

# Proposed HSR Rule Changes



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# Discussion Outline

- Background
- HSR Overview – compare & contrast current & proposed rules
  - Definition of “Person”
  - 10% Investment Only
  - 15% Institutional Investor Exemption
- Proposed Rule Changes - ANPRM
- Why & What is Next?
- Considerations for Boards

# Timeline

- Fall 2020 - Proposed Notice of Rulemaking & Advanced Notice of Proposed Rulemaking
- Public comment period closed February 1, 2021
- No ETA for final rules

# High Level Concerns

- Proposal requires **aggregation** of funds and certain accounts under common management (including other registered funds and non-institutional investor accounts)
  - Will trigger more filings
  - Will require greater disclosure when a filing is required
  - Compliance will become more burdensome and costly
  - Compliance may be impossible in certain scenarios
  - Compliance may create confidentiality concerns
  - Will reduce the availability of current long-standing and often employed exemptions

# HSR Overview

- The Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"), provides that parties to an acquisition of **assets, voting securities, or non-corporate interests** meeting certain jurisdictional thresholds may be required to file a Notification and Report Form with the FTC and DOJ and observe a 30-day waiting period before consummating the transaction.
- The filing required by the HSR Act is purely procedural, creating a mandatory structure for a preliminary antitrust review of large stock acquisitions and M&A transactions
- The HSR Act provides a number of exemptions that may eliminate the need to make an HSR filing; some commonly recognized exemptions include:
  - 10% Investment-Only
  - 15% Institutional Investor Exemption (e.g., certain banks, trust companies, insurance companies, investment companies registered with SEC, broker dealers, etc.)
  - State Actor Exemption (e.g., certain state pension funds)
  - "Pro-rata" Exemption (when Acquiring Person's voting percentage is being diluted)
- Potentially severe consequences for failing to notify a transaction including civil fines and other consequences (divestiture, rescission)

# Current Rules: Definition of “Person”

- The HSR rules currently define a **“Person”** as *“an ultimate parent entity and all entities which it controls directly or indirectly.”*
  - **“Ultimate Parent Entity”** means “an entity which is not controlled by any other entity”
  - **“Control”** has a technical definition under the HSR Act and is not tied to common management
    - **“Control”** of a **non-corporate** entity means having the right to at least 50% of the profits, or upon dissolution, assets of such entity.
    - **“Control”** of a **corporate** entity means ownership of at least 50% of the outstanding voting securities or having the present contractual right to designate half or more of its Board of Directors.
- The HSR rules define an **“Associate”** as an entity that is not an affiliate of such person (i.e., entity that is not HSR-controlled by such person) but:
  - Has the right, directly or indirectly, to manage the operations or investment decisions of an acquiring entity (a “managing entity”); or
  - Has its operations or investment decisions, directly or indirectly, managed by the acquiring person; or
  - Directly or indirectly controls, is controlled by, or is under common control with a managing entity; or
  - Directly or indirectly manages, is managed by, or is under common operational or investment decision management with a managing entity.

# Proposed Rules: Expand Definition of Person

- The new definition of Person will include its associates - i.e., requiring aggregation of all entities under common management
- Example: Fund A, managed by Investment Adviser, is making an acquisition of stock of Issuer 1. Investment Adviser also manages Funds B-E, Separate Accounts 1 & 2 and Endowment for a private university. Only Fund A participates in the investment.
  - But by virtue of the new rules, Investment Adviser will need to aggregate the holdings of all funds, separate accounts and endowments it advises to:
    - Determine if a filing is necessary;
    - Determine if an exemption is available; and
    - If a filing is required Investment Adviser will need to report all entities' holdings.

# Impact of Proposed Rule

- Because of aggregation between commonly managed entities more filings will be required
- To determine if a filing is required Investment Adviser will need much more information from funds not involved in the investment
  - Will Separate Accounts & Endowment even provide information?  
What sort of confidentiality protections?
- Burden in gathering information from parties not involved in investment or whose accounts are not 100% managed by Investment Adviser (e.g., Separate Accounts, Endowment)
- Cost in halting trading to prepare filing
- Cost in fees to prepare & file HSR (filing fees alone range from \$45,000-\$280,000 and there are proposals to increase)
- Compliance may be impossible in certain scenarios



