FTC and DOJ Propose 'Modernizing Merger Filing' Rules

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On Monday, September 21, 2020, the Federal Trade Commission (FTC) and Department of Justice (DOJ) jointly released two proposed rule changes to the Hart-Scott-Rodino (HSR) premerger filing requirements for acquiring parties. In an extension of a 2011 rule change that established the concept of "associates," the first proposed change would require aggregation with the filing person of its associates, which are entities under common management or operational control with the filing person, both when analyzing whether a transaction is reportable and when providing certain information in the filing. The second proposed rule change modestly expands upon the HSR exemption for passive investment acquisitions. The proposed rules remain subject to a period of public comment, after which the FTC and DOJ may consider changes before ultimately adopting or rejecting the proposed rule amendments.

Proposed Change Requiring Aggregation of Filers and Their 'Associates'[1]

This proposed revision would modify a fundamental principle since the implementation of the HSR rules in 1978 — that HSR filing requirements are analyzed solely on the basis of the top-most entity in a filing person's ownership chain, the so-called ultimate parent entity (UPE), and everything that the UPE "controls" by majority ownership.

Under the FTC's new proposal, analyzing whether HSR requirements apply to a particular transaction would require acquiring filing parties to treat all associates as if they were commonly owned with the filing UPE. As such, when considering whether the UPE meets the statutory HSR size-of-person test, the filing UPE would aggregate its holdings with its associates' holdings (*i.e.*, including the assets and sales of all associates). Similarly, when acquiring interest in a target and determining the relevant filing threshold, the filing UPE would aggregate its interest and all of its associates' interests in the same target. In addition, an acquiring person would provide with its filing the financial statements and consolidated revenues broken out by NAICS codes for all of its associates, and would list its associates' subsidiaries in the same manner as it reports this data for its own controlled entities.

Practical Implications

While this proposed rule change would have little impact on the M&A activity of companies and corporations that do not have related investment advisers or managers outside of their corporate structure, it would have significant implications for acquisitions by private equity firms and fund managers, which more typically have externally structured investment advisers and managers. In fact, as the FTC itself acknowledges, the proposed change is likely to dramatically increase the burden of HSR compliance for certain filers, particularly with respect to filing persons who are part of separately owned but commonly managed families of investment funds.

The purpose of the change, as one FTC Commissioner has noted, is that it "will help to prevent acquirers from splitting up transactions into small slices across multiple investment vehicles under their control to avoid reporting."[2] From the agencies' perspective, this rule change will provide greater visibility into potential competition issues

[1] Generally speaking, the 2011 rule change defined associates to include those who have the right (directly or indirectly) to manage the operations or investment decisions or have its operations or investment decision managed in connection with the acquiring person or its controlled entity. As a result of the associate designation, the current HSR notification rules require an acquiring person to provide certain limited information about its "associates" if those entities generate revenues in any of the same North American Industry Classification System (NAICS) codes in which the acquired person reports revenues.

[2] *See*, Statement of Rohit Chopra, "Regarding the Hart-Scott-Rodino Act Premerger Notification Rulemaking Notices," Commission File No. P110014, September 21, 2020.

that might otherwise go undetected. For example, under the current rules, separately owned but commonly managed funds of an investment firm could each currently hold nonreportable amounts of securities of the same issuer without ever having had to make an HSR filing. Under the new proposal, however, each of the investment firm's funds would be required to aggregate its holdings with those of the other funds when determining whether any new acquisition would cross an HSR notification threshold and trigger a filing requirement, thus increasing the likelihood the antitrust authorities will have an opportunity to review such an acquisition.

Proposed Exemption for 'De Minimis Acquisitions of Voting Securities'

The second proposed rule change would exempt from HSR filing any acquisitions of 10% or less of the voting securities of an issuer if the acquiring entity does not have a competitively significant relationship with the issuer.[3]

[3] Among the criteria identified are not being a competitor of the issuer, not holding more than 1% of the voting securities or non-corporate interests of a competitor of the issuer, not sharing officers or directors with the issuer, and not having a vendor/vendee relationship with the issuer, among others.

This change expands the current very narrow "investment only" exemption. The current rule exempts acquisitions of 10% or less of the voting securities of an issuer if the acquiring person is making such acquisitions solely for the purpose of passive investment. Under that rule, if the acquiring person has **any** intention of influencing basic business decisions of the issuer (potentially even something as innocuous as participating in discussions regarding governance best practices), the passive investment exemption may be unavailable.

Practical Implications

The new rule reflects a recognition by the FTC and DOJ that this current narrow interpretation of the investment-only exemption often leads to unnecessary filings for transactions that are highly unlikely to involve material antitrust issues. Notably, however, the proposed rule does not address a long-standing complaint from the business community regarding the lack of any exemption that would apply to an officer's or director's acquisition of shares in his or her own company. The proposed rule will allow investors with some intent to influence the business of the issuer to nonetheless acquire 10% or less and still be exempt from HSR reporting obligations, so long as no competitively significant relationship exists between the investor and the issuer.