207 Hart-Scott-Rodino Act: Compliance Issues Facing Business Entities

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Faculty Biographies

Joseph P. Nisa

Joseph P. Nisa is counsel in the New York office of Skadden, Arps, Slate, Meagher & Flom LLP. His practice has focused on Hart-Scott-Rodino matters for at least 10 years and he has prepared hundreds of HSR Premerger Notifications. He is currently updating the Axinn, Fogg, Stoll and Prager HSR Treatise, Acquisitions Under The Hart-Scott-Rodino Antitrust Improvements Act, to reflect the changes that have occurred in the HSR Act and Regulations in the last year.

Mr. Nisa has also contributed to the ABA publication *Premerger Notification Practice Manual* and is contributing to the update of that publication for the ABA's Antitrust Section.

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Developments under the Hart-Scott-Rodino Act

by Joseph P. Nisa[1]

On February 1, 2001, the first major structural amendments to the Hart-Scott-Rodino ("HSR") Antitrust Improvements Act of 1976 since the HSR Act was initially enacted became effective.[2] Interim rules, intended to harmonize the HSR Rules and Statute, also became effective on February 1, 2001[3]. The HSR Form is amended to include the new reporting thresholds and to require a more detailed focus on the issue of valuation of a transaction, now that filing fees are tied to the value of the stock or assets being acquired. On January 25, 2001, the Federal Trade Commission ("FTC") also published in the Federal Register proposed rules relating primarily to the acquisition of foreign assets or issuers, and invited public comment.[4] Finally, the FTC has adopted Rules of Practice for reviewing and modifying or appealing Second Requests, which became effective on February 1st.

Changes in the Statute and Rules

- The HSR Size-of-Transaction test has been raised from in excess of $15 million to in excess of $50 million. Thus, no acquisitions valued at $50 million or less are reportable. Beginning September, 2004, this threshold will be indexed to reflect the percentage change of the gross national product from the previous fiscal year (the "GNP index").

- For transactions valued in excess of $200 million, the Size-of-Person test has been eliminated. Thus, any transaction in excess of $200 million is potentially reportable, irrespective of the sales and assets of the acquiring and acquired persons or the size of the proposed joint venture. This means that transactions involving newly formed funds or acquisition vehicles that are their own ultimate parent having little or no assets other than the cash that will be used to make an acquisition will no longer be exempt if the value of the acquisition exceeds $200 million.

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[2] Pub.L.No.106-553, 114 Stat. 2762, signed by the President on December 21, 2000.

[3] 16 CFR §§ 801 et seq. Although the Interim Rules are effective as of February 1st, the FTC has invited public comment with respect to the Interim Rules and they may be modified in the future.

[4] At the time of preparation of this article, the proposed rules had not become finalized.

- For transactions valued in excess of $50 up to $200 million, the Size-of-Person test remains the same.

- Filing fees are based on a sliding scale, also subject to the GNP index. For transactions of less than $100 million, the filing fee is $45,000. For transactions of more than $100 million but less than $500 million, the filing fee is $125,000. For transactions in excess of $500 million, the filing fee is $280,000.

- Reporting thresholds are tied to filing fees. The 15% threshold has been eliminated. There are no percentage thresholds for the acquisition of assets. In addition to the $50 million, $100 million and $500 million thresholds, there is a 25% threshold for stock valued at $1 billion or more and a 50% threshold.

- The waiting period after substantial compliance with a second request is now thirty days, rather than twenty. The waiting period after a second request for cash tender offers and filings made in bankruptcy remains ten days after substantial compliance by the acquiring person. In addition, if the initial or extended waiting period ends on a Saturday, Sunday or legal public holiday, the waiting period will extend to the "end of the next day that is not a Saturday, Sunday or legal public holiday."

- In otherwise exempt transactions, such as the acquisition of real property, the amount of non-exempt assets that may be acquired is now $50 million or less.

- The Minimum Dollar Value Exemption, which required an acquiror to comply with the HSR Act in order to obtain control of an issuer for less than $15 million if the issuer had sales and assets of more than $25 million, is eliminated. Under the amendments, $50 million is an absolute floor and 50% or more of a company can be acquired for $50 million or less without having to file HSR.

- The exemption that permitted a party to reach the limit of a threshold within five years without refiling has been amended to account for so-called "transitional filers," namely those transactions that were filed under the old Rules. Transitional filers have one year from February 1, 2001 or until the end of the original 5-year period for making additional acquisitions, whichever comes first, to acquire up to what was the next reporting threshold at the time they filed. For filings made after February 1, 2001, an acquiror still has five years to reach the limit of the new threshold for which it filed (e.g., a person filing to acquire $55 million in stock now has five years to acquire up to $100 million of that stock.[5])

[5] However, it must be emphasized that the value of the transaction is tied to the value of the stock or assets held as a result of the acquisition. This means that an acquiror must aggregate what is already held (at market price) with what is being acquired (at acquisition price). Accordingly, an acquiror who has already acquired $55 million of stock after February 1 will have to refile if it intends to acquire another $55 million within five years and must pay a filing fee of $125,000 (because it will hold $110 million

- Institutional investors may now acquire up to 15% of the voting stock of a company (in excess of $50 million) for investment only purposes, without having to make an HSR filing.

- Aggregation Rules are conformed to the new jurisdictional thresholds.

