COMMENTS OF THE ABA SECTIONS OF ANTITRUST LAW AND INTERNATIONAL LAW

HSR FORM CHANGES – COMMENT

October 13, 2010

The Sections of Antitrust Law and International Law (the "Sections") of the American Bar Association ("ABA")[1] are pleased to submit these comments to the proposed amendments to the Hart-Scott-Rodino ("HSR") Premerger Notification Rules (the "Rules"), the Premerger Notification and Report Form (the "Form") and associated Instructions as reflected in the notice of proposed rulemaking ("NPRM") issued by the Federal Trade Commission ("FTC") on August 13, 2010.[2] The views expressed herein are being presented on behalf of the Sections and have been approved by the Sections' Council. They have not been approved by the House of Delegates or the Board of Governors of the ABA and, accordingly, should not be construed as representing the policy of the ABA.

The Sections applaud the FTC's efforts to amend the Form to reduce the burden on reporting parties and better align the Form with the information the FTC and the Antitrust Division of the Department of Justice ("the Agencies") need to undertake a preliminary review under Section 7 of the Clayton Act. For the most part, the Sections believe the FTC has achieved those objectives. For instance, the Sections agree with the deletion of unnecessary detail in Item 3; the new, more streamlined approach to SEC filings in Item 4(a); the deletion in Item 4(b) of the requirement to submit a regularly prepared balance sheet (supplemented as necessary with the parties stipulating to the "size of the parties" test); the deletion of the Item 5 "base year"; and the reduction in the types of controlled entities that need to be listed in Item 6(a). These and other changes reflect a desirable reduction in the burden on filing parties without compromising the Agencies' efforts.

There are, however, a few instances where the FTC has expanded the reporting requirements and where, in the Sections' view, the requested information is broader than necessary for the Agencies to determine whether a particular notified transaction merits additional review, and not justified by the FTC's rationale for the amendment as set forth in the NPRM. Specifically, as discussed in more detail below, the Sections believe that:

- New Item 4(d) broadens existing Item 4(c) in ways that are overbroad and beyond the scope of the rationale expressed in the NPRM;
- The new defined term "associate" as deployed in Items 6 and 7 is vague and unnecessarily broad; and

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1 The Sections assembled a working group led by Robert Schlossberg to draft these comments. The working group included Jeffrey Ayer, Allison Davis, Ethan Litwin, Gil Ohana and Anthony Swisher.

2 Premerger Notification; Reporting and Waiting Period Requirements, 75 Fed. Reg. 57110 (proposed Sept. 17, 2010).

- The broadening and refining of other Item 5 and Item 6 information could be better tailored to the relevant issue.

<u>Item 4(d)</u>

The NPRM states that the FTC proposes the addition of Item 4(d) to require filing parties to submit certain documents useful to the FTC's substantive review of transactions. The FTC states that this new category of documents is necessary because "parties have differing interpretations as to whether [these documents] are called for under current Item 4(c)". To capture those documents, the FTC has proposed a new Item 4(d) with three different categories of documents that would be required in addition to the Item 4(c) documents the parties currently submit.

As a general matter, the Sections find most troubling that subparts (i) and (ii) – calling for offering memoranda (and similar documents) and third party documents – are not limited to documents prepared for the notified transaction. Although the FTC styles the addition of Item 4(d) as a necessary supplement to Item 4(c), which has always been limited to transaction-specific documents ("prepared … for the purpose of evaluating or analyzing the acquisition"), it does not address why Item 4(d) should capture documents not prepared for the notified transaction. In explaining 4(d)(i), the FTC states that "[w]hen a company is preparing to put itself up for sale, it will often draft or hire a third party to draft a confidential information memorandum … [and m]ost parties already submit these along with their HSR Filings and [this] should not require any additional burden …." This rationale does not support expanding this requirement to documents not prepared for the notified deal and to documents not prepared by or for an officer or director. Similarly, in explaining subpart (ii) the FTC wrote that "third party advisors are often active at all stages of a transaction …. Many parties already submit such competition-related third party materials along with their HSR Filings …." This may be true for transaction-specific materials but not those prepared otherwise.

