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Client Alert

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FTC and DOJ Propose Changes to the HSR Premerger Notification Form

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On June 27, 2023, the FTC and DOJ (the Agencies) jointly announced proposed changes to the HSR premerger[1] notification form. The Notice of Proposed Rulemaking, which appeared in the Federal Register, includes provisions that will require parties to submit substantially more information to the agencies.[2] These sweeping proposals, if adopted, would fundamentally alter the merger review process in the U.S., potentially adding many months to deal timelines. This will necessitate parties either to start filing preparations much earlier than is current practice, or accept a meaningful increase in time between signing and closing.

The current HSR filing and review process, recognized internationally as a model of efficiency, only requires substantive information after a fling is made if questions are raised by the Agencies. Typically, during the initial waiting period, information is required in response to voluntary information requests. If the Agencies continue to have questions, the parties respond to a Request for Additional Information (aka a Second Request). The rationale for this system is that most transactions that require an HSR filing do not raise antitrust issues, which is consistent to the Agencies' own data (e.g., for the most recently reported fiscal year (2021), the FTC and DOJ challenged only 1.2% and 0.7% of HSR reportable transactions, respectively).3

While these proposed changes would bring the HSR filing process more in line with the front-loaded European Commission's (EC) Form CO's and UK Competition and Markets Authority (CMA) requirements, in several key ways, the proposed HSR rules would exceed what is required by these authorities. For example, neither the EC nor the CMA request ordinary course business documents, information about minority interests or interlocking directorates.

Although the FTC and DOJ stated that the intent of the revised form is to "more effectively and efficiently screen transactions," the new information requirements would impose significant new costs on all reportable transactions that likely will extend the HSR filing process – and therefore

merger review timelines – by several months. Indeed, even according to the Agencies, the time required to prepare a typical HSR filing will jump from 37 hours to 144, imposing additional costs along with longer timelines.

We believe that the Agencies' time estimate is understated. Based on our decades of experience and with merger filing processes in other jurisdictions like the European Union and the UK, our view is that the actual time and associated additional costs will be substantially longer and higher.

This estimate is not even taking into account the fact that the Agencies may face difficulties in absorbing the volume of additional information accompanying each HSR filing under the proposed rules. Indeed, even with the current HSR form, the Agencies have made changes to their review process that have extended deal timelines. With the support of DOJ, the FTC suspended the granting of early terminations (note, when first announced in February 2021, the suspension was only to be for a "brief period of time;"[4] it has now effectively become a permanent suspension) to ensure they could review filings using the current HSR form. In other words, the initial 30-day HSR waiting period could not be terminated early (typically, this occurred 10-14 days after the HSR filing). With the proposed changes, this 30-day waiting period is likely to effectively extend to at least 60 days for deals with some competitive overlap, with even more time likely to result[5] unless the current staffing and organizational structures are changed and the HSR clearance process, which decides which agency will review a transaction, is revamped.

INFORMATION REQUIRED UNDER THE PROPOSED RULES

According to the FTC proposed rules, information that will need to be submitted under the new pre-merger notification requirements includes:

1. Final agreements, draft agreements or term sheets "[describing] with sufficient detail the scope of the entire transaction." **Bare-bones letters of intent will no longer suffice.**
2. Additional information about corporate structure, controlling entities, and subsidiaries.

- The new rules require **additional information about subsidiaries**. Under these rules, parties would have to list any subsidiaries by operating company or business, rather than geographically or alphabetically. Filing companies will have to provide not only the legal names of such companies, but also any other names used in the marketplace.
- **Minority shareholders and other non-controlling entities**. The proposed rules would require filing parties to provide information about certain shareholders controlling between 5-50% of parties, all entities directly or indirectly controlled by the acquiring entity, any entity directly or indirectly controlling the acquiring entity, and any entity within the acquiring person that has been or will be created as part of the transaction. This requirement would apply to limited liability partnerships, as well as other entity structures.
- Other **types of interest holders that may exert influence**. The proposed rules would also require filing parties to identify individuals who provide credit or hold non-voting securities, options, or warrants valued at 10% or more.
- **Information about officers, directors, and board observers**. The proposed rules would require parties to identify current and prospective officers, directors, and board observers of all entities within the acquiring or acquired entity, as well as those who hold nomination rights. In addition, parties must identify any other entities that these individuals have served for the two years prior to filing.

3. Detailed information about the transaction.

- **A description of the transaction**. The proposed rules would require the parties to describe the business not only of the Ultimate Parent Entity, but also all entities within the acquiring person.

- **Narratives explaining each strategic rationale for the deal**. These narratives must identify rationales relating to competition, plans for current or future products, and planned expansion into new markets. In addition, parties must identify which submitted documents support the stated rationales.
- A **transaction diagram** showing the deal structure.
- **All portions of the agreement**, including exhibits, schedules, side letters, non-compete agreements, non-solicitation agreements, supply agreements, and licensing agreements, including those that have expired or terminated within a year of filing.

4. Competition and overlaps. The proposed rules require additional information and documents to demonstrate competitive conditions and overlaps.

