

CLASS SLIDES

The HSR Act: Reportability and Investigations

Merger Antitrust Law

Fall 2017 Georgetown University Law Center

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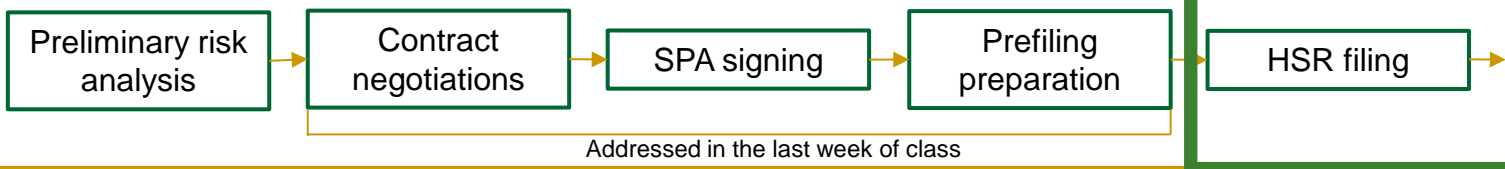
Topics

- Premerger notification
- Initial waiting period investigations
- Second request investigations
- DOJ/FTC merger review outcomes

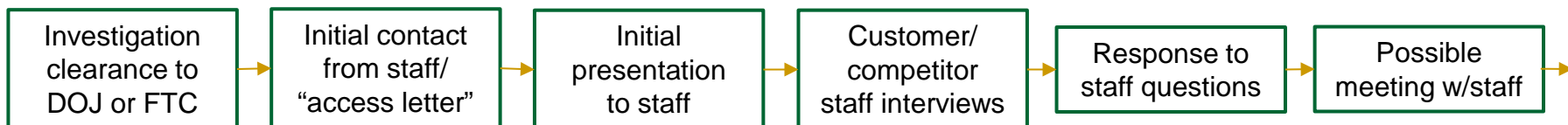
Premerger Notification

Overview of HSR review process

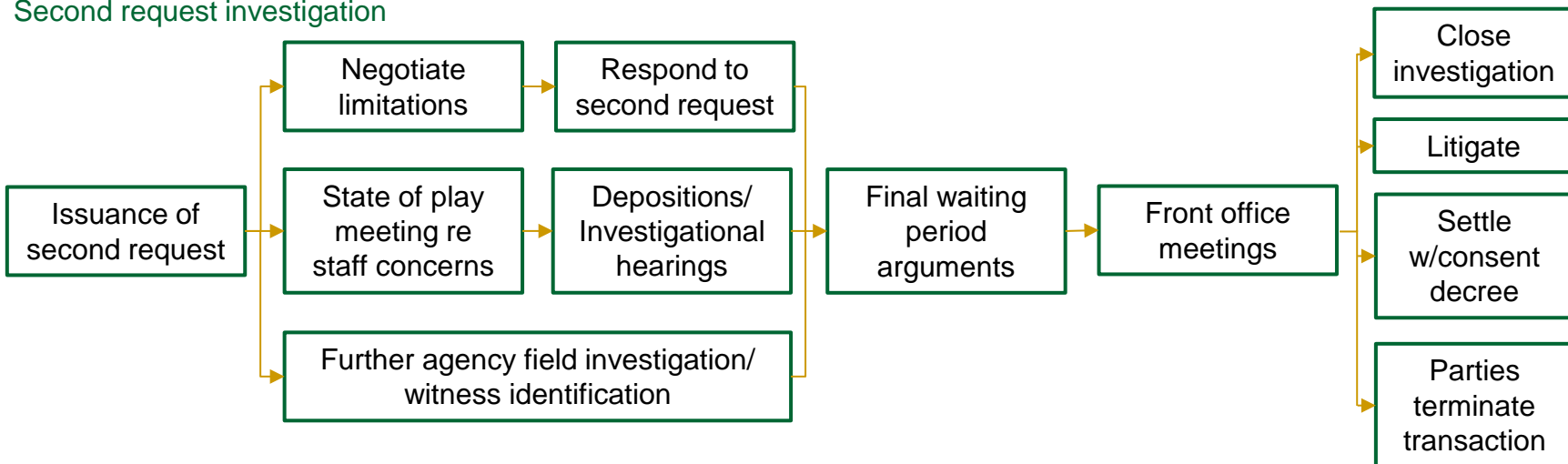
Prefiling/filing



Initial investigation



Second request investigation



HSR Act

- Hart-Scott-Rodino Act
 - Enacted in 1976 and implemented in 1978
 - Applies to large mergers, acquisitions and joint ventures
 - Imposes reporting and waiting period requirements
 - Authorizes “second requests”
 - Not jurisdictional: Agencies can review and challenge transactions that are—
 - Not HSR reportable
 - After the HSR Act waiting period has expired, *even if the agency granted early termination*

