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How Proposed HSR Filing Requirements May Impact the Private Equity Industry

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U.S. antitrust enforcers have dominated the headlines lately, but actions by the enforcers that did not make front page news may prove to be the most consequential for the U.S. economy. At the end of June, the Federal Trade Commission (FTC) and the Antitrust Division of the Department of Justice (DOJ) published a notice of proposed rulemaking (the NPRM) recommending extensive changes to the premerger filings required under the Hart-Scott-Rodino (HSR) Act. While every company in the dealmaking landscape would be impacted by the changes, this article focuses on the effect the NPRM will have on financial sponsors, including private equity firms. Financial sponsors play an important role in global deal markets, investing trillions of dollars annually. The changes in the NPRM, if enacted in their current form, would in particular impact financial sponsors' ability to complete HSR filings quickly and efficiently when investing in companies with a significant U.S. presence.

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Premerger filing requirements have incrementally evolved in the nearly 50 years since the passage of the HSR Act. But the recent changes proposed by the agencies, which were made without first seeking congressional approval, would drastically change the premerger regime in the United States. The HSR review process is structured so that only transactions that raise antitrust concerns on an initial review receive a burdensome "second request" through which the government collects troves of documents and economic data about the parties. The new system would expand the breadth and detail of information transacting parties must initially provide, making every HSR filing a "mini second request," without any filter to first evaluate if the transaction raises meaningful competition issues worthy of further investigation.

This development is especially troubling for financial sponsors, whose business models focus on regularly acquiring companies, making operational improvements to them, and, in some cases, exiting those investments in a relatively quick timeframe. Financial sponsors would be repeatedly subject to these new requirements, some of which would require them to produce closely held information that was not previously shared publicly or with the government, and which they may not even be contractually permitted to share. We analyze below the provisions in the NPRM that may have the greatest effect on financial sponsors.

Provisions in the NPRM That Would Most Impact Financial Sponsors

Overlap Narratives. The agencies propose that filing parties provide "horizontal overlap narratives" about any products or services that compete with (or could compete with) a product of the other party to the transaction. These requirements would potentially apply to any overlapping product line or service provided by any of a financial sponsor's portfolio companies. For each overlapping product, the filing party—whether the buyer or the seller—would have to provide detailed sales and customer information, including revenues; customer categories (e.g., retail, government, education, etc.) and estimated revenue in each category; customer lists with contact information; and detailed geographic information about parties' overlapping operations. Similar information is required for vertical relationships with the transaction counterparty or any of the counterparty's competitors.

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Prior Transactions. The agencies also propose to require the filing party to submit information about all acquisitions it made within the last 10 years of companies that operate in the same NAICS code as an entity controlled by the transaction counterparty, or companies that have horizontal overlaps with the transaction counterparty.

Provision of Documents. The new rules would expand the scope of deal-related document collection to nonofficer "supervisory deal team leads" and would require, for the first time, the submission of all drafts of "Item 4" documents that were shared with an officer, director, or deal team lead. Additionally, financial sponsors would have to provide strategic plans they prepared in the ordinary course of business about any overlap markets.

Ultimate Parent Entity Information. The agencies propose expanding information that financial sponsors must provide about minority shareholders and other noncontrolling entities within their "ultimate parent entity" (UPE). They would require a financial sponsor fifiler to identify any investors holding at least 5% or more in the acquisition vehicles of the transaction, any buy-side limited partner holding 5% or more of any entity that controls or is controlled by those acquiring entities, and any sell-side limited partner investors who will either continue to hold an interest above

5% in the target or will have an interest above 5% in the buyer's acquisition vehicles. In addition, funds and LPs would need to create an organizational chart identifying all of their "affiliates" or "associates," likely requiring a diagram with each of their portfolio companies. The agencies would also require identification of all officers, directors and board observers of all entities within a filing person for the prior two years and, for each individual, a list of any other positions the person has had in the prior two years—even if those other positions are unrelated to the filing person. Lastly, acquirers would have to list all individuals that will: hold options, a board seat, a board observer position, or nomination rights in the acquired entity; provide credit of at least 10% of the entity's value; or manage entities in the transaction.