As discussed in more detail below, much of the additional burden in Items 4(d)(i) and (ii) is due to the fact that these two subparts are not transaction-specific; this results in broadening the search notifying persons will be required to conduct beyond those custodians involved in the notified transaction (and those whose files are now searched to comply with Item 4(c)). This increased burden is compounded by the fact that often persons outside the deal team are not aware of the transaction for confidentiality reasons. The files of such persons could not be searched until the deal is announced publicly (thereby potentially delaying many transactions each year that raise no antitrust issues), unless the parties were forced to expand the group of employees who know about a deal with the attendant increased risk of leaks and press reports. The Sections respectfully suggest that such a significant increase in burden/risk is not justified (and is not at all addressed in the NPRM).

As the FTC is well aware, because the overwhelming majority of reported transactions do not lead to investigations, the information required to be produced with HSR form should be limited to that required to facilitate an Agency decision whether to investigate. The

Agencies are always free to seek information of a kind that would be required to be produced under proposed Items 4(d)(i) and 4(d)(ii) through voluntary information requests or access letters.

One other general comment is that the "note" in the Instructions applicable to Item 4(c) regarding the withholding of documents based upon a claim of privilege should be explicitly broadened to Item 4(d) to clarify that the approach to handling privileged documents covered by Item 4(c) also applies to Item 4(d).

We provide comments to the specific subparts of Item 4(d) below.

Item 4(d)(i) Offering Memoranda

The new instruction asks for "all offering memoranda (or documents that served that function) that reference the acquired entity(s) or assets." Proposed item 4(d)(i) would not raise concerns if it were limited to documents prepared in connection with the proposed transaction, but as drafted it goes much further.

This subpart also calls for the submission of a vaguely-defined category of "documents that serve [the] function" of offering memoranda. A broad view of this term might include a variety of documents; this vagueness might be tolerable in connection with the notified transaction but sweeps far too broadly unhooked from the current deal. The NPRM for the proposed new rules compounds this problem when, in explaining 4(d)(i), it states: "Any such *study, survey, analysis or report* will only be responsive to Item 4(d)(i) if it also contains some reference to the acquired entity(s) or assets." This language does not appear in the proposed rule, but could serve to greatly expand 4(d)(i) by sweeping in documents that contain tangential references "to the acquired entity(s) or assets." The NPRM also says that pre-existing "presentations" given to prospective buyers are the equivalent of an offering memorandum. Thus, the addition of the "documents that serve the function" category potentially extends 4(d)(i) beyond offering memoranda to a whole host of documents and complicates the task of collecting documents responsive to Item 4(d)(i) by introducing the need for a subjective assessment of whether a particular document "serve[s] the function" of an offering memorandum.

Compounding this problem is the fact that proposed item 4(d)(i) is not tied to documents prepared by or for an officer or director. This raises concerns for both collection and the Agencies' substantive analysis. It complicates collection because parties will be required to include these documents in their notification if they were provided to any employee within the filing person. Considering these documents in the initial analysis of a transaction will also likely result in false positives in terms of unnecessary investigations because corporations receive many unsolicited submissions, some of questionable validity, and do not act on them.

The proposed requirement as currently worded is too broad and not justified by the NPRM. Simply limiting the documents to those produced within two years does not significantly reduce that burden, and, instead, raises an inference that multiple drafts of the same document could be required to be submitted. The search required to collect such documents with any assurance of completeness could be very broad; to cast a broad search company-wide, worldwide, to determine if some document touting assets and mentioning the acquired person exists will be very burdensome in many cases.

We respectfully suggest that Item 4(d)(i) be limited in scope to the transaction that is the subject of the HSR filing, and that the instructions specify that only final versions of documents need be supplied.

