HSR AND ANTITRUST CONSIDERATIONS FOR PRIVATE EQUITY FIRMS IN M&A TRANSACTIONS

BY MALIKA LEVARLET, LEO CASERIA & ARIEL YEHEZKEL[1]

1 Malika Levarlet is a senior associate in the Corporate Practice Group in the Washington, D.C. office of Sheppard Mullin, Leo Caseria is a partner in the Antitrust & Competition Practice Group in the firm's Los Angeles office and Ariel Yehezkel is a partner in the Corporate Practice Group in the firm's New York office. He is the Co-Team Leader of the firm's Private Equity team.

I. INTRODUCTION

An increasing number of M&A transactions each year involve private equity firms. Like any other transaction, the parties in private equity deals must be cognizant of the filing requirements under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act") and the substantive requirements of the Clayton Act § 7, which prohibits transactions that may "substantially . . . lessen competition" or "tend to create a monopoly." Over the years, the HSR rules have been modified to target certain information specific to private equity firms and generally have been adding to the burden of the filing parties in private equity transactions. The requirements sometimes differ from those applicable to deals that do not involve private equity firms. This article discusses some of the HSR and antitrust issues that should be considered, and frequently arise, in private equity transactions.

II. DETERMINING THE REPORTABILITY OF A PRIVATE EQUITY TRANSACTION

Determining whether a private equity transaction requires the parties to prepare and file HSR forms, pay the required filing fee and observe the HSR waiting period prior to closing generally depends on whether the "size of transaction" and "size of person" tests are met. Private equity deals that may at first blush appear to be reportable are often determined not to be reportable after a thorough analysis.

In general, the size of transaction test is met if $80.8 million or more of assets, voting securities and/or non-corporate interests are being acquired. The size of transaction considerations are generally the same in private equity deals as they are in other deals.[2] Amounts used to pay transaction expenses and retention bonuses do not count toward the size of transaction thresholds. Similarly, repayment of debt does not count toward the size of transaction threshold (except in asset acquisitions). If a private equity firm is increasing its stake in an entity over time, it must remember to follow HSR aggregation rules and aggregate the current value of what has already been acquired with what will be acquired from the acquired person. Also, in the case of the acquisition of voting securities, there are three different filing thresholds and a new filing is required before a higher threshold can be exceeded. The amount of the filing fee differs depending upon the size of the transaction (at or in excess of $80.8 million, $161.5 million or $807.5 million).[3]

Even if the size of the transaction exceeds $80.8 million, a private equity deal can still be unreportable if the size of person test is not met. This test is based on the size of the acquiring and acquired persons. In general, the size of person test is met if one person has total assets or annual net sales of at least $16.2 million and the other person has total assets or annual net sales of $161.5 million or more, unless the value of the transaction is greater than $323 million, in which case the size of person test does not apply and the transaction is reportable.[4] For HSR purposes, a "person" refers to the Ultimate Parent Entity ("UPE"). A UPE is an entity that is not controlled by any other entity.

Private equity firms are typically structured as limited partnerships and are often their own UPEs because they are not controlled for HSR purposes by their limited partners or general partners.[5] The fact that a limited partnership is managed by a general partner is irrelevant to the HSR control analysis.

Accordingly, where the acquired person does not meet the larger size of person test, an acquiring fund may discover that the entire transaction fails the size of person test because it too, fails to meet the larger size of person test. Private equity firms should also be aware that a newly formed entity such as a new fund or a newly formed acquisition vehicle, which is its own UPE and does not have a regularly prepared balance sheet, may exclude from the "size-of-person" analysis the funds to be used for the acquisition, so long as the transaction value does not exceed $323 million. A fund that has only completed a few small acquisitions or investments may also fall into this category if it has no regularly prepared balance sheet.

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2 15 U.S.C. §18(a)(2)(B) (the $80.8 million threshold is for 2017). All HSR thresholds are adjusted annually and new thresholds go into effect each February.

