

## U.S. ANTITRUST AGENCIES PROPOSE SIGNIFICANT CHANGES TO THE HSR ACT'S RULES FOR INVESTMENT ENTITIES AND MASTER LIMITED PARTNERSHIPS

On September 21, 2020, the Federal Trade Commission ("FTC") and the Antitrust Division of the Department of Justice ("DOJ") (jointly, the "US Antitrust Agencies") published proposed amendments to the rules implementing the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended ("HSR Act"),<sup>1</sup> which governs pre-merger antitrust notification filing ("HSR filing") requirements. There are two main proposed changes, the first of which could have a significant impact on financial investors, such as private equity firms, and other investors that often rely on master limited partnerships.<sup>2</sup> The other proposed change, while appearing to alleviate certain filings by creating a ten percent exemption, leaves important issues unanswered.

*First*, the proposed amendments expand the definition of "person" under the HSR rules to now include certain related "associates." The change will result in acquisitions becoming reportable that currently do not meet the HSR Act's filing thresholds and increase the scope of information required in the HSR filing. *Second*, the proposed amendments create a new *de minimis* exemption for certain acquisitions that would result in the acquiring person holding less than 10-percent of an issuer. This briefing will discuss each proposed amendment, beginning with a discussion of the US Antitrust Agencies' objectives and then

<sup>1</sup> The two Democratic Commissioners voted against the Notice of Proposed Rulemaking, but supported the Advanced Notice of Proposed Rulemaking, which is a more preliminary stage focused on information gathering. *FTC and DOJ Seek Comments on Proposed Amendments to HSR Rules and Advanced Notice of Proposed HSR Rulemaking*, <https://www.ftc.gov/news-events/press-releases/2020/09/ftc-doj-seek-comments-proposed-amendments-hsr-rules-advanced>.

<sup>2</sup> *FTC and DOJ Seek Comments on Proposed Amendments to HSR Rules and Advanced Notice of Proposed HSR Rulemaking*, <https://www.ftc.gov/news-events/press-releases/2020/09/ftc-doj-seek-comments-proposed-amendments-hsr-rules-advanced>.

evaluating the practical impact for firms impacted by the proposed changes.

Note that these are *proposed* amendments. The US Antitrust Agencies will publish in the Federal Register a Notice of Proposed Rulemaking<sup>3</sup> and an Advance Notice of Proposed Rulemaking<sup>4</sup> regarding the proposed changes and will receive comments for 60 days from the date of publication. The US Antitrust Agencies will then determine whether to proceed with the proposed rules.

### Definition of "Person" Under the HSR Rules

The first proposed amendment broadens the definition of "person" under the HSR rules.

Under the current rules, "person" means the ultimate parent entity ("UPE") and all entities the UPE controls.<sup>5</sup> A UPE is the entity at the top of the chain of "control," but which is not "controlled" by any other person or entity, with "control" meaning: a) for a corporation, no entity either (i) holds 50 percent or more of the outstanding voting securities or (ii) is contractually entitled to designate 50 percent or more of the board; or b) for an unincorporated entity, no entity either (i) has the right to 50 percent or more of the profits of the entity or (ii) has the right to 50 percent or more of the assets upon dissolution.<sup>6</sup> As a result of this definition, an investment fund, for example, may be considered its own UPE, even though it is commonly managed as part of a family of funds.

The US Antitrust Agencies believe that this definition of "person" results in fewer HSR filings than they would like to see and inadequate filings for certain types of commonly-managed investment entities. Interestingly, the European Commission's Joint Research Center has just released a 336-page report on the competitive impacts of common shareholding in Europe.<sup>7</sup> While the European Commission report and other research on common ownership has not clearly demonstrated that common ownership gives rise to competitive concerns, the issue appears to be a focus for enforcers in both the US and the EU.

In a first attempt to address the effects of investment funds serving as their own UPE, the US Antitrust Agencies introduced the concept of "associates" in a 2011 rule change.<sup>8</sup> An associate is a managing entity of the acquiring person and all other entities whose operations or investment decisions are managed by the same managing entity.<sup>9</sup> The "associate" concept generally only applies to investment

<sup>3</sup> Notice of Proposed Rulemaking, [https://www.ftc.gov/system/files/documents/federal\\_register\\_notices/2020/09/p110014hsractamendnprm09182020\\_0.pdf](https://www.ftc.gov/system/files/documents/federal_register_notices/2020/09/p110014hsractamendnprm09182020_0.pdf).

<sup>4</sup> Advance Notice of Proposed Rulemaking, [https://www.ftc.gov/system/files/documents/federal\\_register\\_notices/2020/09/p110014\\_hsr\\_act\\_-\\_anprm.pdf](https://www.ftc.gov/system/files/documents/federal_register_notices/2020/09/p110014_hsr_act_-_anprm.pdf).