Analysis of Proposals

These proposals are rife with requirements that may disproportionately burden financial sponsors. Of chief concern is that limited partners are often sensitive to disclosure of their identity to the public and the government. The desire by some limited partners to stay below the 5% disclosable threshold may affect financial sponsors' ability to fundraise. Additionally, the requirement for proposed officers and directors to identify all existing relationships with any other company may deter experienced professionals from serving on (or being appointed to) boards of unrelated companies, for fear of bringing those entities under the scope of HSR review.

As the agencies acknowledge, these requests would create "significant additional" work for funds and limited partnerships in particular, because these entities often have complex organizational structures for their investment vehicles and numerous portfolio holdings. Some of the requested information applies to all portfolio companies of a financial sponsor, even those in a completely separate industry from the target company. The questionable result is that a hypothetical acquisition by a financial sponsor that would not warrant any antitrust scrutiny would nonetheless require the firm to collect and disclose information about its other portfolio companies—including its board members and management—that are not at all related to the market or industry of the innocuous transaction.

Additionally, providing strategic explanations of a transaction or revenues at the product level as required by the overlap narratives section would often require parties to create and collect new information. This type of detailed data has previously been required only at the second request stage, after the agency has already determined that a deal raises antitrust concerns. The agencies claim that these changes will not create a significant burden because parties typically compile this data during deal diligence. In reality, a financial sponsor buyer is unlikely to provide this information about its own portfolio companies to an acquisition target. As a result, a fincancial buyer may need to build more time into the process for preparing HSR filings, which typically can be completed within ten business days under the current rules. They may need to devote significantly more resources and involve many more employees than would otherwise be a part of the deal process to create the requested materials.

To justify the overlap narratives, the agencies claim that they need the expanded information to keep up with the growing complexity of M&A activity and their limited ability to evaluate deals within the 30-day HSR timeline. One wonders whether receiving even more data and documents to review will help them make quicker competitive assessments within the same 30-day timeframe. Add in that less than five percent of reviewed transactions currently receive a second request because of antitrust concerns, and the result is that the agencies will receive a glut of information, most of which is immaterial for antitrust purposes.

Proactive Measures Financial Sponsors Could Take

Financial sponsors could prepare for these new requirements by working in advance to compile information that would be included in an HSR filings. They could regularly update organizational charts for fund investors and LPs, portfolio companies, creditors, and board members as personnel changes are made or portfolio companies are added and divested. Additionally, to assist with preparing overlap narratives, firms could maintain databases with information like customer accounting and product revenue data from portfolio companies in business areas in which they plan to continue investing. For certain holdings, firms might need to devise systems to capture this data on a go-forward basis. Finally, firms could create a running tracker with all of their acquisitions from the prior 10 years.

Takeaways

In its current form, the NPRM would impose many of the burdens of a second request on financial sponsors even for transactions that do not raise any antitrust concerns. The agencies seem to suggest that the burdens are not excessive because the new proposals resemble merger control rules from competition authorities like the European Commission. But this misses the mark. Far fewer transactions are notified in foreign jurisdictions than in the United States, so firms would not be preparing this information for any other jurisdictions in the majority of transactions. And key merger control jurisdictions like the EC have structures in place to allow for “simplified review” of transactions that do not raise substantive antitrust concerns, eliminating the need to provide many of the narrative responses and information requests the submission would otherwise require.

For financial sponsors that regularly conduct M&A activity, a simplified review option could alleviate some of the problems with the NPRM. But others would remain. Given the extent of the proposed changes and the current timeline for comments, any new rules are unlikely to take effect before 2024. Nevertheless, fiancial sponsors need to be prepared to extend out deal timelines to account for the additional time it may take to prepare HSR filings. They can also begin to devise plans to capture data required in the current NPRM while monitoring the rulemaking process for changes to the proposals.

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