Changes in the HSR Form

There have been minor revisions in the HSR Form itself. The Form now contains a section on filing fee payment to enable the agencies to track a wire transfer more easily. The most notable change is the requirement to state the name of a person who determined the valuation of the transaction in cases where the value of a transaction was undetermined and a fair market valuation was required.[6] What is most notable is what has not changed. There has been no change in the definition of Item 4(c) documents, despite years of statements that this Item would be amended. There is no change in the base year for revenues, which remains 1992. And there is no changeover from SIC Codes to NAICS Codes in reporting revenues. The FTC has stated that further changes in the Form may be made in the spring of this year.

- The Form asks whether the filing is remedial, that is, should have been done at an earlier time[7], or whether the filing is being made in the context of a bankruptcy.

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of stock as a result of the acquisition), even though it paid a fee of $45,000 to acquire the initial $55 million of stock. Likewise, an acquiror holding $49 million of stock must file and pay a $45,000 filing fee, even if it were to acquire only $2 million more of stock of the same issuer. Similarly, an acquiror who had acquired 25% of the voting securities of a company for $750 million after February 1st would have had to file and pay a $280,000 filing fee because it had crossed the $500 million threshold. Should it acquire additional voting securities of the company within 5 years valued at $300 million, but representing less than 50% of the company, it would have to file and pay another $280,000 filing fee because it was crossing the "25% valued at more than $1 billion dollar" threshold. Surely the agencies would have done a significant review upon the acquisition of 25% of the company. It is difficult to imagine or justify how the acquisition of additional stock within the 25% threshold (but less than 50%) would require an additional full review at full price. But that is the result of the current rule changes relating to reporting thresholds. It should be noted that Congress did not change the reporting thresholds when it amended the statute. Congress simply created a sliding scale for filing fees. The changes in reporting thresholds were made by the FTC and DOJ in an attempt to reduce some of the potential problems that would have occurred if the sliding fee schedule were applied to the old thresholds. However, the new reporting thresholds will likely bring their own set of problems and potential inequities.

[6] A copy of the FTC Valuation Worksheet is attached below at the conclusion of this memorandum.

[7] In connection with remedial or post-consummation filings, the FTC now requires that a person representing the company state why the filing was not initially made, whether the company has previously inadvertently failed to file, and what steps have been taken to assure that such an oversight will not again occur. See FTC website www.ftc.gov : Procedures for Submitting Post-Consummation Filings. It should be noted that, although such a filing must conform to the state of facts that would

- The Form contains an Item relating to filing fee payment, which requests the taxpayer identification number of the company paying the filing fee, and if the acquiror is an actual person, his or her social security number.

- The Form asks the filing party to identify on a voluntary basis whether any other competition filings are being made in any foreign jurisdictions.

- The Form asks for a specific value of the transaction and, if the valuation is based on a fair market determination, the name of the person who arrived at that determination.[8]

- Item 8 of the Form which sought information about vendor-vendee relationships is no longer a part of the Form.

- The base year for reporting revenues has changed from 1992 to 1997 and all revenues must be reported under the North American Industry Classification System ("NAICS") rather than the Standard Industrial Classification ("SIC") System which had been in effect since the inauguration of the HSR Premerger Notification process.

- The Insurance Appendix has been eliminated. All revenues, including insurance-related revenues must now be reported in Item 5 of the HSR Form.

- Information required about prior acquisitions has been reduced. No longer is the acquiring person required to provide the annual net sales and total assets of the party that was previously acquired.

Proposed Rule Changes

The FTC has proposed changes in other Rules but these changes are not yet effective. The public had until March 19, 2001 to submit comments with respect to the proposed changes. Numerous comments were received, not always favorable. As of the time of the preparation of this article, the proposed rules had not become final rules. As proposed, the changes would be as follows:

- Rule §802.2(g), the exemption for agricultural property, will be narrowed. The current exemption also exempts "associated agricultural assets" such as livestock, structures to house livestock, crops, and other inventory. Under

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have been the case if the filing were done in a timely way, the filing fee will be assesssed under the new sliding scale.

[8] The Form does not contain, but makes reference to, a Valuation Worksheet, which is available on the FTC website and is reproduced at the conclusion of this memorandum. Persons are strongly encouraged to use the worksheet in determining the value of the transaction. If a transaction is at a margin of a threshold, the agencies may very well call and seek documentation of the valuation process.

the proposed rule, associated assets would no longer be exempt and the exemption would apply only to the real property.

• It is being proposed that Rules §802.50 and §802.51, the exemptions relating to the acquisition of foreign assets or voting securities, be modified.

a. The new Rule §802.50 will relate to the acquisition of foreign assets. Such an acquisition would not be reportable unless the assets had over $50 million in U.S. sales attributable to them in the most recent fiscal year, combined with such sales to date (*but no more than 60 days from time of filing or time of closing*)[9]. If the $50 million limit were exceeded, if both parties are foreign, the exemption would still be available if the transaction is valued at less than $200 million and the aggregate sales of both parties in or into the U.S. are less than $110 million in the last fiscal year (*combined with sales since then up to 60 days before filing or closing*) and the total fair market value of the assets[10] of the parties in the U.S. are less than $110 million.

b. The new Rule §802.51 will relate to the acquisition of foreign voting securities. Under proposed Rule §802.51(a), an acquisition by a U.S. acquiror would be exempt unless the foreign issuer had assets in the U.S. with a fair market value of over $50 million or made sales in or into the U.S. of more than $50 million in the last fiscal year (*combined with sales since then up to 60 days before filing or closing*).

