

FTC Proposes New HSR Rules Exempting Certain Under-10% Investments and Aggregating Within Fund Families

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What You Need To Know:

- Proposed new rules would exempt some under-10% investments not currently exempted because not deemed made “solely for the purpose of investment.”
- Proposal would expand the definition of “person” to include “associates,” resulting in additional HSR filings by investment funds within a family of commonly-managed funds.
- Whether to proceed with proposed rules changes along these lines will be decided by FTC and DOJ after receipt of public comments received during a 60-day comment period.

The Federal Trade Commission, by a 3-2 vote along party lines, has proposed for public comment two major changes to its Hart-Scott-Rodino (HSR) Act premerger notification rules.¹ These changes would exempt from HSR filing some under-10% investments² and would require some additional filings by aggregating investments by funds within a family of commonly managed funds.³

Exempting Some Additional Under-10% Investments

The HSR Act exempts from premerger notification and waiting requirements certain categories of transactions and grants the Federal Trade Commission (FTC), with the

concurrence of the DOJ Antitrust Division, authority to exempt (via notice-and-comment rulemaking) additional types of transactions that are not likely to violate the antitrust laws.

One class of statutorily exempted transactions is certain under-10% acquisitions: those that are made “*solely for the purpose of investment.*” The HSR rules provide that in order to come within this exemption, the acquiring person must have “*no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.*”

While the FTC and the DOJ have construed this exemption narrowly, many in the bar and the business community (and at times, the agencies

¹ https://www.ftc.gov/system/files/documents/federal_register_notices/2020/09/p110014hsractamendnprm09182020_0.pdf?utm_source=govdelivery

² As used herein, “under-10%” refers to acquisitions of voting securities that result in the acquiring person holding 10% or less of the voting securities of the target issuer.

³ The Commission simultaneously (by unanimous vote) issued an Advance Notice of Proposed Rulemaking seeking input of several topics to help inform possible future rulemaking efforts. https://www.ftc.gov/system/files/documents/federal_register_notices/2020/09/p110014_hsr_act_-_anprm.pdf. These topics include how to determine the size of transaction, real estate investment trusts, noncorporate entities, and transactions or devices for avoiding HSR.

themselves) have asked whether all under-10% investments should be exempted from HSR as being unlikely to violate the antitrust laws.

The FTC is now proposing exempting more but not all under-10% investments. The thrust of the proposal is that under-10% investments should be exempt from HSR unless the acquiring person already has some type of competitively significant relationship with the issuer. Accordingly, they proposed to carve out from the expanded exemption instances where (1) the acquiring person is a competitor⁴ of the issuer, (2) the acquiring person holds more than a 1% interest in a competitor of the issuer, (3) there is an officer or director relationship (e.g., the investor is an officer or director of the issuer), and (4) there is a significant vertical relationship between the parties.

Expanding the Definition of Person as It Affects Investment Funds

A key concept under the HSR rules that affects both whether a transaction triggers HSR notification and the information that must be provided in a notification is the definition of "person." Person is defined as an "ultimate parent entity" and all entities that it "controls."

As these terms are defined and applied, each individual investment fund is typically its own person even if it is managed by an entity that manages other funds. Accordingly, if Funds A, B, and C are under common management, the holdings of each fund are not aggregated in determining whether the HSR size of transaction threshold is met; similarly, if Fund A is required to file, the information that it provides regarding itself is *generally* limited to information about itself and not the related funds B and C.

Recognizing that *entirely* limiting the information in such a filing to information about Fund A could cause the agencies to miss anticompetitive acquisitions (e.g., the target in Fund A's acquisition is in a concentrated market where Fund B owns a close competitor), the agencies in 2011 introduced the concept of "associates," capturing the managing entity and commonly managed funds as associates of the particular fund that is the acquiring person. The HSR Notification Form was revised accordingly so as to solicit limited information regarding those associates of the acquiring person (or any entities in which an associate had at least a 5%

stake) that derived revenue in the same six-digit North American Industry Classification System (NAICS) Code as the target.

The FTC is now proposing to expand the definition of person to include "associates." This change would affect investment funds in two respects.

First, it would affect whether HSR is triggered, by requiring aggregation across funds. In the example above of three related funds, if each fund planned to acquire \$40 million of voting securities of Target X, this would be treated as a \$120 million transaction that would likely trigger HSR because the current \$94 million size of transaction threshold would be exceeded, instead of the current treatment as three separate \$40 million acquisitions.

Similarly, for purposes of determining if the HSR "size of person" test is met, the assets of commonly managed funds would be aggregated. Currently, if a new fund is created within a fund family, it will often not have to file for its first acquisition because it is allowed to deduct from its total assets the cash to be used for the acquisition. Under the proposal, however, the assets of its associates would be included within the acquiring person.

The second change affecting investment funds would be that some additional information would need to be provided on the Form itself. For example, the NAICS Code revenue information that is required pertaining to the person would include such information regarding associates, as they would be included within the person.

While the FTC's Notice of Proposed Rulemaking does not link the expansion of the definition of person to the proposed new under-10% exemption, the expanded definition of person seems to be a means of limiting the new under-10% exemption within intended boundaries. Without the expanded definition of person, the proposed new exemption could allow a family of funds to amass much more than a 10% stake in an issuer without ever triggering HSR notification. For example, to pose an extreme case, six commonly managed funds would otherwise each be able to acquire a 9% interest in a target in six HSR-exempt transactions.

⁴ The proposal would define "competitor" as either having revenue in the same six-digit NAICS Code or operating in the same line of business.

What Happens Next?

Publication of the Notice of Proposed Rulemaking in the Federal Register, which should occur shortly, will trigger a 60-day public comment period. The agencies will then review the comments and, under the Administrative Procedures Act, must address the substance of the comments when promulgating any changes from the current rules.

When significant HSR rules changes have been proposed, the results have included no action being taken and rules being adopted that closely mirrored or varied more substantially from what was proposed. The process from proposal to final action has taken at least eight months.

The upcoming election may also affect prospects for the proposed rules. While HSR rule changes are seldom politically divisive, in this instance the three Republican commissioners voted in favor of publishing the proposed rules (and the assistant attorney general in charge of the Antitrust Division expressed support)⁵, and the two Democratic commissioners voted against issuing the proposal, voicing concern about exempting additional under-10% acquisitions.⁶

⁵ See <https://www.justice.gov/opa/pr/antitrust-division-supports-modernizing-merger-filing-exemptions-certain-investments>

⁶ See <https://www.ftc.gov/public-statements/2020/09/statement-commissioner-rohit-chopra-regarding-hart-scott-rodino-act> ("While the proposed rule closes a loophole when it comes to investment manager holdings, the proposed approach to exempt a wide swath of minority stakes is concerning and adds to existing information gaps."); <https://www.ftc.gov/public-statements/2020/09/statement-commissioner-rebecca-kelly-slaughter-concerning-premerger>

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