3 These thresholds are for 2017.

4 15 U.S.C. §18(a)(2)(A) (the $16.2 million, $161.5 million and $323 million thresholds are for 2017).

5 For HSR purposes, "control" is different for corporations and unincorporated entities. Control of a corporation is defined as holding, directly or indirectly, 50 percent or more of the corporation's outstanding voting securities or having the contractual right to designate 50 percent or more of the board of directors. For unincorporated entities (i.e. limited liability companies and partnerships), "control" is defined as the right to receive 50 percent or more of the profits or 50 percent or more of the assets upon dissolution. 16 C.F.R. § 801.1(b).

III. INVESTMENT ONLY EXEMPTION FOR PASSIVE INVESTMENTS

Numerous and often complex exemptions to HSR reportability exist. If correctly applied, these exemptions can spare a private equity firm the time and expense of preparing an HSR filing and observing the waiting period. However, if incorrectly applied, or if circumstances change, a private equity firm can find itself facing a fine of over $40,000 per day for HSR noncompliance.[6] One common exemption that is relevant to private equity firms, which has generated some recent enforcement actions due to its misapplication, is the investment-only exemption for passive investments.

The HSR Act exempts acquisitions of up to ten percent of voting securities if they are made solely for investment purposes, regardless of the dollar value of voting securities acquired or held.[7] To qualify for this exemption, the acquirer must be a passive investor. Voting the stock will not eliminate the exemption, but getting involved in the business activities of the issuer will. This "investment-only" exemption has been interpreted narrowly, and alleged violations have been strictly pursued by the antitrust enforcement agencies in recent years.

The presence of any of the following factors can create a presumption that securities are not being held only for investment: "(1) nominating a candidate for the board of directors; (2) holding a board seat or being an officer; (3) proposing corporate action that requires shareholder approval; (4) soliciting proxies; (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."[8] Recent enforcement actions have shed additional light on these factors.

For instance, in 2015, the Federal Trade Commission ("FTC") entered into a settlement with three affiliated hedge fund companies and their management company, Third Point LLC, on charges that they violated the HSR premerger notification requirements by improperly relying on the "investment-only exemption" in connection with their 2011 acquisitions of stock in Yahoo! Inc. According to the complaint, "defendant Third Point LLC, which made investment decisions on behalf of the funds, took actions inconsistent with an investment-only intent, such as communicating with third parties to determine their interest in becoming the CEO or a board candidate of Yahoo." In addition, Third Point allegedly announced that it was prepared to propose an alternate slate for the board and assembled the alternate slate, sent a letter informing Yahoo that it was prepared to join the board, and internally discussed a possible proxy battle. Such actions will eliminate the investment-only exemption.[9]

More recently in 2016, the Department of Justice ("DOJ") announced that activist investor ValueAct Capital agreed to pay a record $11 million fine to settle allegations that it violated the notification requirements of the HSR Act. According to the DOJ complaint, ValueAct purchased shares of Halliburton and Baker Hughes after the two companies announced their merger, and while an antitrust review of the transaction was underway, with the intent to influence the companies' business decisions in connection with the merger and influence the outcome of the antitrust review. Specifically, the Complaint alleges that:

> ValueAct intended to use its position as a major shareholder of these companies to obtain access to management, to learn information about the merger and the companies' strategies in private conversations with senior executives, to influence those executives to improve the chances that the merger would be completed, and to influence other business decisions whether or not the merger went forward.[10]

As a result, it could not rely on the HSR "investment-only" exemption.

The antitrust agencies have made it clear that the intent of the investor is key to the applicability of the exemption. As a result, any private equity firm interested in relying on this exemption should consider whether its role might change from passive to active, and importantly, re-assess its intent upon each subsequent acquisition of additional shares of the same issuer. Likewise, additional acquisitions that bring a private equity firm's total holdings over 10 percent of the issuer's outstanding voting securities will eliminate the exemption.