Item 4(d)(ii) Materials Prepared by Third Parties

The proposed Item 4(d)(ii) asks that the parties "provide all studies, surveys, analyses...and that also reference the acquired entity(s) or assets." The proposed new category reads similarly to Item 4(c) except in two very significant ways: (1) the request is not linked to the notified acquisition and (2) the scope of the request takes in the vague and ambiguous "references" to the acquired entity(s) or assets. The Sections believe that Item 4(d)(ii) would represent a significant expansion of the scope of search and production of documents that would be required to make an HSR filing, without generating a commensurate amount of value to Agency staff early in their review of a notified transaction. Although the limitation of 4(d)(ii) to documents prepared by bankers, consultants and other outside advisors may be intended to increase the yield of useful information while decreasing the burden, the Sections do not believe it accomplishes this. To the extent that third party reports contain significant information specific to the markets at issue in a particular transaction, those reports are likely to be excerpted (or at least referenced) in transaction-specific presentations created by or made to officers and directors that are produced today as 4(c) documents.

The huge burden of the search outweighs the marginal benefit in information gained by the FTC. The two-year limitation does not cure this issue.

1. <u>Overly broad scope</u>

The scope of the request now sweeps up potentially numerous ordinary course documents, creating an enormous compliance burden. It could potentially include:

- Corporate subscriptions to market studies, information or periodicals, many not specifically requested by anyone within the company and frequently extremely voluminous;

- Industry references and databases that are often so large that they are not physically capable of being included in a printed notification;

- Voluminous market research conducted by consumer goods and other companies on a routine basis;

- Information received by financial investors;

- Unsolicited financial and market analyses from investment bankers and consultants seeking to develop business; and

- Reports prepared in the course of patent, securities, antitrust or other forms of economically focused litigation.

While some of these documents might be useful to the Agencies, the submission of these documents is better left to voluntary party submissions or the response to a voluntary information request or an access letter during the first 30 days of Agency review. During the first waiting period, Agency staff typically contacts the parties after the inter-agency clearance process if they identify a transaction where they may want additional information to determine if there are any antitrust issues. To require this material irrespective of whether there is any potential substantive issue (given that the overwhelming majority of transactions merit no substantive review) is unduly burdensome.

2. Unduly Burdensome Searches

Failure to comply with Item 4(c) has been vigorously enforced, in some cases, with multi-million dollar fines[3] and the ability of the Agency to re-start the review clock if it determines that materials that were required to be attached to the HSR Form were not. Companies would be required to search both the electronic and paper files of officers and directors to identify third party reports received in the last two years. These market reports are sometimes broadly distributed, available in primary form (the original reports) and in presentations and alerts created by corporate market research and strategy teams who gather, digest, and circulate market research a company licenses from third-party vendors.

The NPRM states that "If such studies, surveys, analyses and reports ***are found in the files of*** any officer(s) or director(s) (or, in the case of unincorporated entities, individuals exercising similar functions), they should ***be deemed to have been prepared for*** that individual." (Emphasis added.) This interpretation is problematic in that companies have content-rich electronic intranets, with information across the entire company readily accessible to the officer or director, including over a network. In that increasingly common situation, it is unclear what would constitute the "files" of the officer or director.

Thus, to ensure compliance, the company would have to undertake an equivalent effort such as that of producing electronic discovery in litigation, costing up to hundreds of

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[3] In one instance, a company was fined $2.78 million and, in another, over $5 million. More recently, the DOJ investigated and fined a company $550,000 for failure to submit 4(c) documents with its premerger notification, after the FTC had already granted the company's request for early termination. The fines were all based on the fact that the Agencies found the HSR filings deficient for failure to submit the Item 4(c) documents. The FTC and DOJ treated the transactions as if the parties had never filed, charging them $11,000 a day from the day they should have filed until the day the documents were submitted. Penalties are now $16,000 a day.

thousands of dollars and hours of employee and IT time, constituting an undue burden. That type of effort may be the norm in the few dozen cases in which the Agencies issue a second request, but it is not appropriate for imposition at the time a notifying party makes its HSR filing with regard to literally thousands of transactions, the vast bulk of which raise no competitive issues.

Moreover, companies regularly receive unsolicited materials from third parties. As noted above, to treat such documents as prepared by or for an officer or director substantially increases the probability of false positives as to which transactions merit further inquiry.

