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Practice Update

First Major Overhaul of HSR Act Will Greatly Increase Time and Resources Required to Complete HSR Filing

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In June 2023, the Federal Trade Commission (FTC), in conjunction with the Antitrust Division of the U.S. Department of Justice (DOJ), issued a Notice of Proposed Rulemaking to amend the premerger notification form and instructions, as well as the premerger notification rules that implement the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (HSR Act or the Act). This is the first major overhaul of the HSR Act since it was established in 1976. These changes will substantially increase the amount of information, resources, and time required to complete an HSR filing.

Given the breadth of the proposed changes to the premerger notification rules (HSR Rules) and the accompanying premerger notification form (HSR Form), this memorandum will (i) summarize the new HSR Rules and proposed changes to the HSR Form under review by the FTC, (ii) discuss the impacts such rules may have on clients, and (iii) provide certain recommendations based on the new requirements under the rules.

Additionally, it is important to highlight those aspects of the current HSR Rules that will not be impacted by the proposed changes. First, the proposed changes will not alter the statutory mandates for the types of transactions that must be

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reported (i.e., those subject to certain size of person and size of transaction tests) under the HSR Act. Second, the applicable waiting periods (i.e., typically 30 days for the initial review) will be the same. Lastly, the HSR filing, and all accompanying materials submitted with it, will continue to be confidential and exempt from the Freedom of Information Act.

Overview of Proposed Changes

I. Broader Scope of Information Required for HSR Form

The proposed changes to the HSR Rules require disclosure of more information in HSR filings to provide the FTC and DOJ more definitive insight into potential transactions and the intended relationship of the parties after closing. Accordingly, parties will no longer be able to submit a filing based on a bare bones letter of intent without also providing a draft term sheet or draft agreement that reflects "sufficient detail about the scope of the entire transaction." In addition, both parties will now have to submit narrative responses regarding ownership structures, business operations of the parties, transaction rationale, horizontal competitive effects, vertical and horizontal supply relationships, and potential labor market overlaps. These narratives will need to be prepared collaboratively between the filing entity and outside counsel. For each competitive overlap, the parties will need to provide contact information for their top customers; although whether the FTC will actually contact these customers will likely depend on the specific transaction. Preparation of such disclosure will result in significantly increased time spent preparing and negotiating narratives with the client and with the FTC.

II. Transaction Details

The proposed changes to the HSR Rules require the preparation of a more descriptive transaction structure along with an explanation of the various

entities involved in the transaction. The HSR Form will now need to include a detailed transaction timeline, including closing targets, extension provisions, and key payment dates and deadlines.

Given the heightened disclosure requirements, we recommend that clients implement procedures which regularly track and update newly required data. To accomplish this, clients will need to bring more individuals “inside the tent” prior to the announcement of a transaction.

III. Entity Structure

The rules require the preparation of entity structure charts which will need to disclose the following:

- Any entity that manages or is a general partner of an entity within the transaction structure.
- Co-investors, foreign investors, persons, or entities with nomination rights for board members or observers, and any other person holding 5 to 49.9 percent of any entity within the transaction structure.
- Creditors who provide 10 percent or more of the value of any entity within the transaction structure.
  Any existing investor who holds a 5 to 49.9 percent interest in entities controlled by the Acquiring Person (including certain controlled entities outside the transaction structure).
- Entities or persons who hold or will hold nonvoting equity, options, or warrants totaling (or to be converted to total) 10 percent or more of an entity within the transaction structure.
- Organizational charts that illustrate the relationships of all affiliates or associates (whether or not involved in the notified transaction).
- The disclosure requirements of the Acquired Entity would be limited to include identification of the name and percentage ownership of only those

5-to-49.9-percent minority interest holders that will continue to have such an interest in the Acquired Entity after closing.

- Principals, officers, directors, and board observers for all entities controlled by the filing party as well as any entity where such individuals act in a similar capacity.

The requirement to make such disclosures may discourage investments unrelated to the particular transaction by co-investors, creditors, or other influential entities that would not want their identity disclosed to the FTC or DOJ in subsequent HSR filings. Companies frequently involved in transactions requiring HSR filing should maintain this information on a regular basis to ensure it is readily available and accurate.

IV. Agreements

Under the rules, both parties will have to produce all transaction-related agreements (such as key employee retention agreements, transition services agreements, and future supply agreements), including any side letters, schedules, and exhibits. Both parties will also have to produce any existing or recently expired (within the last year) non-transaction-specific agreements between the parties such as existing supply, license, or collaboration agreements. Lastly, the Acquiring Person will have to disclose all entities within the transaction structure that have a pending or active procurement contract with the U.S. Department of Defense or any member of the U.S. intelligence community.

V. Document Retention

Prior to submitting an HSR filing, the parties will have to implement document retention procedures and attest to the accuracy of the contents of the party's filing. The filing parties will also have to attest that appropriate steps have been taken to prevent the destruction of information relevant to the

transaction. Lastly, each filing party will have to identify all communication applications on any system or device used to store or transmit information related to its business operation, as well as all document and data storage systems used by the filing party.

VI. Ongoing Disclosure Requirements

Following an initial HSR filing, the parties will need to produce materials prepared or modified within one year of the date of filing which are responsive to sections 4(c) or 4(d) of the rules. Under the rules, the documents that are responsive to 4(c) and 4(d) now include certain ordinary course resolutions and strategic plans. Foreign clients will need to submit verbatim translations of any documents responsive to 4(c) or 4(d).

