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Axinn Antitrust Insight: FTC Proposes Massive Revisions to HSR Filing Requirements Amounting to a Fundamental Shift in the U.S. Merger Review Regime to Mirror European and Chinese Systems

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PRACTICE AREAS

Antitrust

On June 27, 2023, the FTC published for public comment the first major overhaul to the HSR form in decades. If adopted, the proposal would dramatically increase the amount of information that must be provided with an initial premerger notification, increasing both the burden on the parties preparing their forms and the likelihood that they will receive questions from the FTC/DOJ during the initial waiting period.

And because many of the new requirements are subjective and will necessarily have little prior precedent against which compliance can be judged, Staff will have a significant new tool to delay transactions by threatening to "bounce" the original filing for not adequately disclosing an overlap, a rationale for the transaction, etc. HSR practice does not currently allow the lengthy pre-notification process used in the European Union, United Kingdom, and other burdensome jurisdictions (from which the new rules draw inspiration) to ensure that filings will be deemed complete and in good order before they are formally submitted, so clouds of jeopardy and uncertainty will loom over all HSR filings if the amendments are adopted in their current form.

In accordance with a Congressional mandate, the proposed changes would require disclosure of economic subsidies from certain foreign governments and entities, including most notably China. The definition of "subsidy" is quite broad, including tax credits and government purchases, which will require parties to expand their due diligence into subsidy issues before making an HSR filing.

The proposed rules would also narrow parties' flexibility to file HSR based only on early-stage letters of intent. Taken together, the proposed revisions to the HSR rules—if they survive judicial challenges—will require companies engaged in M&A to be prepared to marshal the required information in a timely fashion to "start the HSR clock."

The public comment period is scheduled to run until August 28, after which the FTC will have to respond to comments and publish a final rule, so it is unlikely that these changes will become effective until the fourth quarter of 2023 at the earliest.

Significant Proposed Changes to the HSR Form

Under the FTC's proposal, the HSR form would be significantly reorganized and expanded so as to require the upfront submission in all deals of a variety of information that is currently sought by the FTC or DOJ (collectively, the "Agencies") either in post-filing "voluntary access letters" or in Second Requests.

New Obligations to Submit Narrative Responses: For example, the revised HSR form would for the first time require the parties to submit narrative descriptions not only of their current business operations, but also of any horizontal overlaps between the parties and their respective strategic rationales for the transaction, requiring parties to take substantive positions on market definition at an early stage likely to have ramifications throughout the deal review process. Parties would also be required to disclose proactively a variety of specific information about (i) any overlapping product or service, including annual sales for the prior two years, (ii) contact information for their top 10 customers overall and in each "category" of such customers they identify, and (iii) a description of any licensing, non-compete, or non-solicitation agreements related to each such product. The form would also require similar disclosures of certain vertical relationships between the parties (or between one party and a competitor of the other) involving "any product, service, or asset (including data)" over the preceding two years. Notably, at least as currently proposed, those requirements would not be subject to any market share or revenue threshold, but rather would apply to any horizontal overlap or covered vertical relationship, no matter how small or competitively insignificant.

New Obligations to Provide Labor and Employment Information: In keeping with the Agencies' recent focus on labor market competition, the HSR form would also require significant new disclosures related to employment issues. For example, the form would require the parties to identify their respective headcount in each of their five largest "standard occupational classifications" (as defined by the Bureau of Labor Statistics) and, for the five largest such classifications in which *both* parties employ workers, break those headcounts out by "commuting zones" (as defined

by the USDA's Economic Research Service). The form would also require the disclosure of certain pending or recently concluded enforcement actions brought by the Department of Labor, NLRB, or OSHA (whether or not related to the proposed transaction).

New Obligations to Identify Corporate Governance Information: Similarly, to support the Agencies' enforcement of Section 8 of the Clayton Act, which restricts interlocking directorates, and similar concerns under other statutes, the HSR form would for the first time require the parties to affirmatively list their directors, officers, and board observers for the prior two years (including, for buyers, those of entities that they control even if they have no relation to the proposed transaction). Both parties would also be required to identify any other companies for which those individuals serve, expect to serve, or have served within the prior two years as directors, officers, or board observers.

Additional Disclosure Obligations for Certain Transactions: The FTC proposal would also impose a number of specific disclosure obligations on specific classes of transactions. For example, filing persons would be required to disclose whether they have any existing defense or intelligence procurement contracts valued at $10 million or more, or any pending bids to obtain such contracts. The proposal would also make mandatory the currently voluntary question as to whether any non-U.S. competition regulator has been or is expected to be notified of the transaction (including the date of the notification or expected notification).

Modifications and Expansion of Certain Existing HSR Form Requirements: The FTC proposal would also increase disclosure requirements in a number of other areas covered by the current HSR form, such as by obligating the parties to provide a deal structure diagram and details/timing of key pre-closing conditions in addition to a narrative transaction description, requiring the identification of additional minority investors and holders of non-voting securities, increasing the geographic overlap information required for industries where competition tends to be in local or regional geographic markets (including the identification of franchisee locations where applicable), and requiring the inclusion of the "business name" along with legal entity names for subsidiaries. The proposal would also significantly expand the current requirement to disclose prior acquisitions in overlapping NAICS codes, by expanding the covered period from 5 years to 10 years, eliminating the exception for targets with assets and sales below $10 million, and requiring a response for the first time from acquired persons. The new proposed rules also

require production of complete translations of any responsive foreign language documents. These changes would be partially offset by some reduction in the sales data currently required in Item 5 of the HSR Form (most notably the elimination of the requirement for manufacturing entities to provide data by NAPCS code).