<sup>5</sup> 16 C.F.R. §801.1(a)(1).

<sup>6</sup> 16 C.F.R. §801.1(a)(3).

<sup>7</sup> *Common Shareholding in Europe*, European Commission (2020), [https://publications.jrc.ec.europa.eu/repository/bitstream/JRC121476/jrc121476\\_jrc\\_commonshareholding\\_final.pdf](https://publications.jrc.ec.europa.eu/repository/bitstream/JRC121476/jrc121476_jrc_commonshareholding_final.pdf). The report noted that the study's results "for Europe are in line with those for the US: about 60% of US public firms in 2014 had common shareholders that held at least 5% both in the firm itself and in a competitor." In trying to analyze the competitive effects of such common ownership, the report noted with caution and numerous caveats that the study suggested there was a "positive association between common shareholding and the market power of firm," while also admitted that "[i]n reality, the phenomenon of common shareholding proved to be particularly complex, and disentangling its various effects continues to be challenging."

<sup>8</sup> 16 C.F.R. §801.1(d)(2).

<sup>9</sup> *Id.*

vehicles and master limited partnerships. Under the current rules, an HSR filing for an acquiring person must include the holdings of associates that generate revenue under the same six-digit NAICS codes as the target.<sup>10</sup>

In the agencies view, experience has proven the current definition of "person" is insufficient. As the Notice of Proposed rulemaking states, competitors do not always use the same NAICS code to describe the same line of business.<sup>11</sup> Associates are also not required to provide any substantive information, such as financials or revenues, about the entities they control.<sup>12</sup> The agencies are also concerned about multiple funds within a family of funds making acquisitions in a common target.<sup>13</sup> By way of **Example 1**, Funds A, B, and C (each of which is its own UPE) are all managed by the same Investment Manager. If the Investment Manager directs each fund to acquire \$40 million in shares of Issuer X, no filing would be required because none of the individual UPEs would acquire voting securities above the size of transaction threshold, even though the combined acquisition of \$120 million exceeds the filing threshold.

As a result, the agencies are currently proposing to change the definition of person to include both the acquiring entity's UPE and all of its associates.<sup>14</sup> This seemingly small change will significantly increase the burden on many financial investors in two ways:

### 1. **Increased filing obligations**

By expanding the definition of "person", transactions previously failing to meet the HSR Act's filing obligations will now trigger HSR filings. As in the example above, the holdings of Funds A, B, and C will now need to be aggregated. The result is a single transaction valued at \$120 million, satisfying the HSR Act's size of transaction threshold.

Similarly, previously funds or portfolio companies may have failed the HSR Act's size of person threshold (applicable to deals valued below \$376 million). By now including "associates" within the definition of "person," when such funds or portfolio companies make an acquisition, it is more likely that the acquiring person will now meet the necessary size of person threshold.

### 2. **Increased information required in HSR filings**

The proposed new definition and rules will also require substantially more information from funds and master limited partnerships in their HSR filings. If the proposed rules are enacted, funds would now need to include not only documents and information about the UPE and entities controlled by the UPE, they will also need to include expanded information from associates and the entities they control. In particular, funds and master limited partnerships will need to provide information about or documents in the possession of associates for Items 4 through 8

<sup>10</sup> HSR Form Instructions, at 9, [https://www.ftc.gov/system/files/attachments/form-instructions/hsr\\_form\\_instructions\\_9-25-19.pdf](https://www.ftc.gov/system/files/attachments/form-instructions/hsr_form_instructions_9-25-19.pdf).

<sup>11</sup> Notice of Proposed Rulemaking, at 11.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 7.

of the HSR filing.<sup>15</sup> These items include, but are not limited to: (a) financial reports; (b) documents prepared by or for any officers or directors analyzing the transaction with respect to competition, the market, competitors, opportunities or growth, or synergies; (c) financial information reported according to NAICS and NAPCS Code; (d) subsidiaries in the US or with sales into the US; (e) minority holdings that overlap with the target; and (f) prior acquisitions of entities that overlap with the target.

By way of **Example 2**: Assume there is Fund I, Fund II, and Fund III. Although each fund is its own UPE, all three funds share the same investment manager. Fund I is making an acquisition. The HSR form would now include documents and information from Fund I, Fund II, Fund III, and all of the entities each controls, such as portfolio companies. Most notably, given the often onerous task, the HSR filing would need to include revenue by NAICS and NAPCS for each of these entities. The proposed change would also require reporting all minority holdings of Fund I, Fund II, Fund III, or any entities they control that derive revenue in the same NAICS Code as the target.

The burden of collecting and reporting the additional required information should not be underestimated. This change would require the filer to collect and keep updated financial reporting from all associates as well as details about the businesses in the associates' portfolios.

