

MEMO# 32778

September 24, 2020

FTC Proposes Aggregation and De Minimis Rules for HSR Filings

[32778]

September 24, 2020 TO: ICI Global Regulated Funds Committee
SEC Rules Committee RE: FTC Proposes Aggregation and De Minimis Rules for HSR Filings

On September 21, the Federal Trade Commission (FTC) issued a proposed rule that would amend the premerger notification rules to (i) require aggregation and disclosure of more information from an acquiring entity in a Hart-Scott-Rodino (HSR) filing; and (ii) exempt a de minimis acquisition of an issuer's voting securities from HSR filing requirements based on certain conditions.[\[1\]](#) The FTC also issued an advance notice of proposed rulemaking that requests comment on whether certain investment exemptions should be updated.[\[2\]](#) We summarize the proposals below.

Comments on the proposals are due 60 days from the date of publication in the *Federal Register*. ICI plans to submit a comment letter on the proposals. We will schedule a member call shortly via Outlook to discuss potential ICI comments, including responses to the FTC's requests for comment and information described below.

Aggregation Rule

The proposed rule would broaden the FTC's definition of "person," which is currently defined as an "ultimate parent entity" (UPE) and all entities that the UPE directly or indirectly controls,[\[3\]](#) to also include all of a UPE's "associates."[\[4\]](#) The proposed definition would apply broadly to the required information elements in a HSR filing and apply to both acquiring persons and acquired persons.

The FTC notes that a fund often structures its investments through multiple non-corporate entities, i.e., fund vehicles, that each qualify as a UPE.[\[5\]](#) Accordingly, the proposed definition would require a UPE that submits a HSR filing as an acquiring person to provide information for a "new, larger [a]cquiring [p]erson" that includes all of these entities—the UPE, its associates (also UPEs), and the entity that manages the UPE and its associates, i.e., the "managing entity." This information would include, for example, details on acquisitions in the same issuer across associated funds.

By obtaining information about associates, the FTC believes that it will be able to better discern the potential competitive impact of a transaction. The FTC specifically notes that it would be able to aggregate a fund's total acquisitions in a single issuer across fund vehicles under common management. Further, according to the FTC, more substantive information

about associates would provide better insight into which entities are commonly managed, how such entities are connected, and whether entities within an acquiring person have made acquisitions in the same industry as the targeted issuer.

The FTC acknowledges that the proposed definition would likely require more filings and increase burdens,^[6] but points out that acquiring persons must already provide some of the additional information. The FTC, however, requests comment on whether there are less burdensome alternatives to obtaining the additional information.

The FTC also requests comment on whether UPEs that are structured as index funds, ETFs, or other similar-type entities should be treated differently. The FTC acknowledges that such entities base their investments on an index and, therefore, applying the proposed “person” definition to them may not be appropriate.

De Minimis Rule

The proposed rule would also create a new rule to exempt the acquisition of 10 percent or less of the voting securities an issuer from HSR filing requirements, unless the acquiring person already has a competitively significant relationship with the issuer. This exemption is separate from the existing exemption for acquisitions of 10 percent or less of an issuer made “solely for the purpose of investment” (the “Investment-Only Exemption”).^[7] The FTC notes that the Investment-Only Exemption, which was adopted in 1978, has been applied narrowly and believes that the new proposed exemption accounts for (i) changes in investment behavior since that time, e.g., greater investor engagement with management; and (ii) the fact that the FTC and the Department of Justice Antitrust Division have rarely engaged in a substantive initial review of a proposed acquisition of 10 percent or less.^[8]

To qualify for the proposed exemption:

1. the acquiring person must not hold more than 10 percent of the outstanding voting securities of the issuer after the acquisition;
2. the acquiring person must not be a “competitor” of the issuer (or any entity within the issuer);^[9]
3. the acquiring person must not hold voting securities in excess of 1% of the outstanding voting securities (or non-corporate interests) of any entity that is a competitor of the issuer (or any entity within the issuer);
4. no individual who is employed by, an principal or agent of, or otherwise acting on behalf of an acquiring person, is a director or officer of the issuer (or of an entity within the issuer) or a competitor of the issuer (or of an entity within the issuer); and
5. no vendor-vendee relationship exists between the acquiring person and the issuer (or any entity within the issuer) that yielded aggregate sales of greater than \$10 million in the most recently completed fiscal year.

