer where the value of sales in the most recent fiscal year was greater than \$10 million in the aggregate.

The proposed rules define “competitor” as any person that either (1) reports revenues in the same six-digit NAICS code as the issuer; or (2) competes with the issuer in any line of commerce. The HSR rules currently do not define the term “competitor.”

Although the proposed de minimis exemption will exempt from HSR reporting certain acquisitions that previously were reportable, the proposed revisions to the definition of HSR “person” will limit application of the new exemption. In order to determine whether an acquiring fund has an interest in a competitor and the percentage held, the fund will need to look not only to the entities under its HSR control, but also to its “associates” and their controlled entities. Moreover, the proposed definition of “competitor” is expansive, and also will limit application of the exemption. As drafted, the term “competitor” includes not only entities that actually compete with the issuer, but also any entities that report in the same six-digit NAICS industry code as the issuer. NAICS codes can be quite broad. Companies often report in the same six-digit NAICS codes even though they do not actually compete with one another. For example, because there is only one NAICS code for off-the-shelf software, under the

FTC's definition, a company that produces software for spreadsheets would be considered a "competitor" of a company that produces software for video games.

The expanded definition of "competitor" in the proposed rules also will likely limit application of the current passive investment exemption. This exemption exempts acquisitions of 10% or less of an issuer's voting securities provided the acquiring person intends to hold the shares "solely for the purpose of investment." Among the types of conduct the FTC has found to be inconsistent with passive investment intent is being a competitor of the issuer or holding an interest in a competitor of the issuer (except that holding a 10% or less passive interest in a competitor generally is allowable). Thus, the proposed definition of "competitor" would likely narrow application of the passive investment exemption because simply reporting in the same NAICS code now would negate application of this exemption even in cases where the entities in question do not actually compete.

Additional Proposed HSR Rulemaking

The FTC is also seeking comments by February 1, 2021, on an Advanced Notice of Proposed Rulemaking ("ANPR") regarding other potential rule changes. Among the topics on which the FTC is seeking information are how parties determine acquisition price and fair market value for purposes of the size of transaction test; the continued applicability of the REIT exemption; the treatment of non-corporate entities; the definition of "solely for the purpose of investment" (as related to the exemption referenced above allowing for certain accumulations of up to 10%); and whether the acquisition of convertible voting securities or board observer rights should be subject to premerger notification obligations. This is an information-gathering exercise, and no proposed rules have been advanced at this time.

Application of the HSR rules to a transaction involves detailed knowledge of the HSR Act and its implementing regulations. If you have any questions regarding the proposed rules, the ANPR or the HSR Act, please contact the authors of this alert or your usual Kirkland contact.

1. As adjusted annually for changes in GNP.↩

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