Under proposed Rule 802.51(b), an acquisition of a foreign issuer by a foreign acquiror would be exempt unless the acquisition conferred control of the foreign issuer which had assets in the U.S. with a fair market value of over $50 million or made sales in or into the U.S. of more than $50 million in the last fiscal year (*combined with sales since then up to 60 days before filing or closing*). If the $50 million limit were exceeded, the exemption would still be available if the transaction is valued at less than $200 million and the aggregate sales of both parties in or into the U.S. are less than $110 million in the last fiscal year (*combined with sales since then up to 60 days before filing or closing*) and the total fair market value of the assets of the parties in the U.S. are less than $110 million.

• Proposed Rule §802.6 is being amended to make clear that in a so-called "mixed transaction" involving an exemption because regulatory approvals

[9] This addition of a period subsequent to the most recent year created an anomalous result. A filing may not be required if the parties file in April of the year because combined sales of the most recent fiscal (calendar) year plus the two months of the present year do not exceed $50 million. However, were the parties to file in October for the same assets, there could very well be a filing because the sales in the months between March and August would bring the total to more than $50 million. This anomaly has been recognized by the agencies and it is expected that final Rules 802.50 and 802.51 will eliminate the requirement to count any sales since the end of the most recent fiscal year.

[10] Assets in this proposed Rule do not include investment assets or voting and non-voting securities.

are required and a non-exempt portion of the transaction, where there is no regulatory approval required, the agencies retain jurisdiction over the non-exempt part of the transaction and an HSR filing would be required if the non-exempt part exceeded $50 million in value.

Second Request Procedures

The FTC has amended its internal Rules of Practice, in connection with procedures relating to the issuance, modification and contestation of Second Requests, effective February 1, 2001. Under the new Rules of Practice, a party must be informed of its right to discuss modifications or clarifications of the Second Request with an authorized representative of the Commission. A conference may be set up within 5 business days of the issuance of the Second Request. At that time, the authorized representative must discuss the competitive issues raised by the proposed transaction and confer about how best to get the information and documents relating to those competitive concerns. Modifications in the Second Request can be made by the authorized representative or, upon its recommendation, to the responsible Assistant Director of the Bureau of Competition. If a recipient of a Second Request believes that it has exhausted its efforts to obtain adequate modifications or clarifications and has not been successful, it may petition the General Counsel in writing not to exceed 500 words. The General Counsel has two days to set up a conference, which should take place within 7 business days from receipt of the petition. Memoranda may be submitted to the General Counsel by both parties not later than 3 business days before the date of the conference. A decision will be made within 3 business days following the conference.

Comment

The major change in these amendments involve the tying of filing fees to the valuation of the transaction. In the past, valuation issues were important only when a transaction hovered around $15 million. However, with the changes, valuation becomes significant anytime an acquiror is near one of the five thresholds. Furthermore, it will become necessary to justify valuations when transactions contain variables which may not be determinable at the time of filing, such as royalty payments, earn-outs, etc. Also, the parties may eliminate the value of exempt assets or voting securities. In a large worldwide transaction, where allocations have not yet been made, someone is going to have to decide which assets or voting securities, if any, are exempt (such as certain foreign assets with no U.S. contacts, or real property that may be a part of a larger transaction) and what is their value. It appears that the main theme of the amendments is revenue raising or revenue assurance and to such an end an enhanced effort must be made by the parties in an area having nothing to do with the original purpose

of the HSR Act. In some ways it may be said that the filing fee tail is now wagging the HSR dog.

Other issues emerge as well. For example, would it be considered a device for avoidance to acquire 90% of the voting securities of a company for $48 million? No filing would be required. The acquisition of the remaining 10% would not be reportable under the Rule that if the acquiror already held 50% or more of the company. Thus, a person would be able to acquire a $54 million company without having to file an HSR if the transaction were stepped.

In a tender offer for at least 50% of the shares, to be followed by a merger, is the value of the transaction the acquisition price for the 50% or is the value of the transaction the aggregate value of 100% of the shares?

Does the form of the transaction matter? Would there be similar filing fee for a hostile tender offer to acquire any and all of the shares of a company but at least 50% of the company and a tender offer pursuant to a merger agreement whereby, by definition, 100% of the stock will be acquired through the merger?

Open market purchases or creeping acquisitions could become especially expensive with respect to filing fees, because an acquiror has to pay a fee based on the value of the shares held as a result of the acquisition. Thus, theoretically, an acquiror would pay $45,000 to acquire $55 million in stock, $125,000 to acquire an additional $55 million of stock, and $280,000 to acquire another $391 million of stock. But if the $501 million of stock represented only 12% of the company's stock, then another $280,000 filing fee would have to be paid to reach the 25% threshold (valued at more than a billion dollars) and another $280,000 to cross the 50% threshold.

What if one overvalues the transaction (e.g., after post-closing adjustments, the purchase price was actually $490 million and not $510 million) and pays too much in filing fees? The agencies have stated that there might be some rebate, but have suggested that it would not be a full rebate.