Basic prohibition

- Section 7A(a)

[N]o person shall acquire, directly or indirectly, any voting securities or assets of any other person, unless both persons (or in the case of a tender offer, the acquiring person) file notification . . . and the waiting period . . . has expired

- A reportable transaction is one that—
 - Involves the acquisition of voting securities or assets
 - Satisfies the thresholds for prima facie reportability
 - Does not fall into one of the exemptions provided by the HSR Act or the HSR Act's implementing rules

Acquisition of voting securities or assets

- The HSR Act applies only to acquisitions of *voting securities* or *assets*
- Voting securities
 - “[S]ecurities which at present or upon conversion entitle the owner or holder thereof to vote for the election of directors of the issuer”¹
- Assets
 - No special definition
 - *Noncorporate interests*: The acquisition of a 50% or greater ownership interest in a non-corporate entity (such as a partnership or LLC) is regarded as an acquisition of the entity’s underlying assets
 - *Exclusive licenses*: An exclusive license is regarded as an asset

Acquisition of voting securities or assets

- *Acquisition*

- Obtaining the “beneficial interest” in the underlying voting securities or assets
- Does not require a formal transfer of legal title
- *Query*: What is a “beneficial interest” for HSR Act purposes?

Acquiring and acquired persons

■ *Person*

- An ultimate parent entity and all entities which it controls directly or indirectly