Overall, the result of these changes is a step-change increase in the burden of preparing HSR forms, particularly for large acquirers or private equity funds that may need to gather and submit information for businesses with little or no relationship to the transaction at issue.

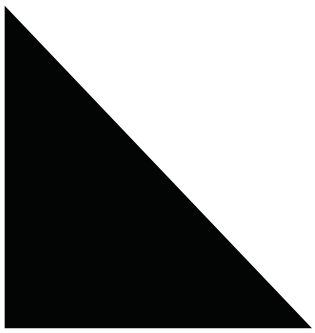
Expanded Document Filing Requirements

The FTC's proposal would also significantly expand the scope of documents that must be provided with an HSR filing beyond the current requirements of Items 4(c) and 4(d), in at least four ways.

First, the FTC would for the first time require the submission not only of transaction-related documents, but also of certain ordinary course competitive analyses. Specifically, it would require the submission of "all plans and reports" that were (i) provided to the Board of the acquiring or acquired entity (or any entity that it controls or is controlled by), (ii) prepared or modified within one year of the filing date, and (iii) that analyze "market shares, competition, competitors, or markets pertaining to any product or service also produced, sold, or known to be under development by the other party" to the transaction, whether or not those documents themselves discuss or relate to the transaction. It would also require the production of any such semi-annual or quarterly reports that were provided to the acquiring or acquired entity's CEO, the CEO of any entity that controls or is controlled by such entity, or such CEOs' direct reports, again without regard to whether they relate to the transaction.

Second, the proposed rules would expand the current requirement to produce Item 4(c) or 4(d) documents that were prepared "by or for" an officer or director to also include documents prepared by or for the "supervisory deal team leads" for a given transaction, i.e., the individuals who "functionally lead or coordinate the day-to-day process for the transaction at issue," whether or not they are officers or directors.

Third, the proposed rules would expand Items 4(c) and 4(d) to require the production not only of final documents, but also of draft documents that were shared with an officer, director, or "supervisory deal team lead." This change will put a premium on the training of the often relatively junior



personnel who typically prepare initial drafts of deal documents and are more likely to use careless or inaccurate terminology that may tend to attract investigatory interest.

Finally, the form would require the submission of any agreement between the acquiring person and any entity within the acquired person (whether or not part of the transaction) that is either in effect at the time of the filing or at any point in the preceding year. The FTC explains that as necessary to "reveal any business interactions or relationships that exist prior to the transaction and that may be affecting premerger competition," but it could create substantial burden, particularly for transactions between companies with multiple lines of business that may interact in unexpected (and benign) ways.

Restricting Filing Based on Letters of Intent

Under current law, parties can file an HSR as soon as they have any executed agreement, even if it is only a short, non-binding letter of intent. The FTC proposes to reduce the number of those early filings by requiring the submission of a "term sheet or draft agreement that reflects sufficient detail about the proposed transaction to allow the Agencies to understand the scope of the transaction and to confirm that the transaction is more than hypothetical."

Requiring Document Preservation

Although it is certainly best practice under current law to issue a litigation hold when a Second Request is known to be imminent, parties do not today uniformly suspend their document retention policies for "routine" HSR notifications that do not appear likely to raise antitrust concerns. The FTC's proposed rules, however, would add an affirmative obligation to do so, requiring the signatory to the HSR to certify that the company has taken "the necessary steps to prevent the destruction of documents and information related to the proposed transaction before the expiration of any waiting period." Related to that requirement, the FTC also proposes to require each HSR filing to "identify and list all communications systems or messaging applications on any device . . . that could be used to store or transmit information or documents related to its business operations" (and implicitly ensure that any such systems, including IM systems, don't delete business-related documents during the waiting period).

Foreign Subsidy Reporting

Last year, Congress enacted a requirement that parties making HSR filings disclose whether they had received subsidies from a "foreign entity of concern" and directed the FTC, in consultation with the DOJ, CFIUS, and other relevant agencies, to publish rules to make that requirement effective. The FTC's proposal would apply to entities that receive a "subsidy" (as that term is defined in the Tariff Act to broadly include a range of financial contributions, including tax credits or exemptions) from a number of countries and entities that "threaten U.S. strategic or economic interests," including the governments of China, Russia, Iran, or North Korea or any agency or arm of those states. It then requires three disclosures:

First, filing parties would have to describe any such subsidy received in the last two years, based on their knowledge and belief following good faith diligence; the FTC invited public comment on whether there should be a de minimis exception to that requirement, but has not yet proposed such a limit.

Second, parties would also have to disclose which of their products are produced in any of those countries of concern and are subject to "countervailing duties" in the U.S. or any other jurisdiction.

Third, parties would have to identify which of their products, based on their knowledge or belief, are produced in whole or in part in a covered country that is currently the subject of an investigation in any jurisdiction for potential countervailing duties.