What if one undervalues a transaction so that after post-closing adjustments, the transaction is actually worth $510 million and not the $490 million as reported and paid for. Would the parties have to refile, pay the additional filing fee? It appears that the agencies will accept the good faith valuation made at the time of filing, but one may need to be prepared to justify that valuation.

Valuation of Transactions Reportable Under The Hart-Scott-Rodino Act

As a result of the 2001 introduction of a graduated filing fee, it becomes necessary to value all reportable transactions with greater precision than was required prior to the amendments. Under the HSR rules, the value of a transaction is based upon the assets or voting securities of the Acquired Person that the Acquiring Person will hold as a result of the transaction. Thus, for example, if an Acquiring Person who holds some voting securities of an Acquired Person purchases additional securities of the same Acquired Person, the value of that transaction will be the value of all the shares held by the Acquiring Person, not just the incremental shares most recently purchased.

The HSR rules specify different techniques for valuing transactions involving assets and voting securities, depending upon the circumstances. The following explanation provides a guide to valuation of reportable transactions under the HSR rules. The rules themselves (16 C.F.R. §§801.10 through 801.15) should be consulted for more precise guidance on valuation issues.

I. Acquisitions of assets

Under the HSR rules, the value of an asset acquisition is Fair Market Value or, if determined and greater than Fair Market Value, the Acquisition Price. Fair Market Value must be determined, in good faith, by the board of directors of the Acquiring Person, or its delegee, as of any date within 60 calendar days prior to filing, if filing is required, or within 60 days prior to closing, if filing is not required. The rules do not specify the valuation or accounting techniques to be used in making such a determination.

Acquisition Price is the total amount of consideration received by the seller(s) for acquisition of their assets. That consideration includes the assumption of any accrued liabilities by the Acquiring Person, and it includes any separate amount paid to the seller(s) for a covenant not to compete. The Acquisition Price is "determined" if the parties have agreed upon the consideration, or if the amount of consideration (e.g., by reason of post-closing adjustments or contingent future payments) can be reasonably estimated. *Anticipated future payments are included at face value and cannot be discounted to present value*. If the Acquisition Price is not determined, then Fair Market Value governs the value of the transaction.

II. Acquisitions of voting securities

The value of an acquisition of voting securities is the value of the voting securities that will be held as a result of the acquisition. That value depends upon whether the stock is publicly traded, and upon whether its acquisition price is determined.

If the stock is publicly traded, the value of the shares to be acquired is either Market Price or Acquisition Price, whichever is greater. For transactions subject to rule 801.30 (e.g., open market purchases, tender offers, conversions, or exercises of options or warrants) Market Price means the lowest closing quotation during the 45 calendar days prior to the HSR filing, if filing is required, or prior to closing, if filing is not required. For transactions not subject to rule 801.30 (generally, acquisitions pursuant to a contract or letter of intent), Market Price is the lowest closing quotation during that portion of the same 45-day period that begins one day before execution of the contract or letter of intent. If Acquisition Price is not determined, Market Price governs the value of the transaction. If Market Price is indeterminable because closing is more than 45 days away, and the Acquisition Price is determined, then Acquisition Price is the value of the transaction. If neither Market Price nor Acquisition Price is determined, Fair Market value determines the value.

If the stock is not publicly traded and the Acquisition Price is determined, the value of the transaction is the Acquisition Price. If the Acquisition Price is not determined, the value of the transaction is the Fair Market Value of the stock, determined by the board of directors of the Acquiring Person or its delegee, as described above.

If an Acquiring Person already holds voting securities of the Acquired Person and will acquire additional shares, the previously held shares are valued at Market Price or Fair Market Value if Market Price is indeterminable (if publicly traded) or Fair Market Value (if not publicly traded), and the additional shares to be acquired are valued in the manner described above. The value of the transaction is the sum of values of the previously held shares and the additional shares to be acquired.

III. Acquisitions of assets and voting securities

Acquisitions of both assets and voting securities are valued by separately determining (as described above) the value of the assets and the value of the voting securities that will be held as a result of the acquisition. If an Acquiring Person holds voting securities of an Acquired Person and will acquire only assets of the same Acquired Person, the value of the previously acquired voting securities is ignored if an HSR filing was made with respect to that previous acquisition. If an Acquiring Person has previously acquired assets of an Acquired Person and will now acquire additional assets from the same Acquired Person, special valuation rules apply. See rule 801.13(b)(2).

IV. Exempt acquisitions

In general, acquisitions of assets or voting securities that are exempt from HSR Act reporting requirements are not included in the valuation of a transaction. Rule 801.15 provides technical guidance concerning which types of acquisitions result in the Acquiring Person's holding the acquired assets or voting securities for purposes of valuation. The following worksheet will guide the Acquiring Person through the steps necessary to determine the value of assets or voting securities held as the result of an acquisition.

Worksheet for Valuation of a Transaction

I. Calculate the value of the voting securities or assets to be acquired.(1) (see § 801.10)

A. Acquisition Price

If the acquisition price is determined, indicate below. (Acquisition price is determined if it can be reasonably estimated).

Cash to be paid at closing	$_____
Cash to be paid at any other time (do not discount to present value)	$_____
Face amount of any note (do not include interest)	$_____
Value of any securities to be paid (describe valuation method below)	$_____
Value of other assets transferred (describe valuation method below)	$_____
Assumption of accrued liabilities (only in asset acquisitions)	$_____
Any other consideration to be paid (describe)	$_____
Acquisition Price	**$_____**

Provide methodology for calculation of valuation of securities paid or assets transferred in the space below. Provide description in the event any other consideration was paid. If estimates are used, briefly describe basis for the estimates.

