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The FTC and DOJ Announce Substantial Changes to the HSR Filing Requirements

July 15, 2011

On July 7, 2011, the Federal Trade Commission ("FTC" or the "Commission") and the Antitrust Division of the Department of Justice (the "Division" or "DOJ") (collectively, the "Agencies") announced[1] substantial revisions to the Premerger Notification Rules and the Premerger Notification and Report Form (together, the "Filing Requirements") under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act"). These revisions are the first substantive changes to the Rules since 2005 and the most significant change since 1989, when substantial filing fees were implemented. The revisions will become effective in mid-August.[2]

[M]uch of the information that is no longer required was of little burden to produce, whereas the additional information required by the new filing requirements imposes a more substantial burden, which in some cases may be quite significant and require advance planning.

The Agencies have cited two primary goals of the reforms: (1) to streamline the Rules by eliminating items of information that have proved to be of little use to the FTC or the Division in evaluating the competitive effects of the reported transaction; and (2) to provide the Agencies with additional information relevant to their competitive effects analysis and not solicited under the current filing requirements. As discussed below, much of the information that is no longer required was of little burden to produce, whereas the additional information required by the new filing requirements imposes a more substantial burden, which in some cases may be quite significant and require advance planning.

OVERVIEW OF THE KEY CHANGES

Item 4(d) requires, for the first time, production of documents not created in connection with the subject transaction but nonetheless arguably relevant to the reviewing agency's analysis.

Item 4(d): additional competition-relevant documents

Item 4(d) broadens existing Item 4(c) to call for the production of three additional categories of documents. Significantly, Item 4(d) requires, for the first time, production of documents not created in connection with the subject transaction but nonetheless arguably relevant to the reviewing agency's analysis. The Agencies have stated that they believe Item 4(d) will not impose significant additional burden on filers and that the documents produced in response will in some instances significantly aid the screening process.

Item 4(d)(i) requires a filing party to submit any Confidential Information Memoranda ("CIM") prepared by or for officers or directors that relate to the sale of the target company. Only documents prepared within one year of the HSR filing date need to be submitted. CIMs often contain substantial data about the business of the target and are therefore potentially very useful to the reviewing agency. If no CIM was prepared, the filing party must submit any documents submitted to officers or directors of the purchaser meant to serve the function of the CIM.

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[1] The DOJ press release may be found at http://www.justice.gov/atr/public/press_releases/2011/272809.pdf.

[2] The Federal Register notice drafted by the FTC containing the final Rules, a Statement of Basis and Purpose, and a copy of the new Form may be found at http://www.ftc.gov/os/fedreg/2011/07/110707hsrfrn.pdf. The revisions will become effective 30 days after publication of this notice, which likely will occur in the next week.

Item 4(d)(ii) requires a filing party to submit any surveys, studies, analyses, or reports prepared by investment bankers, consultants, or other third-party advisors for any officer or director of the filing party for purposes of evaluating market shares, competitors, markets, and future sales prospects that specifically relate to the target company. The materials must have been developed during an engagement or for the purpose of seeking an engagement. Item 4(d)(ii) seems primarily intended to capture bankers' "pitch books," but the language is broad enough to cover all third-party advisors. Item 4(d)(ii) does not capture third party analyst reports or generic industry studies. Item 4(d)(ii) includes analyses produced by counsel; however, if those analyses are protected by the attorney-client privilege or the attorney work-product doctrine, they must be identified on a privilege log if not produced. As with Item 4(d)(i), only documents prepared within one year of the HSR filing date need to be submitted.

Item 4(d)(iii) requires filing parties to submit all studies, surveys, analyses and reports prepared for an officer or director evaluating or analyzing synergies and/or efficiencies to be realized from the proposed transaction. Financial models, which can be quite bulky, need not be produced unless they contain stated assumptions, without which such documents are unlikely to aid the Agencies in their analysis. Submission of such documents at the time of filing had previously been voluntary. The Agencies appear to believe that documents analyzing efficiencies that are created prior to filing are more likely to be reliable than those created at a later time in the investigative process.

