# PROPOSED AMENDMENTS TO HART-SCOTT-RODINO ACT REGULATIONS COULD DRAMATICALLY EXPAND FILING OBLIGATIONS OF INVESTMENT MANAGERS

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**U.S. Antitrust, Competition, and Trade Regulation and Asset Management and Investment Funds Alert**

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The Federal Trade Commission (FTC) recently announced its intent to publish a Notice of Proposed Rulemaking (NPRM)[1] amending its rules under the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act). If adopted after notice and comment, the proposals would:

1. Create a reporting exemption for certain de minimis investments; and
2. Require aggregation of investments by entities under common management, in addition to those under common control.

While the first of these proposals may have a modest effect in reducing filings under the HSR Act, the second could dramatically increase the exposure of many investment managers to the HSR Act and related obligations.

## BACKGROUND

The HSR Act requires parties to acquisitions meeting certain threshold criteria to submit a premerger notification and report, commonly referred to as an HSR filing, pay a filing fee of at least $45,000, and observe a waiting period prior to closing any reportable transaction.[2] The waiting period provides U.S. antitrust agencies time to review the pending transaction to determine whether it is likely to violate U.S. antitrust laws.

The acquiring person[3] must also disclose in its HSR filing, under certain circumstances, information about its "associates", which include investment funds and similar entities either managed by or under common management with the acquiring person, but not under common control.[4]

There are several exemptions to the reporting requirements, including one relevant to investment funds and their managers for passive investments of 10 percent or less of an issuer as long as such acquisitions are "solely for the purpose of investment."[5] The FTC's Premerger Notification Office (PNO), however, has interpreted this exemption very narrowly, and any action by an investor other than merely voting its shares may be viewed by the PNO as activity inconsistent with an investment-only intent, even if the activity does not represent an effort to exert control over a company.[6] In an era of expanded shareholder engagement by institutional investors and fund managers, the availability of this exemption (as currently interpreted by the PNO) is likely to become even more limited over time.

## THE PROPOSED CHANGES

### De Minimis Investment Exemption

Under the proposed changes, an acquisition of 10 percent or less of an issuer's voting securities will be exempt from the requirements of the HSR Act as long as the investor: a) is not a competitor of the issuer; b) does not hold more than a one percent interest in any competitor of the issuer; c) is not an officer or director of either the issuer or a competitor of the issuer; and d) does not have a vertical relationship (e.g. vendor and vendee or licensor and licensee) with the issuer. A competitor would be defined under the rules as "any person that (1) reports revenues in the same six-digit NAICS industry codes[7] as the issuer, or (2) competes in any line of commerce with the issuer."[8]

In theory, this exemption would expand the ability of investors to make investments that are not made "solely for the purpose of investment." But in practice, an investor with a well-diversified portfolio would need to know the NAICS codes of every issuer in which the investor holds more than one percent. If any single code overlaps with an issuer in which an investment is planned, the exemption would not be available. Consequently, very large investors may not be able to rely on the exemption in most cases, and the significant monitoring costs and complexities involved could well result in many investors simply foregoing the exemption.

### Aggregation of Associate Holdings

Under the current rules, information on associated holdings is disclosed in some HSR filings, but the initial determination as to whether a filing is ultimately required considers only entities under common control, without regard to any associated holdings. "Control," in this context, is defined as (1) for corporate entities, the holding of at least 50 percent of the voting securities, or the present contractual right to select at least 50 percent of the members of the board; and (2) for noncorporate entities, the right to at least 50 percent of the profits, or 50 percent of the assets upon dissolution.[9] Thus, under the current rules, managers of investment funds and separate accounts generally are not deemed to "control" those funds and accounts for HSR filing purposes, even if they generally are deemed to have voting and investment power over the accounts under applicable federal securities laws.

The proposed changes would significantly expand the definition of the acquiring and acquired persons for purposes of determining whether filing thresholds are met, and thus, whether an HSR filing is required. Under the proposal, acquiring and acquired persons would include not only those entities under common control, but also those entities under common management, which would include investment funds.

For example, currently, if an investment manager or general partner manages five private funds in which no single person holds a 50 percent or greater interest, each fund would separately determine whether it needs to make an HSR filing; the funds would not be aggregated for purposes of determining filing obligations of either the funds or of the manager.

Under the proposed regulations, the holdings of each of these funds would be aggregated under the investment manager or general partner that exercises management authority over each fund. In this scenario, the investment manager would be treated as the acquiring person for acquisitions made by any of the funds that it manages.

The intent behind the proposed revisions is to subject coordinated investments made by distinct pools of capital under common management to the requirements of the HSR Act, for example, the placement of a large acquisition by a private equity sponsor into multiple funds and co-investment vehicles. However, the proposal would also have a significant impact on entities that manage a large number of funds such as institutional investment managers (and potentially, affiliated insurance companies). The impact on many different types of investment managers could be profound, as administration and monitoring costs would dramatically increase, as would the number of required HSR filings.

## THE COMMENT PERIOD

The comment period for the proposed regulations will open for 60 days once the NPRM is published in the *Federal Register*. Please contact your regular K&L Gates lawyer or [any member of our Public Policy, Antitrust, or Asset Management and Investment Funds groups] if you are interested in formulating a strategy to respond to the proposed changes.

# FOOTNOTES

[1] Click here for PDF

[2] See 15 U.S.C. § 18a (2019). Generally speaking, an HSR filing is required, unless otherwise exempted, where the transaction is valued above US$94 million, one of the parties has annual net sales or total assets of US$188 million or more, and the other party has annual net sales or total assets (total assets only for the acquired person if it is not a manufacturer) of US$18.8 million or more. The above amounts are adjusted every year.

[3] A "person" under HSR regulations includes the ultimate parent entity of the acquiring or acquired entity, and every other entity controlled by that ultimate parent. 16 C.F.R. § 801.1(a)(1).

[4] An "associate" is an entity that: a) has the right, directly or indirectly, to manage the operations or investment decisions of an acquiring 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 decision management with a managing entity. 16 C.F.R. § 801.1(d)(2).

[5] 16 C.F.R. § 802.9. There is also an exemption for certain institutional investors, including banks, insurance companies, and investment companies, which permits acquisitions of up to 15% of the voting securities of a company, as long as the investment is made 1) in the ordinary course of business; and 2) solely for the purpose of investment. 16 C.F.R. § 802.64.

[6] See ABA Section of Antitrust Law, *Premerger Notification Practice Manual*, 127 (5th Ed. 2015). Contrast this with SEC Rule 13d-1(c), which defines a passive investor as one who has not "acquired the securities with any purpose, or with the effect, of changing or influencing the control of the issuer." 17 C.F.R. § 240.13d-1.

[7] The North American Industry Classification System (NAICS) is the standard used by Federal agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy. Persons submitting HSR filings are required to aggregate their revenues by NAICS code.

[8] The proposed exemption does not replace the passive investment exemption in 16 C.F.R. § 802.9. The new exemption would permit shareholders to engage in activities the PNO would likely deem as not inconsistent with a

strictly passive intent.

[9] 16 C.F.R. § 801.1(b).

## KEY CONTACTS

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