B. Fair Market Value (if required) **$_____**

Provide the methodology used in calculating the Fair Market Value (FMV) of the assets or voting securities to be acquired. (Indicate factors used such as: discount rate, terminal value, earnings or cash flow multiples, Appraiser's names and addresses, or any other relevant information used to calculate the FMV).

C. Market Price of Voting Securities (if required) **$ _____**

Provide the date and closing quotation used in calculating Market Price (see § 801.10(c)(i)):.

Value before adjustment for exempt portions. **$ _____**

II. Adjustment for exempt assets or voting securities

If the rules allow some of the assets or voting securities being acquired to be excluded in determining the value of the transaction, determine the FAIR MARKET VALUE of the exempt assets or voting securities that are part of this acquisition. Deduct this amount from the value calculated above.

Provide the methodology used in calculating the Fair Market Value (FMV) of the exempt assets or voting securities. (Indicate factors used such as: discount rate, terminal value, earnings or cash flow multiples, Appraiser's names and addresses, or any other relevant information used to calculate the FMV).

Exempt Portion **$ _____**

Total Value after Adjustment **$ _____**
Use this figure to determine the filing fee.

Endnote:

1. If you would hold previously acquired assets or voting securities of the same acquired person as a result of this acquisition, within the meaning of the Rules, those assets or voting securities must also be valued. See preceding discussion on valuation and 16 CFR §§ 801.1

Change in Reporting Revenues under HSR Act

As of July 1, 2001, the base year for reporting revenues in Items 5(a) and 5(b)(i) on the Hart-Scott-Rodino ("HSR") Premerger Notification Form (the "Form") changed from 1992 to 1997. Further, no longer are revenues reported using the Standard Industrial Classification ("SIC") system. Rather, as of July 1, 2001, revenues must be reported under the North American Industry Classification System (the "NAICS"). Finally, the Insurance Appendix has been eliminated from the Form and insurance-derived revenues must now be reported in Item 5 of the Form, along with all other revenues for U.S. operations. These changes were announced as Interim Rules, published in the Federal Register of May 9, 2001 (66 Fed. Reg. 23,561).

The NAICS was developed to replace the SIC system. The SIC system was found to be inadequate in reflecting two significant economic trends that had great impact upon the economy in the last twenty years, namely, the emergence of service-producing industries and the rapid development of technology based industries. For example, there were no SIC codes to describe Internet commerce.

In 1992 the Economic Classification Policy Committee ("ECPC") of the Office of Management and Budget began the development of the NAICS system. Canada and Mexico also participated in the development of NAICS. The NAICS divides the economy into 20 sectors and identifies nine new service industries sectors and 358 new national industries.

The NAICS is based on a production-oriented or supply-based conceptual framework that groups together businesses using identical or similar production processes. The NAICS uses a 6-digit coding system which is comparable to the 4-digit SIC industry wide code. The NAICS also provides a 7-digit product class code (comparable to 5-digit SIC code) and a 10-digit product code (comparable to 7-digit SIC code). A review of the NAICS codes will take place every five years to keep them current as economic sectors evolve.

Companies should have begun collecting revenue data by NAICS codes beginning in 1997. It is important that companies review their revenue reporting procedures because after June 30, 2001, SIC codes will no longer be accepted on the HSR Form. Information regarding the NAICS can be found in the North American Industry Classification—United States 1997 (the "NAICS Manual"), published by the Executive Office of the President, Office of Management and Budget. The NAICS Manual contains conversion tables to assist in converting SIC codes into the appropriate NAICS codes. Copies of the NAICS Manual may be ordered from the following website: http://www.ntis.gov/product/naics.htm.

HSR Compliance Issues Facing Business Entities

ACCA 2001 Annual Meeting
San Diego, California

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What is the Hart-Scott-Rodino Antitrust Improvements Act of 1976?

(a) A pain in the neck
(b) An opportunity for Uncle Sam to collect a fee
(c) An opportunity for Uncle Sam to look at the eggs before they are scrambled
(d) All of the above

How HSR Premerger Notification Works

- Prior to Closing, Acquiring and Acquired Persons Submit HSR Premerger Notification and Report Forms to FTC and DOJ. Filings Are Confidential and Exempt From FOIA Disclosure
- Submission Triggers Either a 15 Day or 30 Day Waiting Period
- Each Agency Separately Reviews Filing: Only One Agency May Open an Investigation ("Clearance")
- Early Termination is Granted if Parties Request It and Agencies Do Not Have Substantive Concerns About Transaction; Notice of Grant of Early Termination is Made Public 24 Hours After It Is Granted or
- If Early Termination is Not Requested, Waiting Period May Simply Expire and No Public Announcement is Made by the Agencies or
- A Request for Additional Information ("Second Request") is Issued, Tolling the Waiting Period Until 30 Days After Substantial Compliance With Second Request
- Government May Close Investigation, Enter Into Negotiations for a Consent Decree or Sue to Seek an Injunction to stop the Transaction

Who Has To File

- The Acquiring Person
- The Acquired Person
  - The Seller is not necessarily the Acquired Person
  - The Acquired Person is not necessarily the Acquired Entity

Some Definitions

- Person – A Person Means an Ultimate Parent Entity and All Entities It Controls Directly or Indirectly
- Ultimate Parent Entity – An Entity Which Is Not Controlled By Any Other Entity
- Entity – Any Natural Person, Corporation, Company, Partnership, Joint Venture, Association, Trust, Estate, Foundation, Fund, Institution, Society, Union or Club et al.