## Ten-Percent Exemption

The second proposed amendment would create a new exemption from HSR filing requirements for the acquisition of 10 percent or less of an issuer's voting securities, with defined exceptions to the exemption.

The HSR rules require filings on the basis of the size of the transaction and in some cases the size of persons involved in the transaction. However, the rules also create numerous exemptions for different types of transactions that exceed these thresholds, but that the agencies do not expect to give rise to competitive issues. Under the current rules, there is an exemption for acquisitions of 10 percent or less of an issuer, if the acquisition is made "solely for the purpose of investment."<sup>16</sup>

The agencies have interpreted "solely for the purpose of investment" narrowly, so investors often face significant risk if they elect not to file.<sup>17</sup> Thus, many filings are made for transactions that pose no competitive concern. A recent retrospective study revealed that from FY 2001 to FY 2017, the agencies received a total of 26,856 HSR filings, including 1,804 for acquisitions of 10% or less of outstanding

<sup>15</sup> For acquired persons, the information required in Items 5-7 of the HSR filing will still be limited to the assets, voting securities, or non-corporate interests being acquired.

<sup>16</sup> 16 C.F.R. §802.9.

<sup>17</sup> The following is considered conduct inconsistent with an acquisition "solely for the purpose of investment": "(1) Nominating a candidate for the board of directors of the Issuer; (2) proposing corporate action requiring shareholder approval; (3) soliciting proxies; (4) having a controlling shareholder, director, officer or employee simultaneously serving as an officer or director of the Issuer; (5) being a competitor of the Issuer; or (6) doing any of the foregoing with respect to any entity directly or indirectly controlling the Issuer." *Statement of Basis and Purpose for the 1978 HSR Rules*, 43 FR 33450, 33465 (July 31, 1978), [https://www.ftc.gov/sites/default/files/documents/hsr\\_statements/43-fr-33450/780731fr43fr33450.pdf](https://www.ftc.gov/sites/default/files/documents/hsr_statements/43-fr-33450/780731fr43fr33450.pdf).

voting securities. During that same period, the US Antitrust Agencies did not challenge any acquisitions involving a stake of 10% or less.<sup>18</sup>

The new rule would go beyond the existing "solely for the purpose of investment" exemption and exempt all acquisitions that would result in the acquiring person holding 10% or less of the issuer, with carve outs. An acquiring person will not be eligible for an exemption if it:

1. is a competitor of the issuer;
2. holds 1% or more of the equity of any competitor of the issuer;
3. has a representative serving as an officer or director of the issuer or any of its competitors; or
4. has vendor-vendee relationship with the issuer.<sup>19</sup>

The term "competitor" is not currently defined by the HSR Act or the rules promulgated under it. Therefore, the amendments propose to define "competitor" as any entity that: (1) reports revenues in the same 6-digit NAICS code, or (2) that competes in any line of commerce with the issuer.<sup>20</sup>

The breadth of the proposed definition of "competitor" could undermine the use of the exemption or, at least, increase the risks of relying upon it. Six-digit NAICS code often sweep up a wide array of industries that do not, in reality, compete with each other in any meaningful sense. The circular nature of the second part of the definition – that a competitor is an entity that competes in any line of commerce – is less than clear and will place significant burden on filing parties to determine whether they believe the US Antitrust Agencies would agree that the acquiring person and acquired entity do not compete.

The concerns in relying on the proposed new exemption are exacerbated when one considers that the new definition of "person" would apply. To illustrate, in Example 2, assume Fund I is acquiring 5% of an issuer. Fund I could not rely on the proposed exemption if Fund II or Fund III hold even 1% of a "competitor." An entity wishing to avail itself of this exemption will thus have to analyze every entity within the new definition of "person" of which it holds more than 1% and determine whether those entities generate revenue in any NAICS codes that overlap with the issuer or otherwise "compete." For many firms, this inquiry could be prohibitively difficult.

## Conclusion

These proposed changes are aimed at ensuring that the US Antitrust Agencies are notified of potentially relevant transactions and that they receive appropriate information to assess the competitive significance of these transactions. However, the current proposal of broadening the definition of "person" will dramatically increase the burden on firms trying to comply with the HSR Act's requirements. And while the goal of the newly proposed exemption is commendable, the definition of "competitor" could trip up many acquirers, especially those with a wide portfolio of investments.

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<sup>18</sup> Notice of Proposed Rulemaking, at 7.

<sup>19</sup> *Id.* at 29.

<sup>20</sup> *Id.* at 31.

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If you have questions about the proposed rules and how they may impact you, please contact us.

Similarly, if you would like to make a public comment or otherwise respond to the proposals, please let us know. Public comments, which will be published in the Federal Register, are due within 60-days after the proposals are published. Recognizing that the proposal will increase the burden on certain parties, the US Antitrust Agencies have invited comments on alternative ways they could obtain more insight into families of funds and master limited partnerships within HSR filings.

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