3. Privileged Documents/Log

This Item potentially sweeps within its breadth a host of privileged documents. Outside antitrust counsel is a “third party advisor” and conducts analyses that likely “reference the acquired entity” evaluating competitor related issues. An interpretation that includes outside counsel will impose a significant additional burden by requiring time to be spent collecting documents from outside counsel, reviewing those documents for privilege and then logging each of those documents on a privilege log. None of that effort will aid the FTC in analyzing the transaction, but it will put a significant burden on the parties in attempting to comply with the new request. In order to avoid this unintended consequence of the expansion of this document category, documents prepared by outside counsel should be expressly excluded from being covered by Item 4(d)(ii).

4. Potential Clarifications or Limitations

The Sections respectfully suggest that subpart 4(d)(ii) be eliminated. To avoid the foregoing concerns, the subpart should be limited to final versions of documents prepared in connection with the notified transaction, and if the subpart were so limited, then it would be surplusage as it would be subsumed within Item 4(c).

If the FTC declines to eliminate this subpart, the Sections would urge the FTC to amend the subpart to provide:

- It would only be applicable if there were an Item 7 overlap;
- It would only require searches of individuals aware of the notified transaction;
- It would be limited to narrative documents and exclude all databases;
- The rule should state outright that it does not intend to capture privileged documents produced by outside counsel, thus eliminating the need for the search and review of those documents;
- The documents should be limited to those that an officer or director personally requested (eliminating unsolicited materials as well as subscription data that circulates broadly among large companies); and

- The documents should be limited to final versions only.

Item 4(d)(iii): Documents Discussing Synergies and/or Efficiencies

As a general matter the Sections have no objection to this subpart as (i) efficiencies and synergies are an important part of the analysis, (ii) many of these documents are already captured in the Item 4(c) search and (iii) this subpart limits the relevant documents to those prepared for the transaction.

The Sections, though, are concerned that the addition of Item 4(d)(iii) might inappropriately lead some staffs to take the view that efficiencies not identified or quantified in documents submitted in response to this Item may not be raised by the parties at a later point in the merger review process, for example in response to the standard second request interrogatory regarding the identification and quantification of efficiencies, or that such later identified synergies will be given little if any weight. To avoid this misunderstanding, the Sections recommend that the FTC make clear in its response to public comments that the failure to identify particular efficiencies in Item 4(d)(iii) documents is without prejudice to the ability of the merging parties either to identify additional efficiencies at a later time or to provide additional information regarding the quantification of previously identified efficiencies. Further, language clarifying that only final versions of such documents need to be submitted would be helpful.

"Associate"

The FTC's definition of "associate" and its use in Items 6(c)(ii), 7(b)(ii) and 7(d) contains ambiguity that could cause uncertainty about compliance requirements, and unnecessarily increase the burden of compliance. The FTC has defined an "associate" of an acquiring person as an "entity that is not an affiliate of such person but: (A) has the right, directly or indirectly, to manage, direct or oversee the affairs and/or the investments of an acquiring entity (a 'managing entity'); or (B) has its affairs and/or investments, directly or indirectly, managed, directed or overseen by the acquiring person; or (C) directly or indirectly, controls, is controlled by, or is under common control with a managing entity; or (D) directly or indirectly, manages, directs or oversees, is managed by, directed by or overseen by, or is under common management with a managing entity." 16 C.F.R. § 801.1(d)(2).

The defined term "associate" appears in three places on the proposed Form. First, in Item 6(c)(ii), an acquiring person would be required to report the minority holdings of its associates to the extent those minority holdings were in companies that had revenue in industry codes defined by the North American Industry Classification System – United States ("NAICS") that overlap with the acquired company. Second, in Item 7(b)(ii), the acquiring person would be required to identify its associates that had a NAICS code overlap with the acquired company. Third, in Item 7(d), the acquiring person would be required to provide geographic information (in the same manner as called for by current Item 7(c)) for its associates that had a NAICS code overlap with the acquired company.

The new associate concept applies most directly to private equity funds, which often are organized in a way such that several funds may share common management but not be included within the same "person" for HSR purposes. The new definition and the new reporting requirements reflect the FTC's long-stated desire to gather information about the holdings of such funds that is not captured under the present and previous versions of the Rules and the Form. Although the new rules will serve to advance that goal, the Sections have concerns regarding ambiguity, potential unintended consequences, and the breadth of the reporting requirements.