Control

- Re Corporations
  - Holding 50% or more of the voting securities
  - Having the contractual right to appoint 50% or more of the Board
  - Having the right to select 50% or more of the Board by virtue of a combination of holding voting securities and having the contractual power to appoint member to the Board
- Re Partnerships and LLC's
  - Having the right to 50% or more of the profits or
  - Having the right to 50% or more of the assets upon dissolution
    - Note that control of a partnership or LLC is not based on legal or defacto ability to direct the business activities of the entity, such as a General Partner of a Limited Partnership.

Jurisdictional Requirements

- Commerce Test
  - A person must be engaged in commerce
- Size-of-Person Test
  - One Person must have sales or assets of $10 million
  - The Other Person must have sales or assets of $100 million
  - In transactions valued at more than $200 million, the Size-of-Person Test is eliminated
- Size-of-Transaction Test
  - Transaction must be valued in excess of $50 million

When to File Checklist

- Asset Acquisition: Assets valued at more than $50 million (including value of assumed liabilities) ; $10 million and $100 million persons (except if transaction is valued at more than $200 million, in which case there is a filing despite size-of-persons)
- Stock Acquisition: Voting securities valued at more than $50 million; $10 million and $100 million persons (except if transaction is valued at more than $200 million, in which case there is a filing despite size-of-persons)
- Formation of Partnership: Never Reportable
- Acquisition of Partnership Interests: Not reportable unless 100% of the partnership interests are being acquired, in which case transaction is treated as an acquisition of the underlying asset of the partnership
- Formation of Limited Liability Corporation: Reportable if two or more pre-existing businesses are contributed and at least one member will have control of the LLC.
- Formation of Joint Venture Corporation: Any contributor who will receive more than $50 million of Newco stock provided that there are at least two $10 million persons and one $100 million person. If stock to be acquired exceeds $200 million, that person has to file even if the joint venture Size-of-Person test is not satisfied.
- Secondary Acquisition: If Company A acquires control of Company B and Company B holds stock of Company C valued at more than $50 million, Company A will have to file separately to acquire the stock of Company C (provided Size-of-Person test is satisfied).

Exemptions

- Even if Jurisdictional Tests are met, a filing may not be required because it is exempt.
- Some exemptions:
  - If you already hold 50% of the voting securities
  - Ordinary Course Transactions
  - Realty Exemption (but not casinos, race courses or ski facilities)
  - Exemptions of Foreign Assets or Voting Securities
  - Up to 10% if for Passive Investment Only
  - Carbon-based minerals (with limitations)
  - Acquisitions that do not raise pro rata share of stock held; stock spin-offs

Types of Transactions

- 801.30 Transactions
  - Acquisitions of voting securities from parties other than the issuer or the ultimate parent of the issuer
  - Waiting period begins when acquiring person files
  - Types: Open market or third party purchases, tender offers, secondary acquisitions, conversions, exercise of warrants or options
  - Need for Notice Letter to be sent to Acquired Person

- Non 801.30 transactions
  - Based on agreement, letter of intent or agreement in principle between the parties, one of whom is issuer or ultimate parent of issuer
  - Asset purchases
  - Waiting period begins when both parties file

Early Termination

- Parties may routinely seek early termination; no reason required
- No prejudice for asking or not asking
- If granted, names of parties and whether it is a stock or asset deal becomes public soon after grant
- If not sought, and waiting period expires, there is no publication by government

Confidentiality

- All materials submitted in connection with HSR filing are confidential and are not subject to disclosure under FOIA
- Limited Exceptions: Congress may obtain materials or they may be discovered in litigation or administrative procedure
- State Attorneys General do not have right to obtain HSR filings
- Foreign governments do not have right to obtain HSR filings

Filing Fees

- The obligation is on the acquiring person
- This may be negotiated
- Based on value of assets or voting securities held as a result of the acquisition
- Three-tiered fee schedule:
  - $45,000 - for transactions of more than $50 million up to $100 million;
  - $125,000 - for transactions of more than $100 million up to $500 million
  - $280,00 – for transactions of more than $500 million

Notification thresholds

- Formerly $15 million, 15%, 25% and 50%
- Now $50 million, $100 million, $500 million, 25% if valued at more than $1 billion and 50%

Rule §802.21

- Rule §802.21 permits a party to acquire up to the limit of the notification threshold for which it initially filed within five years without having to refile or pay an additional filing fee
- Transitional Rule: for those who filed under the old thresholds, they have until the end of the five year period or February 1, 2002 (whichever comes first) to reach the limit of the threshold for which they filed

The HSR Form

- Not really substantive, unlike many other world-wide competition filings
- Information sought is theoretically readily available at company

Content of Form

- Deal description and valuation
- Certain SEC filings (10-Ks, 10-Qs, 8-Ks, Annual Proxy Statement, Schedule TO)
- Annual Reports to Shareholders and/or other financial statements
- Competitive documents (4(c) documents)
- Company revenues for base year (1997) and most recent year by NAICS codes
- Identification of subsidiaries and other controlled entities such as partnerships, LLCs or joint ventures
- Information about 5%-50% shareholders of parent and any non-wholly owned subsidiaries (not partnership interests or LLC membership interests)
- Identification of companies in which company has 5%-49% interest (not partnerships or LLCs)
- Overlap (of NAICS codes) with other party
- Prior acquisitions (by acquiring person)

§801.90 - Transactions or Devices for Avoidance

- "Any transaction(s) or other device(s) entered into or employed for the purpose of avoiding the obligation to comply with the requirements of the act shall be disregarded and the obligation to comply shall be determined by applying the act and these rules to the substance of the transaction."