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6 16 C.F.R. 1.98(a), 15 U.S.C. §18(a)(g)(1).

7 16 C.F.R. § 802.9.

8 See 43 Fed. Reg. 33,450, 33,465 (July 31, 1978); ABA Section of Antitrust Law, Premerger Notification Practice Manual, Interpretation 127 (5th Ed. 2015).

9 See: https://www.ftc.gov/news-events/press-releases/2015/08/third-point-funds-agree-settle-ftc-charges-they-violated-us.

10 See: https://www.justice.gov/opa/pr/justice-department-obtains-record-fine-and-injunctive-relief-against-activist-investor.

IV. UNDERSTANDING THE COMPETITIVE IMPACT OF THE PROPOSED TRANSACTION

There is sometimes a misconception that a private equity deal is not likely to generate any substantive antitrust concerns because it involves a financial buyer rather than a strategic buyer. While that may often be true, it is not always true, particularly where a private equity firm has already made prior acquisitions or investments in the same market segment. Indeed, the operations of their portfolio companies and those of their associates (explained in more detail below) will guide the competitive impact analysis of the antitrust agencies. Private equity firms should therefore remain cognizant of the potential competitive impact of any proposed acquisitions and analyze each of them carefully under the DOJ and FTC's 2010 Horizontal Merger Guidelines when designing and implementing their acquisition and disposition strategies.[11]

Recent transactions illustrate that antitrust agencies analyze the substantive antitrust issues facing M&A deals involving funds just as rigorously as in any other transaction. For example, hedge fund SPO Partners II, L.P. acquired Aggregates USA, LLC in 2010, but when it proposed to sell Aggregates USA to competitor Vulcan Materials Company in 2017, the DOJ and the State of Tennessee filed a complaint seeking to enjoin the proposed acquisition. According to the complaint, the two companies were the only producers of coarse aggregate in parts of Tennessee and Virginia, and their combination would result in higher prices and reduced service for customers in those areas. In December 2017, the DOJ required Aggregates USA to divest certain quarries and yards to resolve the department's competitive concerns.[12]

Similar results have occurred in other recent deals. In 2016, GTCR Fund X/A AIV LP and its subsidiary Cision US Inc. agreed to divest the public relations workflow software suites sold under the Agility and Agility Plus brands, as a condition of the acquisition of UBM's PR Newswire business, to prevent a duopoly in the provision of media contact databases to businesses and other organizations in the United States.[13] And in 2015, Cerberus, a private equity fund that was the majority owner of Albertsons, was required, along with Albertsons and Safeway Inc., to agree to sell 168 supermarkets to settle FTC charges that the proposed $9.2 billion merger of Safeway and Albertsons would likely be anticompetitive in 130 local markets in Arizona, California, Montana, Nevada, Oregon, Texas, Washington and Wyoming.[14]

As with any transaction, the substantive antitrust issues and risks depend on the specific facts relating to the market or markets affected by a proposed transaction.

V. PREPARING AN HSR FORM FOR A PRIVATE EQUITY FIRM

When a transaction involving a private equity firm is determined to be reportable and the HSR form must be prepared, there are certain unique issues that apply to HSR forms in private equity deals. These unique reporting considerations are the product of recent amendments to the rules and interpretations by the FTC. Over time, the antitrust agencies have been modifying their requirements in order to ensure that competitive issues that arise in private equity deals do not escape scrutiny, which has led to greater burdens on private equity firms.