First, the Sections encourage the FTC to better define the concept of "manage, direct or oversee" in the definition of associate. The term "oversee," in particular, is vague and provides little guidance as to what relationships would or would not be covered. For example, an individual without any decision-making authority who is on the two investment committees overseeing two investment funds would arguably "oversee" both funds even though the two funds could hardly be considered associated based upon this tangential relationship. Moreover, to the extent the term "oversee" applies to entities other than master limited partnerships or equity funds (which are the two examples specifically noted by the FTC in the NPRM), it could unintentionally have far-reaching effects.

To help resolve these concerns, the Sections respectfully suggest that the term "oversee" be deleted from this section. The Sections also have concerns about the breadth of the phrase "manage, direct" outside of the investment fund context. Thus, the Sections also suggest that the FTC provide further guidance regarding the exact scope of the definition of "associate," possibly limiting it to master limited partnerships and private equity funds.

In addition, specifically with respect to amended Item 6(c)(ii), the Sections are concerned that the breadth of this item could create a significant additional burden on a filing party, while providing the Agencies with little additional useful information. As it is written, Item 6(c)(ii) would require a filing party to report minority holdings of minority holdings (i.e., associates). For example, suppose Fund 1 is making an acquisition. Fund 1 is managed by Manager X. Manager X also manages Funds 2 through 11. Manager X has only a minority stake in each Fund (otherwise, they would all be included within the filing person and Item 6(c)(ii) would not even apply). Each of Funds 2 through 11 have 10 portfolio companies. Under Item 6(c)(ii) as it currently stands, Fund 1 would need to survey 100 portfolio companies, with only tangential relationship to Fund 1, to determine if any of them had minority investments in companies that might have a NAICS code overlap with the acquired company. This would impose a substantial additional burden on the filing party, while providing little additional useful information to the Agencies, given the information on associates that will be provided under amended Item 7.

Amended Item 6(c)(ii) also seems to go far beyond the concern articulated by the FTC. In the NPRM, the only rationale provided is that "[t]he current Form may also fail to detect instances in which entities that are under common management with the acquiring person, but are not part of the same UPE . . . already have minority holdings of the acquired entity(s) or assets." The proposed Item 6(c)(ii) goes far beyond what would be necessary to correct this problem. The Sections respectfully suggest that the FTC could greatly reduce the burden on filing parties, while still correcting this issue, by limiting Item 6(c)(ii) to minority holdings of the target company, rather than minority holdings in any company that shares a NAICS code overlap with the target company.

Item 5

Item 5 of the Form requires each filing party to state the industries in which it operates within the United States, under the NAICS codes, and to state its US revenues associated with each NAICS code. This item is widely recognized as one of the most time-consuming parts of the Form to complete. The Sections therefore support the FTC's proposal to reduce the burden of responding to Item 5 by, among other things, requiring that the parties provide information only for the most recent year. Nevertheless, the Sections believe that Item 5 will continue to require substantial time and effort for compliance, and proposes the following two modifications to reduce this burden.

1. Eliminate the "Double Listing" of A Party's Manufactured Products Under Both Manufacturing NAICS Codes and Wholesale/Retail NAICS Codes

Under the current interpretation of Item 5, if a party manufactures a product at a US plant and wholesales that product directly from that plant, the party responds to Item 5 using only the NAICS code for manufacturing and states its US sales revenues for that product. However, if instead the party manufactures the product at a US plant, but conducts its wholesaling operations in locations apart from its plant, the party should respond to Item 5 by listing both a NAICS code for manufacturing and a NAICS code for wholesaling or retailing the product. In such a "double listing" scenario, the party is required to state its intercompany transfer revenues for the product under the manufacturing NAICS code, and its total US revenues for the product under the wholesaling/retailing NAICS code. *See* ABA, Section of Antitrust Law, Premerger Interpretation Practice Manual (4th ed. 2007)), Int. 263.