- **Additional transaction-related documents, including drafts**. The proposed rules call for drafts of documents responsive to items 4(c) and 4(d), whereas the current rules and practice require only final versions.
- In addition to **documents prepared by or for** officers and directors, the proposed rules would require documents prepared by or for "**Supervisory Deal Team Lead(s**)," who "functionally [lead] the deal team."
- **Ordinary Course documents**. Semi-annual and quarterly plans and reports, prepared in the ordinary course, which discuss market shares, markets, and competition within markets inhabited by both filing parties will also be required so long as they have been shared with an officer or director. The parties must provide the author, date, and organizational chart showing the authors of all such documents.
- A **competition analysis narrative** describing basic business lines, providing product or service information for all related entities, and identifying current and potential competitive overlap and relationships between the parties.
- A **horizontal overlap narrative** in which each party identifies its current and planned principal categories, products, and services. Parties must identify any submitted document that supports these narratives.
- A **supply relationships narrative** identifying any existing or potential vertical or supply relationships between the parties and reporting the sales and purchases between the parties or with other customers that use the product, services or assets of the filing person and compete with the other filing person.
- **Labor market analysis** that includes workforce categories, geographic information, and details on past labor / workforce violations.
- **Updated use of North American Industry Classification System ("NAICS") Codes**. Under the proposed rules, the Agencies will no longer require precise revenue amounts organized by code. Rather, filing parties would group the codes into five different levels of revenue: less than $10 million; between $10 million and $100 million; between $100 million and $1 billion; and more than $1 billion. Where two or more codes may arguably apply to a given product or service, parties would be required to submit both codes and clarify. For filers that contain more than one company or unit, the proposed rules would require the reporting of these codes to be broken down by unit, rather than aggregated across the entity. Furthermore, filers would be required to report pre-revenue and pipeline projects expected go generate over $1 million within the next two years.

5. Additional Information:

- **Breakdown of subsidies**, such as grants and loans, from foreign governments including China, North Korea, Russia, and Iran.

- Details about any existing or potential contracts with foreign defense or intelligence agencies valued at $10 million or more.
- History of acquisitions going back ten years, regardless of size.
- Any merger filings occurring in other jurisdictions.

IMPLEMENTATION TIMELINE

The FTC and DOJ will accept public comments about the proposed rules through August 28, 2023, barring a deadline extension. The agencies will undertake an additional review after the public comment period closes and then publish a final version. Due to the nature of the new requirements, the Office of Management and Budget (OMB) will also review the rules.

Given these factors and also looking at how long the process is taking for the FTC's proposed rules on non-competes (the proposed rules there were first announced on January 5, 2023 and were to go into effect after the 60-day comment period. It has now been 6 months since the rules were first proposed with the FTC now indicating that the rules will go into effect April 2024). In light of this, the proposed changes are not expected to go into effect for at least several months – or longer if the rules are challenged in court.

KEY TAKEAWAYS

The revised requirements have important implications for how companies should announce transactions and communicate with their stakeholders throughout the regulatory review process.

1. **Strategic rationale narrative**: Companies will need to submit to regulators at the outset of the review process a clear strategic rationale that articulates specific benefits of the transaction for a range of stakeholders, including consumers, employees, and local communities. The transaction narrative will need to anticipate and address regulatory and third-party concerns that may arise throughout the review process. To the extent that the transaction is notified in other countries, the narrative must also be consistent with positions taken across jurisdictions.
2. **Additional scrutiny**: There is a lower likelihood that certain transactions will "fly under the radar" given potential new requirements to disclose existing and planned horizontal and vertical overlaps.
3. **Putting past deals in context**: The potential disclosure requirement for transaction histories going back a decade could assist the enforcement agencies in attempts to draw unfavorable conclusions regarding acquirers' past M&A activity. It will be important for companies to be prepared to contextualize past acquisition strategies.
4. **Private Equity will face increased burdens** due to the proposed requirements requesting additional information about minority investors, limited partners, and corporate structure. The requirement that certain categories of information be broken down by individual entity, rather than aggregated, could prove particularly burdensome for these companies.
5. **Interlocking directorates**. The added requirements about directors, officers, and board observers reflect an attempt by the Agencies to detect and combat interlocking directorates. As such, filing companies will need to closely scrutinize directorates prior to filing.
6. **Start HSR preparations early**: It will be important to start HSR filing preparations early in anticipation of increased complexities and burden associated with an even longer U.S. antitrust regulatory review process. These issues could also extend to items such as maintaining investor support of the transaction and retaining employees during a longer transitional period and uncertainty for the parties.

7. **It may be more challenging to file transactions based on a letter of intent**. While still permitted under the proposed rules, more than a bare bones LOI will be required, and the parties will be required to provide drafts of the definitive agreements. In addition, the requirement for customer contact information puts the confidentiality of a proposed transaction at risk if the Agencies contact these customers.
8. **Mapping employee distribution and providing labor history**: Understanding how the potential new disclosures of employee locations and classifications, worker safety, and unfair labor practices (ULPs) will be organized and interpreted will be important so that filing parties develop strategies to explain significant employee overlaps or potential labor issues. This type of information will potentially allow the enforcement agencies to improve their ability to deploy labor market monopolization theories during deal challenges.

We will continue to monitor the development of these rules throughout the comment period and beyond. Please reach out with any questions you may have.

[1] See https://www.ftc.gov/news-events/news/press-releases/2023/06/ftc-doj-propose-changes-hsr-form-more-effective-efficient-merger-review.
[2] See https://www.federalregister.gov/documents/2023/06/29/2023-13511/premerger-notification-reporting-and-waiting-period-requirements.
[3] See https://www.ftc.gov/system/files/ftc_gov/pdf/p110014fy2021hsrannualreport.pdf.
[4] See https://www.ftc.gov/news-events/news/press-releases/2021/02/ftc-doj-temporarily-suspend-discretionary-practice-early-termination.
[5] This increase time would be consistent with the effective timeline parties face when making merging filings in other jurisdictions that have front-end loaded information filing requirements.