- Trying to be a little too clever for one's own good
- Defenses:
  - Legitimate business purpose (not wanting to pay the filing fee is not a good enough reason)
  - Real economic impact on parties

FTC

YOU ARE NOT ALONE WHEN YOU CREATE A 4(c) DOCUMENT

What is a 4(c) document

- All studies, surveys, analyses and reports which were prepared by or for any officer(s) or director(s)(or in the case of unincorporated entities, individuals exercising similar functions) for the purpose of evaluating or analyzing the acquisition with respect to market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets…

Creating 4(c) documents

- Don’t do it
- Educate your colleagues
- Try to restrain the enthusiasm of your business people and financial advisors
- Avoid bad language

Antitrust Lexicon

- THE GOOD, THE BAD AND THE UGLY
  - The Good
    - Business segment
    - Product category
    - Customer base
  - The Bad
    - Markets
    - Market Shares
    - Price Leader
  - The Ugly
    - Dominate
    - Control
    - Crush
    - High Entry Barriers
    - Leverage Our Position

" 'When I use a word,' Humpty Dumpty said in rather a scornful tone, 'it means just what I choose it to mean – neither more or less.'

'The question is,' said Alice, 'whether you can make words mean different things.'

'The question is,' said Humpty Dumpty, 'which is to be master, that's all.'"

Lewis Carroll
Through The Looking Glass

What to look for

- Board Presentations containing discussion of competitive or strategic issues
- Board minutes if discussion covered competitive or strategic issues
- E-mails to or from officers that discuss competition, markets, etc.
- Pro forma financial statement or analyses of future sales, earnings if they contain assumptions related to sales growth or profits that may result from the proposed combination
- Presentations made by one party's management to other party's officers or directors if competitive issues are discussed

What more to look for

- Information packages, including offering memoranda or presentations prepared by seller or its investment bankers, if competitive issues are discussed
- Press releases, Q&As for press, public, investors including internet or intranet communications to employees, shareholders, etc. that discuss strategic impact of transaction
- Letters to shareholders, customers or employees explaining the strategic advantages of proposed transaction
- Handwritten notes of director or officer taken during board meeting, or banker's presentation if notes discuss competition, markets, etc.
- Notes made by an officer to use in connection with a presentation to Board which discuss competition, competitors, etc.
- Presentations made to bank to obtain financing if strategic issues are discussed

Typically Not 4(c)

- Earlier drafts of documents (unless earlier version went to Board) or financial models
- Documents prepared in the ordinary course of business, e.g., business or strategic plans
- Documents prepared for other regulatory filings, e.g., EU, FCC, SEC

Locating 4(c) documents

- Identify potential sources and recipients
  - Deal team
  - Inside & outside directors and their staffs
  - Preparers of Board materials and attendees at Board meetings
  - Outside consultants such as financial advisors and investment bankers

Collecting 4(c) documents

- Contact all potential sources and recipients by phone, e-mail or memo
  - Request that they return responsive documents or sign off that they do not have any responsive documents
- Collect documents
  - Identify documents by source
  - Note author, date of preparation and context of preparation
  - Be overinclusive initially
  - Consult with outside HSR counsel
  - Keep record of documents eventually excluded with explanation for their exclusion

Go To Jail: Do Not Collect $200

- Not really 
- Penalties for Failure to Produce 4(c) Documents
  - Filing deficient; restarts waiting period
  - If deal has already been consummated, civil penalties of up to $11,000 per day for each day in violation
    - Penalties of almost $3 million have been assessed
      - Automatic Data Processing - $2.97 million
      - Blackstone- $2.785 million
  - Person certifying may also be liable
    - Blackstone case

Merger Review Process

- HSR Filing Made; Waiting Period begins
- Each Agency Reviews Filing
- Early Termination
- Interested Agency Seeks Clearance
- Period of Voluntary Compliance
- Waiting Period Ends or Second Request Issued
- Waiting Period Tolled with Issuance of Second Request
- Second Request Modifications Sought
- Second Request Complied With
- Waiting Period Restarts
- Agency Goes Away, Negotiates or Sues

Second Request

- Burdensome and costly
- Requires responses to detailed interrogatories and extensive document production
- Specific Guidelines about how materials are to be produced
- Privilege Log
- Certification
- Substantial Compliance

Appeals Process

- Agency Prosecutor, Judge and Jury
- Agencies have become a little more sensitive to burdensomeness of process
  - Initial Senate version of HSR amendment placed real constraints on agencies and created a hearings process before independent Federal magistrate
  - Final version of bill restored appellate review to senior officer of agency but requires agencies to continue to work of streamlining process and reporting to Congress of reform efforts.
- Modification and Appeals Procedure in Place
  - Appealing modification requests
  - Appealing substantial compliance issue
- Substantial Compliance
  - They know it when they see it