Item 5(a): foreign manufactured products

For the first time, the filing requirements now require that filing parties who manufacture goods outside the U.S. for importation and sale into the U.S. provide revenues for such goods by 10-digit NAICS manufacturing code. The Agencies will use that information in connection with their evaluation of competitive overlaps, because imported goods may compete with domestically produced goods, especially in an increasingly globalized economy. The increased burden here is obvious: foreign subsidiaries almost certainly do not track revenues in this way at present. Accountants working in these subsidiaries will have to identify NAICS codes that describe their products and may want to put in place systems that track shipments by NAICS code on an ongoing basis. As with the new reporting requirements for "associates," described immediately below, the public comments concerning the substantial burden imposed by this requirement did not persuade the Agencies to abandon or modify the requirement.

Item 6(c) and Item 7: associated entities

Under Item 6(c), filing parties must now provide additional information about what are called "associates." Associates are non-affiliates of the acquiring company that have the right to manage the acquiring company, or are managed along with the acquiring company, under a common management agreement. Examples provided by the Agencies include: general partners of a limited partnership; other partnerships with the same general partner; other investment funds whose investments are managed by a common entity or under a common investment management agreement; and investment advisors of a fund. Filing parties must disclose the minority investments of associates of 5 percent or more that derive revenue in any of the same 6-digit NAICS codes as the target entity. The filing party also must include associates' holdings in reporting NAICS code overlaps between the parties to the transaction under Item 7.

The Agencies have long wanted to gather more information about the holdings of private equity and other investment funds. Specifically, the Agencies are concerned that a person or group could gain an effective majority of a target's shares, without this fact becoming known to the government, by spreading minority holdings across a number of affiliates. The new requirement is intended to prevent such "stealth" takeovers by soliciting information about funds that share common management with the filing party but that are not included within the same "person" as that term is used for HSR purposes.

The Agencies estimate that less than 20% of reportable transactions will be affected by Item 6(c), with most parties experiencing no change. Nonetheless, the burden imposed on some filers by the new reporting requirements, including large financial institutions, private equity firms, and oil and gas master limited partnerships, could be significant.

Elimination of unnecessary burden

The Agencies did streamline the filing requirements in certain respects by eliminating items that over time had proved to be of little use to them in the merger screening process. Filers will no longer be required to provide copies of SEC financial reporting documents or electronic links to those documents in the SEC's EDGAR database. Likewise, filers will no longer be required to provide a detailed breakdown of the voting securities to be acquired in the proposed transaction. Finally, filers will no longer be required to provide "base year" revenue data by NAICS economic code.[3] The elimination of these items is part of a longstanding FTC review program, now mandated by federal law,[4] to reduce unnecessary regulatory burden on business.

CONCLUSION

Foreign manufacturers likely to be subject to Item 5, along with private equity funds, other investment funds, and limited partnerships likely to be affected by the new associate reporting requirement of Item 6(c), should begin planning how they will gather such information in advance of their next reportable transaction.

The Agencies appear to have considered carefully the comments they received on the August 2010 draft, but in the end they made relatively few changes to the final version. The Agencies appear to believe that the burden imposed on filers by each new piece of required information is justified by the benefit that information will bring to the Agencies' merger screening process.

For some filers, the changes described above may require immediate action. Foreign manufacturers likely to be subject to Item 5, along with private equity funds, other investment funds, and limited partnerships likely to be affected by the new associate reporting requirement of Item 6(c), should begin planning how they will gather such information in advance of their next reportable transaction.

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[3] Current data will continue to be required.

[4] On Monday, July 11, 2011, President Obama signed an Executive Order extending to independent agencies, including the FTC, a mandate previously imposed on executive agencies to streamline, insofar as possible, regulations that could impede job creation. The same day, the FTC released an updated schedule calling for staff to review more than a third of the Commission's 66 rules and guides by the end of 2011.