■ *Ultimate parent entity (UPE):*

- An entity which is not controlled by any other entity

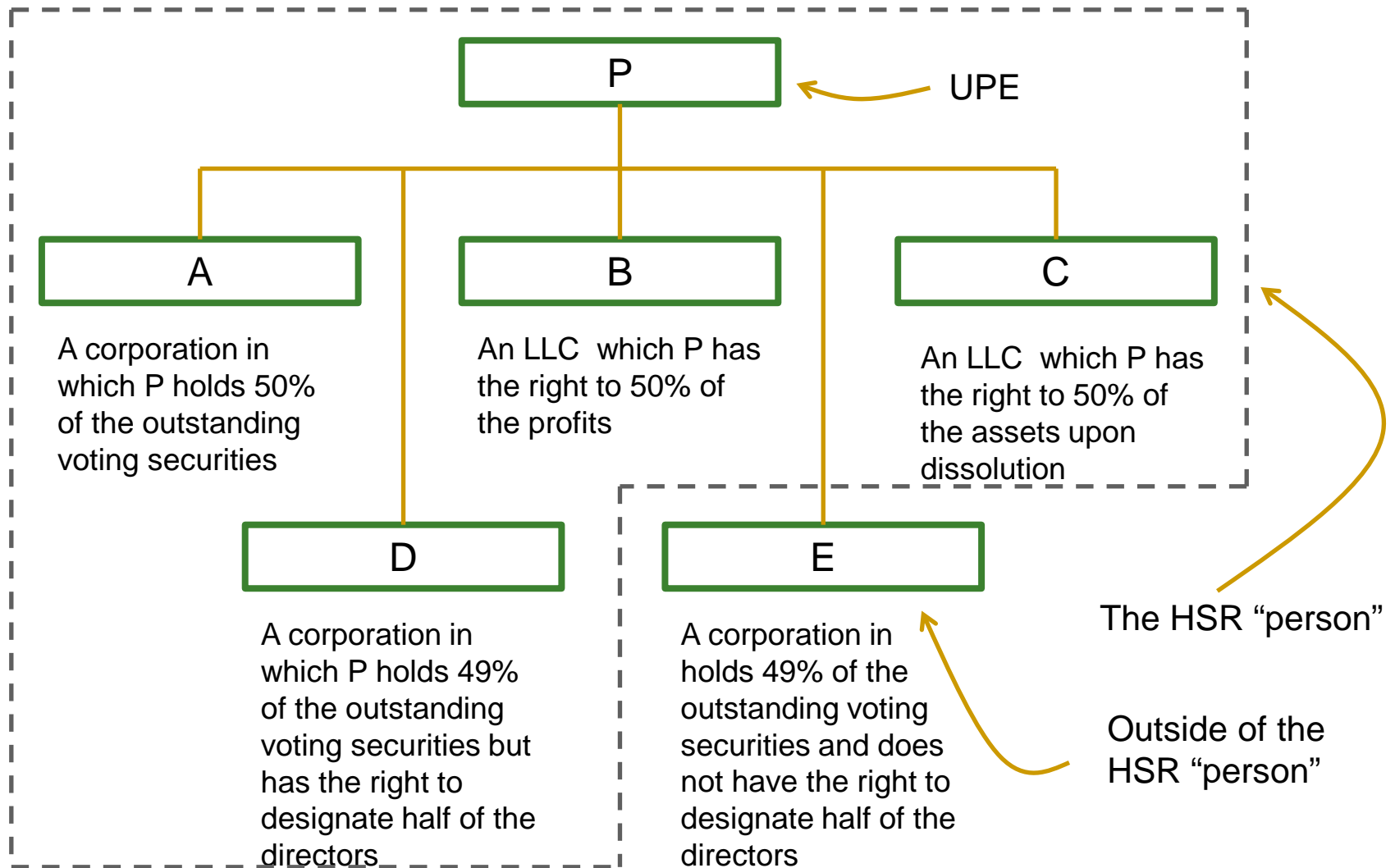
■ *Control*

□ *Either*

- Holding 50 percent or more of the outstanding voting securities of an issuer, *or*
- In the case of an unincorporated entity, having the right to 50 percent or more of the profits of the entity, or having the right in the event of dissolution to 50 percent or more of the assets of the entity; *or*

- Having the contractual power presently to designate 50 percent or more of the directors of a for-profit or not-for-profit corporation, or in the case of trusts that are irrevocable and/or in which the settlor does not retain a reversionary interest, the trustees of such a trust.

Acquiring and acquired persons



Prima facie reportability

Size of transaction*	Prima Facie Reportability		
Up to and including \$80.8 million	Not reportable		
Above \$80.8 million up to and including \$323.0 million	Reportable if : (1) satisfies the “size of person” test, and (2) no exemption applies <div style="display: flex; justify-content: space-between;"> <div style="width: 30%; text-align: center;"> <p><i>Acquiring person</i></p> <p>\$161.5 million (in total assets or annual net sales)</p> <p><i>Or</i></p> <p>\$161.5 million (in total assets or annual net sales)</p> <p><i>Or</i></p> <p>\$16.2 million (in total assets or annual net sales)</p> </div> <div style="width: 30%; text-align: center;"> <p>Size of person test</p> <p>and</p> <p>and</p> <p>and</p> </div> <div style="width: 30%; text-align: center;"> <p><i>Acquired person</i></p> <p>\$16.2 million (in total assets or annual net sales of a person engaged in manufacturing)</p> <p>\$16.2 million (in total assets of a person not engaged in manufacturing)</p> <p>\$161.5 million (in total assets or annual net sales)</p> </div> </div>		
In excess of \$323.0 million	Reportable absent an exemption		

Prima facie reportability

- **Thresholds**
 - Measured against everything the acquiring person will hold as a result of the pending acquisition, not just the amount to be acquired in the pending transaction
- **Asset acquisitions**
 - Acquisition price + value of assumed liabilities
- **Voting securities acquisitions**
 - Acquisition price for voting securities to be acquired + value of voting securities already held
 - *Note:* Acquisitions of minority interests can be reportable

Notification thresholds

- An otherwise reportable transaction is not subject to the reporting and waiting period requirements of the HSR Act if—
 1. The reporting and waiting period requirements were satisfied within the last five years for a prior acquisition, *and*
 2. The pending acquisition will not cause the acquiring person to cross a notification threshold

Notification thresholds ¹
\$80.8 million
\$161.5 million
\$807.5 million
25% of the voting securities if their value exceeds \$1,615.0 million
50% of the voting securities if their value exceeds \$80.8 million

- An HSR filing is effective for one year

Filing fees

Value of Transaction ¹	Filing Fee
≤ \$80.8 million	No filing required
> \$80.8 million but < \$161.5 million	\$45,000
≥ \$161.5 million but < \$807.5 million	\$125,000
≥ \$807.5 million	\$280,000

- Paid by the purchaser, unless the parties agree to a different arrangement (e.g., split the fee)

HSR Act filing

- Uses a prescribed form: Requires no—
 - Market definition
 - Calculation of market shares or market concentration statistics
 - Presentation of any antitrust analysis or defense
- Both the acquiring and acquired persons must submit their own filing
- Key information required:
 - Transaction documents (e.g., stock purchase agreement)
 - Annual reports and financial statements
 - Revenues by NAICS codes
 - Corporate structure Information
 - Majority-owned subsidiaries
 - Significant minority shareholders
 - Significant minority shareholdings
 - “4(c)” and “4(d)” documents

HSR Act filing: 4(c) and 4(d) documents

- 4(c) documents
 - Studies, surveys, analyses or reports
 - Prepared by or for officers or directors of the company (or any entities it controls)
 - That analyze the transaction
 - With respect to markets, market shares, competition, competitors, potential for sales growth, or expansion into product or geographic markets

