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## MERGERS AND ACQUISITIONS

## The HSR Act – What You Don’t Know Can Cost You



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With increased HSR enforcement actions in recent months (see [https://www.ftc.gov/system/files/documents/reports/enforcement-actions/enforcement\\_actions\\_final\\_updated\\_jan\\_2017.pdf](https://www.ftc.gov/system/files/documents/reports/enforcement-actions/enforcement_actions_final_updated_jan_2017.pdf)) and the maximum penalty for HSR violations rising to \$40,654 a day, it is especially important that individuals and entities who participate in acquisitions add HSR compliance to their pre-closing checklists. The challenge sometimes is to know what types of acquisitions are potentially HSR reportable and when to call an HSR specialist.

Despite being an antitrust law, the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the “HSR Act”) does not apply only to transactions that could raise substantive competitive issues nor even only to acquisitions of controlling interests in corporations. In fact, it sometimes can apply even when a minority stockholder does not acquire a single additional voting share, but its percentage of a corporation’s voting shares increases through a redemption, buy back, or other transaction. As a result, the antitrust agencies have pursued enforcement actions against not only companies, but also against officers, directors, and investors. Thus HSR should be considered **before** acquiring *through any means* corporate voting shares (or an increased per-

centage of voting shares), controlling interests in partnerships or limited liability companies (“LLCs”), or assets. Below is a brief description of the HSR Act and a few possibly surprising examples of acquisitions that could trigger HSR filing requirements.

**What is the HSR Act?** Under the HSR Act, the “acquiring person” and the “acquired person” must each submit a separate premerger notification to the U.S. antitrust agencies and observe a waiting period before they may close if their acquisition satisfies HSR threshold tests and no HSR exemption applies. The waiting period is generally 30 days, although it can be shortened if the parties request and receive early termination (“ET”) of the waiting period or extended if either agency chooses to investigate the transaction further and issues a “Second Request” for additional information to the parties. If the parties receive a Second Request, a second waiting period would begin generally after both parties are in substantial compliance with the Second Request. During any waiting period, the parties may not consummate the transaction.

There are two principal HSR threshold tests – the size of transaction and the size of person tests. The size of transaction test would be satisfied if the acquisition is valued in excess of \$80.8 million (adjusted annually) under HSR valuation and aggregation rules. The size of person test only applies if the HSR value of the transac-

tion is less than or equal to \$323 million (adjusted annually). If the transaction has an HSR value in excess of \$323 million (as adjusted), the transaction is reportable unless exempt. If the HSR value of the transaction is less than \$323 million (as adjusted), it would not be HSR reportable if the size of person test would not be satisfied. Generally, the size of person test would be satisfied if the HSR ultimate parent entity (“UPE”) of one party has at least \$161.5 million (adjusted annually) in annual net sales or total assets and the UPE of the other party has at least \$16.2 million (adjusted annually) in annual net sales or total assets.

### **A Sampling of Possibly Surprising Acquisitions That May Be Subject to the HSR Act**

**A. Acquisitions by Officers or Directors of Stock in Their Companies** The acquisition of voting shares of a corporation through any means and by anyone (including individuals) is subject to HSR reporting requirements if applicable threshold tests are satisfied and no exemption applies. Thus, the HSR Act may apply when officers or directors acquire voting shares of their corporations even through stock-based compensation awards and regardless of how small a percentage of voting shares they would hold in the company. The Federal Trade Commission has long advised that the passive investor exemption – which can apply when an acquiring person will acquire and hold 10% or less of a corporation’s voting shares and other factors are satisfied – does not apply to acquisitions of company shares by company officers or directors since by definition they do not have the subjective intent to be passive and not influence management. Not surprisingly, officers and directors have been the subject of enforcement actions and have had to pay significant HSR fines.