The End Game

- 30 day waiting period restarted (except cash tender offers and filings in bankruptcy – 10 days)
- Waiver of 30 day limit
- Outcomes
  - Agency Goes Away
  - Negotiate toward consent decree
  - Go to court
  - Abandon deal

Recent Enforcement Actions

- FTC v. The Hearst Trust et al.
  - Deal closed
  - Customers complained
  - FTC opened investigation and subpoenaed documents
  - Discovered 4(c) documents that were not included in original 1997 filing
  - Complaint alleges continuing HSR violation from December 1997 to present
  - Parties currently in negotiation
  - FTC seeking divestiture and disgorgement

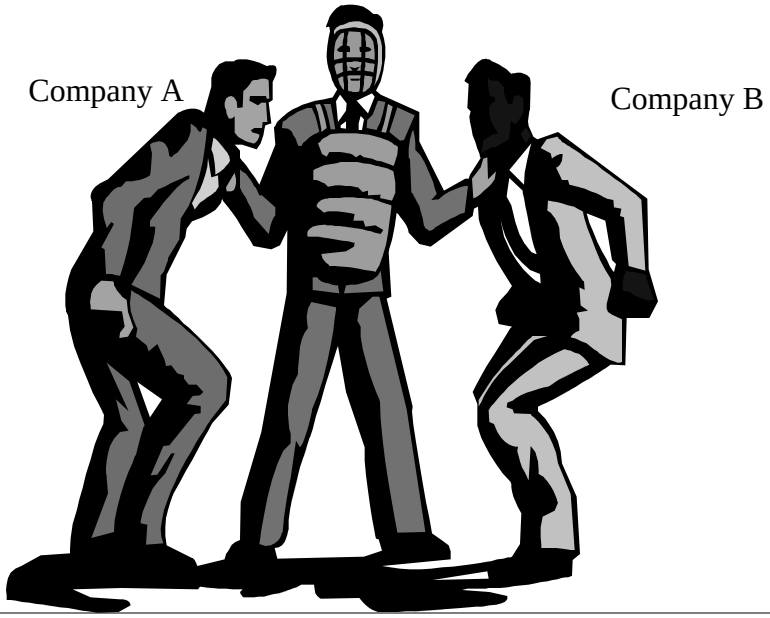
Gun-Jumping

- United States v. Computer Associates International, Inc. (“CA”), Platinum technology International inc. (“Platinum”)
- Both CA and Platinum Parties to the Litigation
- Civil Penalty of $1.267 million sought to be split between parties
- Bad Conduct
  - Extraordinary conduct of business restrictions in merger agreement
  - Even during pendancy of waiting period CA installed one of its employees at Platinum’s headquarters to review and approve customer contracts and undertake other activities related to management of Platinum
    - CA need to approve any contract that provided for discounts of more than 20% off list price or that amended standard contract terms.
    - CA reviewed competitively sensitive information about Platinum’s customers and business strategy
    - CA made other day-to-day management decisions

United States v. Input/Output, Inc. and Laitram Corporation (1999)

- During pendancy of waiting period, Input/Output, Inc. ("I/O"):
  - Circulated internal memo announcing the reorganization of I/O and assigning digiCOURSE (acquired entity) officers to positions within I/O
  - Transferred 3 persons from digiCOURSE'S sales office to I/O's sales office, receiving I/O e-mail addresses and having access to I/O's internal reports and e-mail systems
  - Gave the 3 persons business cards with I/O titles and distributing them to digiCOURSE customers
  - Had president of digiCOURSE travel to Europe to resolve a dispute between I/O and one ots customers and to accept a settlement on behalf of I/O
  - Consulted with President of digiCOURSE re another potential acquisition of a competitor

You Are The Man



Pre-closing Information Exchanges

- Do not exchange competitively sensitive information that goes beyond due diligence and is not needed to assess value of the target
- Do not implement integration plans
- Maintain economic independence of parties and their competitive relationship, i.e., do not create a Copperweld unity of interest situation

Some Specifics

- Re Joint Bids:
  - Request must come from customer
  - Market conditions may permit joint proposal
  - If contract is to begin before closing
    - Should be a joint venture or combined proposal from both parties
    - Made by one lead firm with participation of other
    - Separate competitive proposals
  - If contract is to begin after closing
    - Either of the above or
    - In name of new company

Other Do's and Don'ts

- Do not exchange customer lists or information, contract provisions or allocate customers
- Do not exchange pricing information or strategies
- Do not agree or consult re standards or strategies for extending credit
- Do not agree to or discuss planned or possible withdrawal from particular markets or lines of business
- Do not agree or consult about introduction of new products, responses to competition from other competitors, new marketing strategies or techniques

Other Do's and Don'ts

- Do not exchange, coordinate or discuss prices paid for services from outside vendors
- Do not exchange, coordinate or discuss agent commission rates or broker fees or information on future commissions or brokers fee
- Do not discuss agent consolidations or terminations
- Do remain vigilant about gun-jumping behaviors
- Do always ask yourself "Would my company be compromised competitively if the other side had this information and the deal fell through?"

THE END