The double listing requirement causes a double counting of the party's revenues. It increases the possibility of error in the response to Item 5, and is burdensome because many company's central financial systems do not track intercompany transfer revenues among subsidiaries by product.

Unfortunately, the NPRM proposes to expand the double listing requirement. Under the previous Form, goods that were manufactured by a reporting party and imported into the US needed to be recognized in the Item 5 response only by a wholesaling or retailing NAICS code. The NPRM proposes that under the new Form, goods manufactured by a party outside the US and imported into the US should conform to the double listing requirement. That is, when a reporting party manufactures a product outside the US and ships the product directly from its plant to customers it reports the product only under a manufacturing NAICS code. If it instead ships the product to a US facility that it owns and sells the good from that facility, it must report the product under both a manufacturing NAICS code and a wholesale/retail NAICS code. The NPRM does not explain how this double listing requirement benefits the government's investigation of the potential competitive consequences of a transaction, or how such benefits outweigh the substantial burden of compliance.

The Sections propose that a party that manufactures a good (whether in the US or outside the US) and sells it inside the US, should respond to Section 5 only with the manufacturing NAICS code associated with that good and the party's total US sales. The Sections believe that the information from this simplified reporting standard will be sufficient to provide the government with a description of the nature and description of the party's US economic activities.

2. <u>Do Not Eliminate the "De Minimis" Exception From Item 5</u>

The NPRM proposes eliminating the de minimis exception which permitted a filing party to omit listing non-manufacturing industries (as defined by 6-digit NAICS codes) in which the party did not earn at least one million dollars in the last financial year. Given that companies have very minor operations in many industries, this de minimis exception has played an important role in reducing the burden of properly characterizing those minor operations by NAICS codes and allocating revenues to those codes.[4]

The NPRM states that the FTC is concerned that filing parties that take advantage of the de minimis exception in response to Item 5 might mistakenly apply the exception in response to Item 7, and not list an overlap in the parties' operations. The Sections suggest that this concern could be adequately addressed by including a specific instruction in Item 7 that the de minimis exception does not apply to that item. Separately, the Sections believe the FTC should consider applying the de minimis exception to Item 7; the number of transactions raising antitrust issues in product markets where one party has less than $1 million in sales must be rare or non-existent.

<u>Item 6(c)(i)</u>

Item 6(c)(i) would require a reporting person to list its holdings of at least 5% but less than 50% in any issuer or unincorporated entity. For the acquiring person, the response would be limited to entities that derive revenues in the same 6-digit NAICS code as the acquired entity(s) or assets. For the acquired entity, the response would be limited to entities that derive revenues in the same 6-digit NAICS code. The proposed instruction to Item 6(c)(i) states further that:

> *Holdings of issuers or unincorporated entities with total assets of less than $10 million, may be omitted. In responding to Item 6(c)(i), it is permissible for a filing person to list all entities in which it has a reportable minority interest.*

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[4] For example, minor revenues from service contracts associated with a product the reporting party manufactures, or interest income from the company's bank accounts, are commonly not reported today in response to Item 5, but would appear to be required to be reported under the proposed revision.

Unfortunately, the structure of these two sentences might imply that a filing person can choose to take advantage of one sentence or the other, but not both. That is, if the filing person does not limit its response to those entities that have revenues in the same NAICS code as the other filing party (or entity or assets), the person cannot exclude those entities with total assets of less than $10 million. Such a result would be contrary to the current operation of Item 6(c) and do little to aid in the government's substantive review.

Therefore, the Sections propose that the sentences be rewritten as follows:

In responding to Item 6(c)(i), (a) it is permissible for a filing person to list all entities in which it has a reportable minority interest; and (b) holdings of issuers or unincorporated entities with total assets of less than $10 million, may be omitted.

<u>Conclusion</u>

The Sections commend the FTC's efforts to amend the Form to reduce the burden on reporting parties and better align the Form with the information the Agencies need to undertake a preliminary merits review. For the most part, the Sections believe the FTC has achieved those objectives. As noted above, however, in a few instances the Sections believe the reporting requirements can be narrowed and better tailored consistent with the expressed rationale in the NPRM and without sacrificing Agency effectiveness.