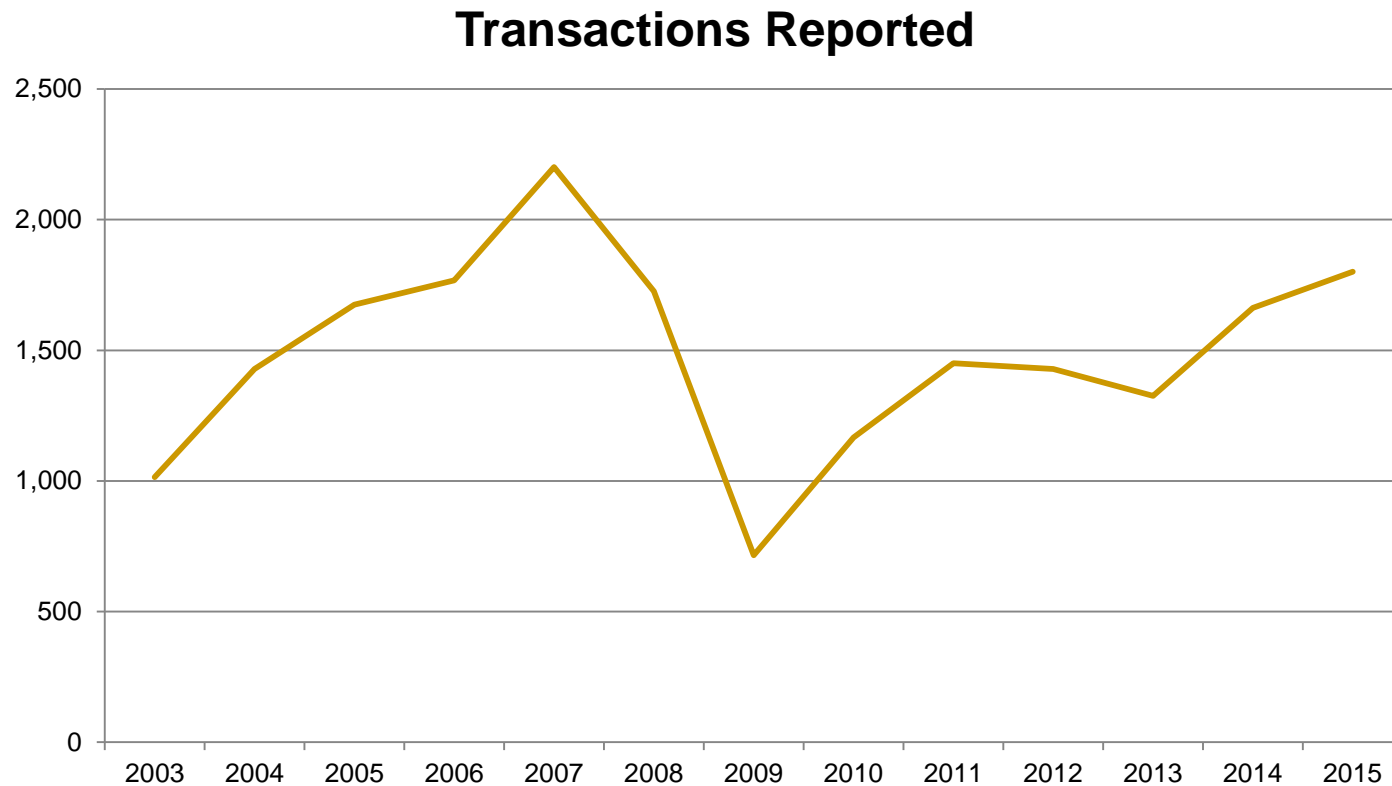
- 4(d) documents
 - Confidential Information Memoranda (“CIM”)
 - Third party advisor documents
 - Synergy and efficiency documents

- Failure to provide all 4(c) and 4(d) documents
 - Makes the HSR filing ineffective, so that the waiting period never started
 - Also, civil penalties (fines) for closing a transaction without observing the applicable waiting period

Selected exemptions

- **Intraperson**
 - Acquired and acquired person are the same
- **Investment**
 - Hold no more than 10% of target's outstanding voting securities
 - 15% for certain institutional investors
 - Acquirer must have a purely passive investment intention
 - Any membership on the board of directors or other involvement in the management of the company (other than voting shares) voids exemption
- **Convertible voting securities**
 - Acquired securities have no present voting rights
- **Acquisitions of non-U.S. assets**
 - Must not generate sales in or into the U.S. of more than \$80.8 million
- **Acquisitions of non-U.S. voting securities by non-U.S. persons that either**
 - Do not confer control over the target, or
 - Do not involve assets in the U.S., or sales in or into the U.S., over \$80.8 million

HSR Act Notifications



Source: Fed. Trade Comm'n & U.S. Dept. of Justice, Hart-Scott-Rodino Annual Report Fiscal Year 2015, at App. A.