The FTC specifically states that that conditions (2) and (3) relate to concerns about the purported anti-competitive effects of “common ownership,” in which investors with small minority stakes in a competitor can influence the behavior of an issuer. The FTC acknowledges that the issue remains subject to debate but notes that these disqualifiers would allow it to receive information that yields further insight. The FTC requests comment on these disqualifiers, including whether a different ownership percentage would be more appropriate.

Advanced Notice of Proposed Rulemaking on Investment-Only and Institutional Investor Exemptions

The FTC also issued a separate advance notice of proposed rulemaking requesting information on seven topics related to the HSR premerger notification rules, including the Investment-Only Exemption and the HSR filing exemption for institutional investors that acquire 15 percent or less of the voting securities of an issuer (the “Institutional Investor Exemption”). The FTC explains that it is “tak[ing] a fresh look” at these exemptions based on developments in institutional investing, which include the expansion of fund holdings, increased shareholder engagement in corporate governance, and common ownership concerns. The questions related to these exemptions focus on (i) the definition of “solely for the purpose of investment” under the Investment-Only Exemption and (ii) the definition of “institutional investors” under the Institutional Investor Exemption, both of which were adopted in 1978.

Institutional Investor Exemption

With respect to the Institutional Investor Exemption, the FTC seeks information to inform whether it should update the definition of “institutional investor” to include additional types of entities. In addition to asking whether the 15 percent threshold is still appropriate, the FTC also asks whether the exemption should be based on an investor’s activities or the type of investor. The FTC also requests information on the activities of index funds and exchange-traded funds.

Influence Outside the Scope of Voting Securities

The FTC also asks questions about whether other mechanisms outside of voting securities can be used to exercise influence over an issuer company and, therefore, should be reported in an HSR filing. These mechanisms include the acquisition of convertible voting securities with the right to appoint board members and the use of board observers.

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endnotes

[1] Premerger Notification; Reporting and Waiting Period Requirements (Sept. 21, 2020), *available at* https://www.ftc.gov/system/files/documents/federal_register_notices/2020/09/p110014hsra_ctamendnprm09182020_0.pdf.

[2] Premerger Notification; Reporting and Waiting Period Requirements (Sept. 21, 2020), *available at* https://www.ftc.gov/system/files/documents/federal_register_notices/2020/09/p110014_hsr_act_-_anprm.pdf.

[3] Section 801.1(a)(1).

[4] An “associate” of an acquiring person is defined as a non-affiliated entity that meets one of the following criteria: (i) it has the right, directly or indirectly, to manage the operations or investment decisions of an acquiring entity (a “managing entity”); (ii) it has

its operations or investment decisions, directly or indirectly, managed by the acquiring person; (iii) it directly or indirectly controls, is controlled by, or is under common control with a managing entity; or (iv) it directly or indirectly manages, is managed by, or is under common operational or investment decision management with a managing entity. Section 801.1(d)(2).

[5] The FTC's proposed rule would also apply to investment entities that are structured as master limited partnerships.

[6] The FTC notes that the proposed rule could also lead to fewer filings and reduce burdens for acquiring persons in circumstances where multiple fund vehicles would each be required to make a HSR filing when acquiring interests in the same issuer, which would also require remitting a filing fee per filing. The proposed rule would require only one filing and payment of a single filing fee.

[7] Section 802.9. Section 801.1(i)(1) defines "solely for the purpose of investment" as a person who holds or acquires voting securities with "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer."

[8] The FTC notes that it previously proposed to revise Section 802.9 in 1988 but did not adopt a final rule.

[9] The FTC requests comment on its proposed definition of "competitor," which would include any person that (i) reports revenues in the same six-digit NAICS Industry Group as the issuer or (ii) competes in any line of commerce with the issuer. The FTC acknowledges that this definition is broad and requests comment on other potential definitions.