**B. Redemptions** A company’s redemption of its own securities is exempt so far as the company as an acquiring person is concerned. However, redemptions can still trigger HSR filing requirements for companies as acquired persons and for company stockholders as acquiring persons. This would be the case if a company stockholder was instrumental in causing the redemption and if (i) its percentage of the company’s voting shares (calculated under HSR rules) increases following the redemption, (ii) it satisfies applicable HSR threshold tests, and (iii) no HSR exemption applies. Thus officers or directors who are also company stockholders and instrumental in causing a redemption could have an HSR filing obligation in connection with the redemption. Likewise, company stockholders who fund the redemption could have an HSR filing obligation in connection with the redemption.

**C. Distributions of Assets Upon Dissolution** When partnerships or LLCs are dissolved, their assets are sometimes distributed to their partners or members. Because the acquisition of assets is a potentially HSR reportable event, such distributions could trigger HSR filing obligations. While an HSR exemption could apply to the acquisition of a dissolving entity’s assets by a partner or member who controlled the dissolving entity under HSR control tests before the dissolution, a minority partner’s or member’s acquisition of assets in the dissolution could be reportable if applicable HSR threshold tests would be satisfied as a result and no exemption applied.

**D. IP Licenses** The acquisition of an exclusive license to a patent or trademark is considered the acquisition of an asset under the HSR rules and could therefore be subject to the HSR Act’s filing and waiting period requirements. Significantly, however, what constitutes the level of exclusivity necessary for a license to be considered the transfer of an asset varies depending on the type of intellectual property at issue. In the case of patent licenses, the exclusivity can be partial or limited. For example, the HSR Act would apply to the acquisition of exclusive rights to a patent even if limited to a field of use or territory. However, in the case of trademark licenses, the HSR Act would not apply if the rights were only exclusive with respect to certain products or services. Further, the FTC has adopted special rules to apply to the acquisition of licenses for pharmaceutical intellectual property. See 16 C.F.R. Sections 801.1(o), (p), and (q), and 801.2(g).

**E. Acquisitions of Foreign Assets or Interests of Foreign Entities Even by Foreign Purchasers** The acquisition of assets, voting shares of corporations, or interests in non-corporate entities could be subject to the HSR Act, even if such assets or entities are foreign and even if the purchaser is foreign. There are a number of exemptions that could apply, however. For example, the acquisition of interests in a foreign entity may qualify for an exemption if the foreign entity directly or indirectly did not have a sufficient level of revenues (in excess of \$80.8 million subject to adjustment) in or into the U.S. in its most recent year and if it does not directly or indirectly hold non-exempt assets located in the U.S. with a sufficient fair market valuation (in excess of \$80.8 million subject to adjustment). See 16 C.F.R. Sections 802.50, 802.51, and 802.4. Although there are a number of exemptions that could apply, their application is complex and experienced HSR counsel should be consulted before reliance on any exemption.

**F. Treatment of Foreign Entities as Corporate or Non-Corporate** It is also worth highlighting that the HSR rules vary depending on whether an entity is deemed for HSR purposes to be a corporate or non-corporate entity. This affects, among other things, application of the HSR control, aggregation, and valuation rules. For example, while the acquisition of a minority position in a corporation could be subject to the HSR Act, the acquisition of interests in a partnership or LLC would not be HSR reportable unless, among other things, the acquiring person would acquire HSR control of the target – interests entitling the acquiring person to at least 50% of the profits or assets of the target. As a result, whether an entity would be deemed a corporate or non-corporate entity could be outcome determinative in assessing whether an HSR filing would be required. It is obvious whether U.S. entities are corporate or non-corporate. However, the FTC has adopted a special test to determine whether to treat a foreign entity as a corporate or non-corporate entity. Specifically if the holders of a foreign entity’s securities may vote their shares for a supervisory board of directors, the foreign entity would be treated as a corporate entity for HSR purposes. If not, it would be treated as a non-corporate entity.

**Conclusion** The HSR rules and exemptions are technical and the agencies from time to time modify or overturn their prior advice regarding certain rules or ex-

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emptions. Therefore, before voting shares, non-corporate interests, or assets change hands through any means, and even before a stockholder's percentage of the voting shares of a corporation increases, it is prudent to consult with HSR counsel to determine if the ac-

quisition could trigger HSR filing and waiting period requirements. Corporate, securities, and benefits lawyers and in-house counsel should add HSR to the top of their pre-closing checklists.