Waiting periods

- **General rule**
 - Cannot close a reportable transaction until the waiting period is over
- **Initial waiting period**
 - 30 calendar days generally
 - 15 calendar days in the case of
 - a cash tender offer, or
 - acquisitions under § 363(b) of bankruptcy code
- **Extended waiting period**
 - Waiting period extended by issuance of a second request in initial waiting period
 - Waiting period extends through—
 - Compliance by all parties with their respective second requests
 - PLUS 30 calendar days (10 calendar days in case of a cash tender offer)
- **Investigating agency may grant early termination of a waiting period at any time**

Waiting periods

- Timing agreement
 - The merging parties can voluntarily commit to give the agency additional time to complete the investigation
 - But a timing commitment does *not* technically extend the statutory waiting period

HSR Act violations

■ HSR Act prohibition

- The HSR Act provides that “no person shall acquire, directly or indirectly, any voting securities or assets of any other person” in a reportable transaction without observing the filing and waiting period requirements
- The HSR regulations provide that a person holds voting securities or assets when it has a “beneficial interest” in them
- → “Acquire” voting securities or assets when an entity obtains a beneficial interest in the voting securities or assets

■ Violations can be expensive

- \$40,654 per day for every day of the violation—Equals over \$14.8 million per year

■ Two basic types of violations

- Failure to file
- Gun jumping

Failure to file

■ Violation

- ❑ Failing to file an HSR report and observe the waiting period requirements in a reportable transaction before acquiring a reportable “beneficial interest”

■ Scenarios

- ❑ Failure to file at all
 - Intentional failure to file
 - Inadvertent failure to file
 - Improper invocation of an exemption (usually the investment exception)
- ❑ Filing an insufficient report (e.g., a report that is incomplete because it does not contain all Item 4(c) and 4(d) documents)

■ Prosecutorial discretion

- ❑ Vigorous enforcement for intentional failures to file
- ❑ “One-bite” rule for inadvertent failures to file
 - No enforcement action on first failure
 - Enforcement actions on subsequent failures
- ❑ Varies with culpability in invoking exemption

“Gun jumping”

- Violation

- The FTC takes the position that a person has a beneficial interest in the voting securities or assets of the target company within the meaning of the HSR Act when the person can exercise a degree of management influence on operations of the target.
- Exercising this influence prior to the end of the waiting period is called “gun jumping”

Recent HSR Act enforcement actions

Year	Acquirer	Target	Violation	Reason	Civil Penalties	% Max
2017	Ahmet H. Okumus	Web.com	Failure to file	Inadvertent	\$180,000	65.3%
2017	Mitchell P. Rales	Colfax	Failure to file	Inadvertent	\$720,000	1.6%
2016	Fayez Sarofim	Danaher	Failure to file	Not investment	\$720,000	
2016	Caledonia Investments	Kinder Morgan	Failure to file	Beyond five-year period	\$480,000	
2016	ValueAct	Bristow Group	Failure to file	for exemption		
2016	ValueAct	Baker Hughes	Failure to file	Not investment	\$11,000,000	
2016	Len Blavatnik	Halliburton	Failure to file	Inadvertent	\$656,000	25.2%
2015	Leucadia Nat'l Corp	TangoMe	Failure to file	Inadvertent	\$240,000	3.4%
2015	Third Point Offshore Fund	Goober Drilling	Failure to file	Not investment	None	
2015	Flakeboard	Yahoo	Failure to file	Not investment	None	
2015	Flakeboard	SierraPine	Gun jumping		\$1,900,000	53.5%
2014	Berkshire Hathaway	USG Corporation	Failure to file	Inadvertent	\$896,000	100.0%
2013	Barry Diller	Coca Cola	Failure to file	Inadvertent	\$480,000	5.0%
2013	MacAndrews & Forbes	Scientific Games	Failure to file	Beyond	\$720,000	42.9%
2012	Biglari Holdings	Cracker Barrel	Failure to file	five-year period		
2012	Biglari Holdings	Cracker Barrel	Failure to file	Not investment	\$850,000	50.1%
2011	Brian L. Roberts	Comcast	Failure to file	Inadvertent	\$500,000	5.7%
2010	Smithfield Food	Premium Standard	Gun jumping		\$900,000	48.7%
2009	John C. Malone	Discovery	Failure to file	Inadvertent	\$1,400,000	11.9%
2008	ESL Partners	AutoZone	Failure to file	Inadvertent	\$800,000	24.7%
2008	ValueAct Capital Partners	Various	Failure to file	Inadvertent	\$1,100,000	37.3%
2007	Iconix	Rocawear	Failure to file	Incomplete filing	\$550,000	59.5%
2007	James D. Donder	Neighborcare	Failure to file	Inadvertent	\$250,000	25.5%
2006	QUALCOMM	Flarion	Gun jumping		\$1,800,000	54.2%

