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HART-SCOTT-RODINO OVERHAUL

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As the latest evidence of increased antitrust enforcement, on July 7 the Federal Trade Commission and the antitrust division of the Department of Justice jointly published sweeping changes to Hart-Scott-Rodino rules. HSR enables the FTC and the DOJ to analyze the potential competitive effects of a proposed transaction and initiate a preclosing challenge if warranted, by requiring a filing and waiting period. Absent an exemption, the requirement applies to transactions meeting a relatively small "size" test of $66 million, often including the value of prior acquisitions involving the same seller or target.

The changes are the most comprehensive in HSR's 33-year history. Several changes eliminate obsolete sections of the form, and the agencies responded to comments by carving back on some of the more extreme proposals. But several remaining changes raise HSR compliance burdens, increasing the cost and time needed to prepare filings, especially imposing new reporting obligations on private equity, other investment fund "families," oil and gas master limited partnerships, or MLPs, and other partnerships or LLCs that are managed by another entity that does not control them.

The changes will fundamentally alter the way companies prepare HSR filings, including documents to be collected, methods for compiling annual revenue data and the need for processes to collect information from noncontrolled entities deemed "associates." Concerns over expanded breadth are exacerbated by the stringent potential penalties for incomplete HSR submissions. Several companies have been fined millions; many more suffer transaction delay, a serious risk under the new rules. This article highlights the most significant changes.

Item 4(c), long the most burdensome HSR requirement, demands documents meeting three criteria: (1) created by or for officers or directors ("Officer/Director Requirement"); (2) evaluating or analyzing the transaction ("Transaction Requirement"); and (3) with respect to "market shares, competition, competitors, markets, potential for sales growth [or] expansion into new products or geographic markets" ("Content Requirement"). New Item 4(d) requires filing parties to broaden their production (even for transactions with no competitive overlap) to include: (1) confidential information memoranda, or CIMs; (2) third-party analysis; and (3) efficiencies/synergies documents.

Unlike 4(c), 4(d) will require CIMs regardless of whether the content requirement is satisfied. The agencies responded to numerous "overbreadth" objections concerning proposed deletion of transaction and officer/director requirements by requiring: (1) that the CIM "specifically relate to the sale of the acquired entity(s) or assets"; (2) preparation by or for officers and directors of the acquiring or acquired entities and their ultimate parent entities; and (3) preparation within the past year. The most difficult requirement may be a need to produce documents shared during due diligence that "served the purpose of a [CIM] when no such [CIM] exists," but a stated intent to "capture materials that provide an in-depth overview or analysis" of the target may help.

The changes also require the production of documents prepared by bankers, consultants or other third-party advisers "during an engagement or ... for the purpose of seeking an engagement" and meeting the content requirement, otherwise mirroring CIM requirements. Given the response to comments, this revised rule has less impact except to emphasize that unsolicited "pitch books" can be required and the need for caution by bankers and other advisers.

In perhaps the most significant expansion on the documents front, documents evaluating or analyzing synergies and/or efficiencies that also meet the officer/director and transaction requirements--currently outside Item 4(c)--must also be submitted. These documents are sometimes submitted by filers voluntarily or requested during the initial 30-day waiting period. But now they must be submitted at the outset, even if the deal poses no conceivable antitrust concern, and the agencies specifically note that documents responsive to this item "may carry greater weight" than materials submitted later. Accordingly, a heightened and earlier focus on the content of such presentations may arise.

Until now, Item 5 required reporting of revenue from "U.S. operations" classified by North American Industrial Classification System, or NAICS, codes for a "base year" (2002), and additional data for products subsequently added or deleted. These requirements have been eliminated.

Yet for multinationals, these benefits are likely offset by a new requirement to report revenues for foreign-manufactured products sold into the U.S. under NAICS manufacturing codes. Previously, such revenues were reported only if the goods passed through "U.S. operations" of the filing person, such as warehouses, and then only under simple wholesaling codes. Direct shipments to U.S. customers fell outside Item 5 because no U.S. operations are involved, but now must be reported under detailed NAICS manufacturing codes, as well as shipments from a company's foreign manufacturing plants to its U.S. operations. These changes significantly increase compliance burdens on companies with foreign manufacturing operations.

Item 6(c) requires filing persons to report minority investments (5% to 49.99%) in corporate (now also noncorporate) entities. In a change aimed primarily at private equity/investment funds and MLPs, Item 6(c)(ii) expands reporting by acquiring persons to include minority investments held by "associates" and all entities they control that "overlap" by NAICS code or "industry" with the target.

Associates include entities under common management (as to operations or investments) with the acquiring person, but not under common "control"--essentially eliminating the long-standing ability of private equity/investment funds and MLPs to focus mainly on the acquiring fund and its portfolio companies and ignore noncontrolled entities for HSR purposes. Examples of associates include general partners of a limited partnership, other investment funds that are commonly managed, other partnerships with the same general partner and energy MLPs.

Responding to comments on burden, the agencies narrowed the definition of associates and will allow filers to respond to this item based on information in their (and associates') regularly prepared financials less than three months old. But significant questions--and best practices to be developed--remain as to how to identify associates and compile the necessary information. In particular, it may be difficult to take much comfort in broad reliance upon financials versus a diligent inquiry of associates, when those financials may omit sufficient industry or NAICS information to enable compliance with the agencies' strong preference for a response tailored by reference to overlaps with the target.

Item 7 currently requires all filing persons to identify NAICS code "overlaps" between the parties to the transaction. In another change aimed at private equity/ investment funds and MLPs, acquiring persons must now identify overlaps with "associates" and all entities they control. The financial statement approach allowed for Item 6(c) may not be relied upon here, further undermining the utility of that limitation.

In perhaps the most glaring example of a burden increase, the information necessary to complete Items 6 and 7 extends to potentially thousands of entities controlled by associates but not by the filing person. Consider a hypothetical commented upon to the agencies and not disputed in the final commentary: Buying Fund A's general partner manages nine other funds, creating 10 associates--each with 30 portfolio companies, and with each portfolio company controlling 10 subsidiaries. The potential need to gather information for Items 6(c) and 7 relating to 3,000 entities, all uncontrolled by the filing person, raises obvious concerns. Although the agencies have included a "knowledge or belief" standard that allows for some gaps in the information needed, they will likely still expect diligent inquiries of associates to get a sense of overlaps within a potentially large population of controlled entities.

Companies need to review the proposed changes closely to assess the impact on their next filing. Even (or especially) if they file frequently, numerous internal changes to processes in place may be required. Private equity firms, other investment funds, MLPs and any entities managed by others that don't control them must carefully consider the scope of newly mandated "associate" information. Outside and in-house counsel should also evaluate the effect on deal timelines and standard contract provisions concerning HSR. With the expanded scope of document and data collection, deadlines for submitting filings and termination or "drop dead" dates need to be reconsidered.

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