# Current Rules: 10% Investment-Only Exemption

- Certain acquisitions are exempt from HSR notification where the acquiring person:
  - Holds, as a result of the acquisition, 10% or less of the issued and outstanding voting securities of an issuer; and
  - Acquires the shares “solely for the purpose of investment”
  
- The HSR rules define “solely for purpose of investment” as having **“no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.”**
  - FTC guidance and recent enforcement actions provide additional color; engaging in or even seriously contemplating or planning the following precludes use of the investment-only exemption:
    - Nominating a candidate for the board of directors of the issuer;
    - Proposing corporate action requiring shareholder approval;
    - Soliciting proxies;
    - Having a controlling shareholder, director, officer, or employee simultaneously serving as an officer or director of the issuer;
    - Being a competitor of the issuer;
    - Doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer;
    - Asking third parties about interest in being a candidate for the board or CEO of the issuer, and not abandoning such efforts;
    - Communicating with the issuer about potential candidates for the board or CEO of the issuer, and not abandoning such efforts; and
    - Assembling a list of possible candidates for the board or CEO of the issuer, if done with the knowledge of the CEO

# Current Rules: 15% Institutional Investor Exemption

- Certain acquisitions are exempt from HSR notification where the acquiring person:
  - Is an *Institutional Investor* as defined in 16 C.F.R. 802.64;
  - Holds, as a result of the acquisition, 15% or less of the issued and outstanding voting securities of an issuer,
  - Acquires the shares in the ordinary course of business; and
  - Acquires the shares “solely for the purpose of investment”
  
- **Exceptions to the Exemption.** The exemption is not available to an institutional investor for a transaction in which:
  - the investor will acquire voting securities of an institutional investor of the same type as any entity included within the investor; or
  - any entity within the investor, which is not an institutional investor, holds any voting securities of the issuer whose voting securities are to be acquired

# Proposed Rules: Blanket *de minimis* Exemption

- **FTC proposes adding a new *de minimis* exemption that would apply to the acquisition of 10% or less of a company’s voting shares so long as the acquiring person does not have a “competitively significant relationship” with the acquired entity**
  - Removes subjective intent but
  - Requires that one cannot hold more than 10% of a "competitor" (and proposed definition of “competitor” is overly broad)
    - Reports in same NAICS code or competes in any line of commerce
      - NAICS codes are overly broad, imprecise
      - NAICS codes are not publicly available
      - Investment Advisers do not track NAICS of all companies in which they are invested
      - Issuers can change NAICS codes as they reclassify existing operations or acquire/dispose of companies and/or business lines
  - Proposed definition of “person” may remove the ability of some investors to rely on the *de minimis* exemptions given the aggregation requirements
  - Uncertainty over whether this definition affects the pre-existing Investment-Only Exemption

# Proposed Rules: Institutional Investor

- Similar to investment only, the proposed change to the definition of person may mean entities cannot use exemption if they in the aggregate exceed 15% or if any account managed by the Investment Adviser is not an institutional investor

# Proposed Rule Changes - ANPRM

- ***Advanced Notice of Proposed Rulemaking***
  - **FTC intends to gather information on seven topics to help determine whether future amendments are required to the HSR Rules**
    - Calculation of Size-of-Transaction Test
    - Treatment of REITS
    - Treatment of Non-Corporate Entities
    - Exemptions of Minority/*De Minimis* Acquisitions
      - ***FTC inquiries regarding Institutional Investor Exemption and lowering the 15% threshold***
    - Treatment of Non-Voting Interests
    - Devices for Avoidance
    - Changes to the Filing Process

# Rationale for rule changes

- Common ownership debate
- Feeling that not enough information is provided in current filings to analyze substance

# Practical Effect of Rule Changes

- Increases uncertainty over the HSR coverage analysis (who is responsible for filing) and increases disclosures required in HSR filings
- Privacy/Confidentiality Concerns
- Materially increases preparation time/burden for most parties
  - Need to rethink diligence requests, stage at which HSR experts are consulted, assumptions about certainty to closing
- Uncertain effects on HSR clearance time
  - Proposed rule changes may increase the number of filings received by the agencies (aggregation of person/associates affecting size-of-transaction analysis, fewer acquisitions qualify for exemptions)
  - Increased disclosures may affect length of agency review
  - Most advisers will not want to filing, so will limit

# Considerations for Boards

- 1. Possible need to change investment strategies
- 2. Consider implementing compliance policies and procedures
- 3. Impacts on Fund adviser mergers
- 4. Disclosures