HSR Act enforcement actions

■ Factoids

- 61 total enforcement actions since the HSR Act was enacted—all settled by consent decree
- Fines
 - September 5, 1978 – November 19, 1996: \$10,000 per day
 - November 20, 1996 – February 8, 2009: \$11,000 per day
 - February 9, 2009 – July 31, 2016: \$16,000 per day
 - August 1, 2016 – January 23, 2017: \$40,000 per day
 - January 24, 2017 – present: \$40,654 per day

Initial Waiting Period Investigations

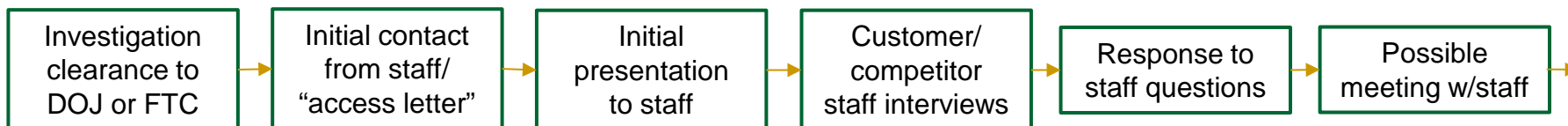
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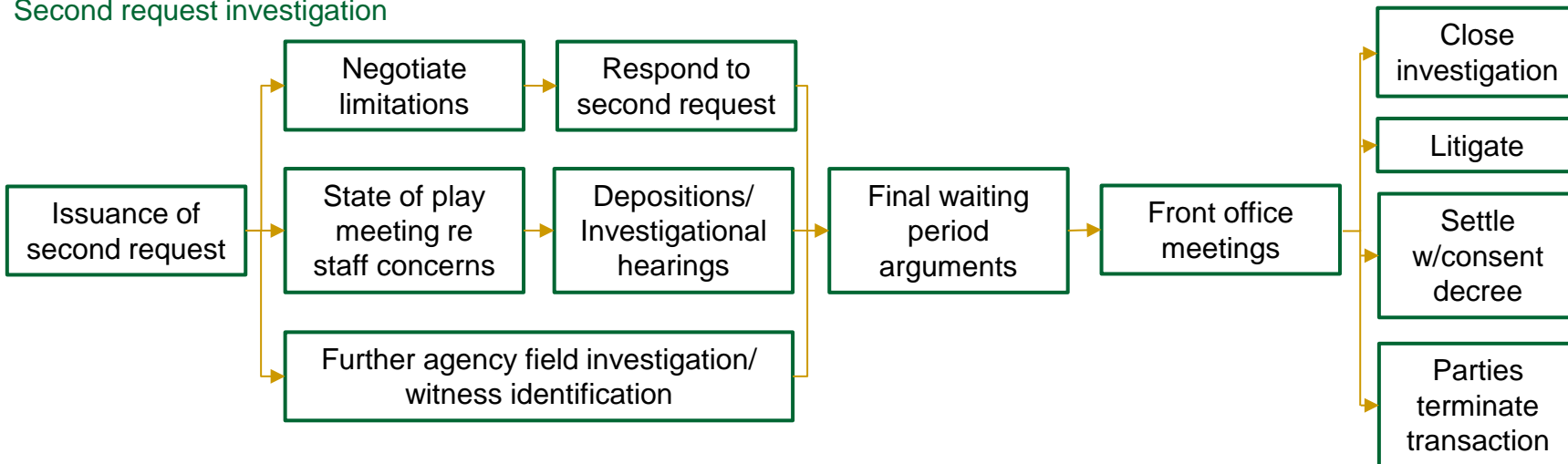


Addressed in the last week of class

Initial investigation



Second request investigation



Initial steps

- Parties must file HSR forms with both the DOJ and the FTC
- FTC Premerger Notification Office (PNO) reviews for technical compliance
- Agency “clearance”
 - Agencies decide which one, if either, will investigate the transaction
- Once “cleared,” the investigating agency may initiate contact with the reporting parties
 - The parties are free to contact the DOJ or FTC before clearance
 - BUT the contacted agency is supposed to invite the other agency to any meeting or other communication with the merging parties