VII. Labor/Workplace Safety

Under the proposed changes to the HSR Rules, the parties will have to produce Standard Occupational Classification (SOC) codes, as defined by the Bureau of Labor Statistics, for the five largest categories of workers employed by either party. In addition, the rules also require the disclosure of the aggregate number of classified employees in each Economic Research Service commuting zone, as defined by the Department of Agriculture, where both parties report an overlapping SOC code. Lastly, the rules require disclosure of any penalties or decisions issued against either the Acquiring Person or Acquired Person by the U.S. Department of Labor Wage and Hour Division, the National Labor Relations Board, or the Occupational Safety and Health Administration.

Increased Time and Financial Commitment

The proposed changes to the HSR Rules and HSR Form will require significantly longer preparation time for a filing. The FTC has estimated that the time needed to prepare an HSR filing could increase by up

to four times and some commentators have estimated that the time needed by certain large foreign companies to prepare an HSR filing could increase by up to ten times. Counsel will need to include additional specialists, such as labor counsel, to provide input on each filing. Additionally, the cost associated with preparing an HSR filing will equally increase dramatically given the increased time and resources needed to prepare one. The more complex a transaction (e.g., if the transaction involves a horizontal overlap or other competitive issues), the more resources and time will be needed to prepare the HSR filing. Given the increased time commitments, clients anticipating the need to make an HSR filing will need to begin the process well in advance of executing a definitive agreement.

Impact on Private Equity Transactions

In recent years, the FTC and DOJ have publicly placed greater scrutiny on private equity transactions. This has been evident not only in the public comments by agency leadership, but in recent enforcement actions targeting private equity firms, interlocking directorates, and "roll-up" acquisitions. The increased disclosure requirements are a clear example that the FTC and DOJ intend to make enforcement against private equity transactions a priority even where only limited substantive competition issues may be implicated.

Private equity sponsors should be aware that under the proposed rules, the process of preparing an HSR filing will become a more burdensome, lengthy, and costly exercise. Additionally, sponsors should be aware that the new HSR Rules will allow the antitrust agencies to collect and maintain information related to matters that have not been part of the traditional premerger review process and related competition analysis. Lastly, sponsors should be aware that these new HSR Rules increase the risk for investigations by the FTC and DOJ and the likelihood of challenges to transactions.

The proposed HSR Rules are, in part, designed to address a growing concern by the FTC and DOJ that LPs and co-investors may be exercising increased influence over strategic decisions of portfolio companies or getting extraordinary access to portfolio companies' competitively sensitive information. Given the increased disclosure requirements, private equity sponsors should verify if there are any prior notices or restrictions on disclosing the identity of a limited partner in a separate agreement.

Under the proposed HSR Rules, the parties would have to provide the following information, which was not previously required:

- For the buyer, an organization chart for all funds and master limited partnerships organized by the operating company or business.
- For the buyer, the identity of limited partners and minority shareholders up and down the chain of control and/or that may exert influence over the buyer, including:
    - those holding 5 percent or more, but less than 50 percent, of voting securities/ non-corporate interests for each entity up and down the chain of control between the buyer and its ultimate parent entity and any transaction-specific special purpose or co-investment entities;
    - lenders providing credit equal to 10 percent or more of the target's value;
    - holders of 10 percent or more of non-voting securities, options, or warrants;
    - management firms that have agreements to manage entities related to the transaction; and
    - investors that have board appointment rights for board members or board observers.
- Both sides would be required to disclose not only legal entity names, but all "dbas" and "street names" used in the prior three years.

- Both sides would be required to disclose for each entity within their organizational structure current and former (within the last two years) officers, directors, and board observers, as well as prospective officers, directors, and board observers.
    - To identify the potential for interlocking directorates, for each individual disclosed, the entities will also have to identify all other entities for which each individual currently, or within the last two years, has served as an officer, director, or board observer.
    - For the buyer, the identity of other interest holders up and down the chain of control is also required.

Conclusion and Key Takeaways

Clients will need to build sufficient time into their transaction timeline to account for the significantly longer time it will take to gather information not always maintained in the ordinary course of business but that will be required to prepare the HSR filing under the proposed changes. The parties will need to agree on realistic time periods post-signing of a definitive agreement to complete an HSR filing (instead of the typical five to ten business days). The proposed changes to the HSR Rules will impose significant record keeping requirements, especially for large private equity sponsors.

Parties should begin preparing the HSR filing before a definitive agreement is executed. While this will require parties to incur significantly more legal fees before consummation of a transaction is certain, it will save time and avoid delays post-execution. The proposed changes to the HSR Rules would significantly expand the scope of disclosures regarding prior acquisitions and would impose a more rigorous record-keeping requirement for parent or holding companies to track historical information.

Private equity sponsors planning to sell a portfolio company in an auction will need to carefully consider the categories of potential buyers to invite from an antitrust perspective. Private equity sellers would also need to consider both horizontal overlap and vertical relationships in their selection of a buyer. When conducting an acquisition as part of a roll-up strategy, the private equity buyers will need to consider whether the acquisition would result in an investigation by the FTC or DOJ. When a transaction is part of a series of acquisitions, the antitrust agencies will examine the transaction in the context of the whole series and consider the cumulative impact of the acquisition.