For instance, Item 4(b) requires the submission of annual audited financials for the filing person and entity. The acquiring person must also submit unconsolidated financials for any controlled entity that generates revenue in a North American Industry Classification System ("NAICS") code from which the acquired person or entity also generates revenue. In other words, financials for entities contributing to horizontal overlaps must be provided. Prior to a September 1, 2016 amendment, a single consolidated financial statement covering the UPE and all controlled entities would have satisfied this requirement. This change was made because consolidated annual reports, particularly for funds, do not always provide sufficient information about the specific operating company that contributes to a horizontal overlap.[15]

Perhaps the biggest hurdle relating to the preparation of an HSR form in a private equity deal is the "associates" analysis and related reporting requirements that apply to acquiring persons. This was the product of a 2011 amendment. Item 6(c)(ii) of the HSR form requires an acquiring person to list minority holdings of its associates that contribute to a NAICS code overlap with the acquired person, and Item 7(b)(ii) requires an acquiring person to list operating companies controlled by its associates that contribute to a NAICS code overlap with the acquired person. The purpose of this addition was to close a gap in information regarding entities that are commonly managed with the acquiring person,

11 See: https://www.justice.gov/atr/horizontal-merger-guidelines-08192010#1.

12 See: https://www.justice.gov/opa/pr/justice-department-requires-vulcan-divest-17-aggregate-facilities-order-acquire-aggregates.

13 See: https://www.justice.gov/opa/pr/gtcr-agrees-divest-third-largest-media-contact-database-provider-us-order-proceed-acquisition.

14 See: https://www.ftc.gov/news-events/press-releases/2015/01/ftc-requires-albertsons-safeway-sell-168-stores-condition-merger.

15 See: https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1610008.

such as families of investment funds, but are not under common HSR "control." In order to provide this information, a private equity firm must first identify its associates.

16 CFR 801.1(d)(2) provides that an "associate" of an acquiring person is an entity that is not an affiliate of such person but: (a) has the right, directly or indirectly, to manage the operations or investment decisions of an acquiring entity (a "managing entity"); (b) has its operations or investment decisions, directly or indirectly, managed by the acquiring person; (c) directly or indirectly controls, is controlled by, or is under common control with a managing entity; or (d) directly or indirectly manages, is managed by, or is under common operational or investment management with a managing entity. The FTC offers numerous informal interpretations, as well as a 16-page "Decision Tree For Identifying Associates," to help identify associates.[16]

Examples of associated entities include the general partner of the UPE or other entities with the same general partner. As mentioned above, private equity funds are generally their own UPEs as they are not controlled for HSR purposes by their general partners. Thus, the associates analysis allows the antitrust agencies to see the bigger picture and capture information relating to general partners and entities under common management that may impact the substantive Clayton Act §7 analysis.

Accordingly, private equity firms should consider taking a thorough look across their family of funds to identify their associates up front. Once identified, it is a good idea to keep a list of such entities and their respective NAICS codes to facilitate future filings. Despite the guidance provided by FTC, the exercise remains difficult and time consuming, in particular for a first filing.

Where a private equity firm is the acquired person, it avoids these issues. Information relating to associates is only required for the acquiring person's form.

VI. CONCLUSION

In conclusion, conducting a thorough HSR and antitrust analysis in a private equity M&A deal can be a time-consuming and complicated exercise, particularly where a private equity firm is the acquiring person. Parties must remember that the information required for an acquiring private equity firm's form can be significantly greater than when that same firm is the acquired person. Sufficient lead time should be built in to permit investigation and analysis by outside counsel. Keeping updated records from transaction to transaction regarding information that may apply to future HSR filings can streamline the process and make things much easier when an HSR form must be prepared. Finally, like any other transaction, the substantive antitrust issues under Clayton Act §7 should be thoroughly analyzed.

16 Decision Tree For Identifying Associates, available at: https://www.ftc.gov/sites/default/files/attachments/hsr-resources/decision-tree.pdf; ABA Section of Antitrust Law, Premerger Notification Practice Manual, Interpretation 204 (5th Ed. 2015); FTC Informal Interpretation No. 1607005, available at: https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1607005; FTC Informal Interpretation No. 1109003, available at: https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1109003; FTC Informal Interpretation No. 16110001, available at: https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/16110001.