Initial contact by investigating staff

- Usually occurs 7-10 days after filing
- Three purposes
 1. Inform parties of the investigation and introduce the investigating staff
 2. Request that the parties provide certain information to the staff on a voluntary basis
 - Most recent strategic, marketing and business plans
 - Internal and external market research reports for last 3 years
 - Customer lists of the firm's top 10-20 customers (including a contact name and telephone number)
 - NOT requested in consumer retail deals
 - (Sometimes but rarely) competitor lists and estimates of market shares
 3. Invite the parties to make a presentation to the staff on the competitive merits of the transaction

Initial merits presentation

- Critical to do completely, coherently, and quickly
 - Often a large “first mover” advantage in being the first to give the staff a systematic way to think about the transaction
 - Well-prepared business people are the best to present
 - Need to anticipate and answer staff questions
 - Need to clear and compelling
 - Need to anticipate and be consistent with what the staff is likely to hear from customers
 - Need to do quickly

Initial merits presentation

- Best presentations—
 - Anticipate all of the issues the staff will raise
 - Provide answers that are supported by company documents and consistent with customer perceptions, and
 - Have all of the facts right
- Ideally, the rest of the investigation needs to do no more than defend the analysis of the first presentation

Initial merits presentation

- My ideal structure (when the facts fit)
 1. Provide an overview of the parties and the transaction
 2. Provide an overview of the industry (if the staff is not familiar with the industry)
 3. Explain the business model driving the transaction
 4. Identify the customers benefits implied by the business model
 5. Explain why market conditions would not allow the transaction to be anticompetitive in any event

Customer/competitor staff interviews

- Occupies the bulk of the remaining time in the initial investigation
- Customer views are given great weight
- Competitor conclusions are given little weight

End of the initial waiting period

- Three options for the agency
 1. Close the investigation
 2. Issue a second request
 3. Convince the parties to “pull and refile” their HSR forms to restart the initial waiting period

Second Request Investigations

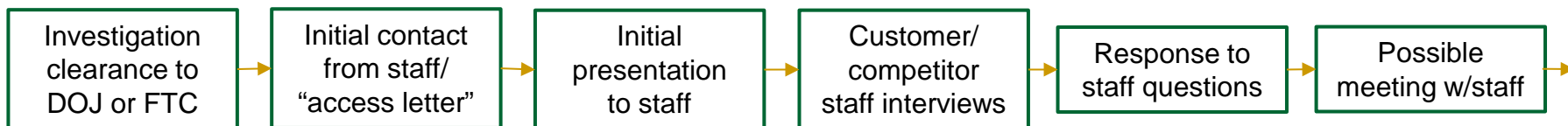
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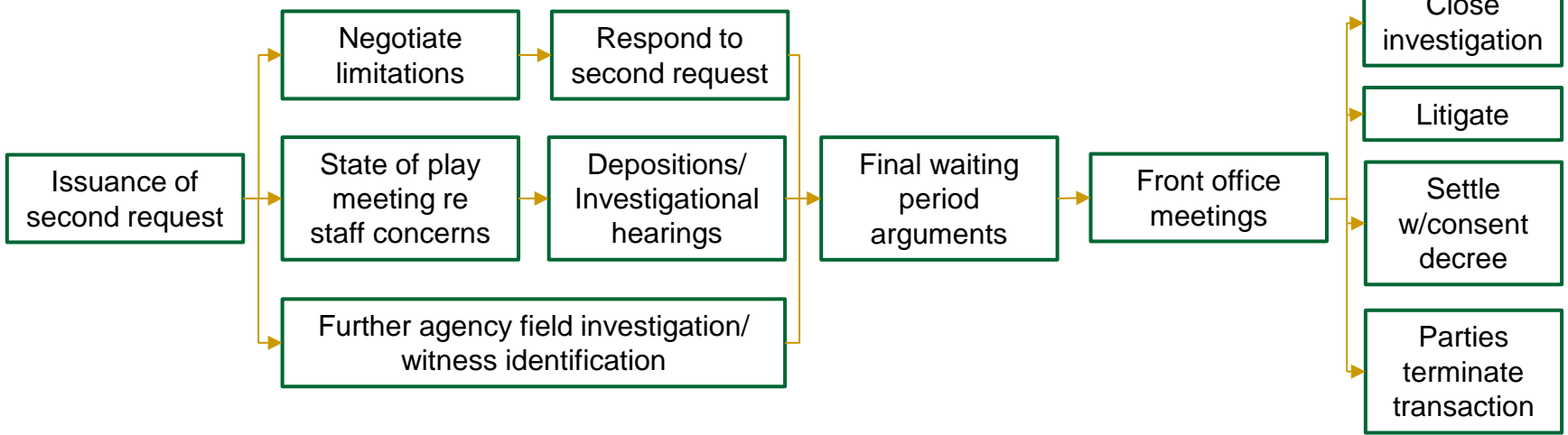


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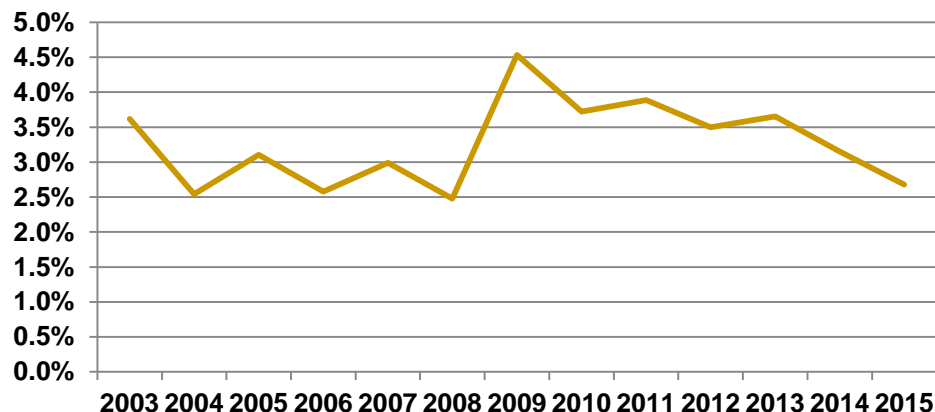
Second request investigation



The second request

- HSR Act authorizes investigating agency to issue one request for additional information and documentary material (a “second request”) during the initial waiting period to each reporting party
- Issuance of a second request extends waiting period until—
 - All parties comply with their respective second requests, and
 - Observe a final waiting period (usually 30 days) following compliance

Percentage of Eligible Transactions Receiving Second Requests



Second request investigations

- Second request
 - Blunderbuss request
 - DOJ and FTC each have “model” second requests, but typically customized with additional specifications
 - Typically takes 6-16 weeks to comply
 - Often covers 60-120 custodians
 - Data interrogatories
 - Narrative interrogatories
 - Document requests (including e-mails and other electronic documents)
 - Non-English language documents must be translated into English
- Depositions of business representatives of parties
- Documents and testimony from customers and competitors
- Expert economic analysis

Final waiting period

■ Timing

- Begins when all parties have submitted proper second request responses
- Ends 30 calendar days later
 - 10 days in a cash tender offer
- Parties often voluntarily “extend” the final period¹
 - Provides additional time for agency to complete investigation
 - Usually better than being sued!
 - May be necessary to complete meetings
 - May be necessary if a consent decree is being negotiated

■ “Timing agreements”

- Agencies like to negotiate “extensions” early in a second request investigations so that they know how much time they have before the deal can close
- Typically will accept 60 days beyond the normal expiration of the waiting period
 - 30 days for the staff (making a total of 60 for the staff after second request compliance)
 - 30 days for the front office
- Technically a contract, but real effect is more of an estoppel
- Do NOT extend the HSR Act statutory waiting periods

The final arguments

- Formal meetings at the end of the investigation

	DOJ	FTC
1	Investigating staff	Investigating staff
2	Section Chief & staff	Assistant Director & staff
3	Deputy Assistant Attorneys General (legal and economics)	Directors meeting (Bureau of Competition/ Bureau of Economics)
4	Assistant Attorney General	Five FTC Commissioners (meet individually)

- Numerous informal meetings can occur up the chain at the end of the investigation
- *Critical question:* How much of its analysis will the investigating staff disclose to the parties?

Merger Review Outcomes

Possible outcomes in DOJ/FTC reviews

Close investigation

- Waiting period terminates at the end of the investigation with the agency taking no enforcement action, or
- Agency grants early termination prior to normal expiration

Litigate

- DOJ: Seeks preliminary and permanent injunctive relief in federal district court
- FTC: Seeks preliminary injunctive relief in federal district court
Seeks permanent injunctive relief in administrative trial

Settle w/consent decree

- Typical resolution for problematic mergers
- DOJ: Consent decree entered by federal district court
- FTC: Consent order entered by FTC in administrative proceeding

Parties terminate transaction

- Parties will not settle at the agency's ask and will not litigate, or
- Agency concludes that no settlement will resolve the agency's concerns and the parties will not litigate
 - Examples: AT&T/T-Mobile, NASDAQ/NYSE Euronext