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HSR Form Changes – Comments, Project No. P989316
October 18, 2010[1]

These comments are respectfully submitted in response to the notice of proposed rulemaking ("NPRM")[2] issued by the Federal Trade Commission ("FTC") on August 13, 2010 regarding proposed amendments to the Hart-Scott-Rodino ("HSR") Premerger Notification Rules (the "Rules"), the Premerger Notification and Report Form (the "Form") and associated Instructions (the "Instructions").[3] The authors of these comments understand that the objectives of the proposed changes are "to streamline the Form and make it easier to prepare…" and "to capture additional information that would *significantly assist the Agencies in their initial review."*[4] As stated in the NPRM, the "Form is designed to provide [the Agencies] with the information and documentary material *necessary and appropriate for an initial evaluation* of the potential anticompetitive impact" of reported transactions.[5]

We support the FTC's proposals to streamline the Form by eliminating certain sections that are "not as helpful as originally anticipated." On balance, however, we believe that the proposed amendments would, in fact, make it significantly more difficult, time consuming and expensive to prepare an HSR filing, and that in most cases the increased costs and burden born by filing parties would far outweigh the incremental assistance provided to the Agencies during their initial review. Moreover, we believe that certain of the proposals request documents and information that go far beyond the scope of what is "necessary and appropriate for an initial evaluation." Such detailed requests should be reserved for transactions that present potential competitive issues significant enough to justify the issuance of an access letter or a second request. Based on our experience, parties are highly motivated to respond to any potential Agency concerns during the initial review period in order to avoid an extension of the waiting period (or the issuance of a second request) and thus work very quickly to provide voluntary responses to any Agency information request.

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[1] Ms. Grise and Messrs. Jahnke and Cuomo are partners in the Antitrust Practice Group of the law firm Howrey LLP. Messrs. Cooper and Cohen are Of Counsel with Howrey LLP. The authors wish to thank Ryan M. Foley, an Associate in Howrey's Antitrust Practice Group, for his assistance in preparing these comments. These comments express the personal views of the authors, based on their collective experience on several hundred merger matters. These comments are not being submitted on behalf of Howrey or any client of Howrey.

[2] Premerger Notification; Reporting and Waiting Period Requirements (NPRM); Proposed Rule, 75 Fed. Reg. 57110 (published Sept. 17, 2010).

[3] The FTC published the NPRM with the concurrence of the Assistant Attorney General of the U.S. Department of Justice ("DOJ", together with the FTC, the "Agencies").

[4] NPRM, at 57110 (emphasis added).

[5] Id (emphasis added).

As the Agencies have noted on numerous occasions, "[t]he vast majority of mergers pose no harm to consumers…." [6] According to their publicly-released statistics, the Agencies are highly successful in quickly and efficiently identifying those transactions that raise no substantial competitive concerns under the HSR review process that is currently in place, which includes access to a wide array of information and resources. Indeed, for more than 95% of the transactions reported under HSR, the Agencies promptly determine – *i.e.*, within the initial 15- or 30-day waiting period immediately following a filing – that a substantial lessening of competition is unlikely.[7]

The Agencies "base such expeditious determinations on material provided as part of the HSR notification, experience from prior investigations, and other market information. For many industries, a wealth of information is available from government reports, trade directories and publications, and Internet resources. For some transactions, the parties volunteer additional information, and for some, the Agencies obtain information from non-public sources. The most important non-public sources are market participants, especially the parties' customers, who typically provide information voluntarily when the Agencies solicit their cooperation."[8]

All of these data sources augment the already substantial amount of information provided with a typical HSR filing and are available to the Agencies during the initial waiting period. Given the Agencies' successful track record in clearing 95% of reported transactions during the 30-day initial waiting period and the substantial volume of information available to the Agencies during their review, it is difficult for the authors to understand how several of the proposed amendments would "significantly assist the Agencies in their initial review," especially when the burden imposed on all filing parties is weighed against any incremental benefits to the Agencies.

The proposed amendments published in the NPRM raise numerous issues of interest, but our comments address only those we believe most important. We are most concerned with the potential burdens to our clients associated with the following amendments: (1) the addition of new categories of documents under proposed Item 4(d); (2) the proposed changes to Item 5, under which the *de minimis* exception is eliminated and the "double listing" of foreign manufactured NAICS codes is required; and (3) the introduction of new "associate" requirements under Items 6 and 7 of the Form. In addition to the increased burden of collecting and providing these additional data and documents with an HSR filing, each of these proposed changes has numerous other far-reaching implications that are critical to business, including prolonging the timeline for when a filing can be made (and a deal can be closed), confidentiality issues and document preservation. In addition, given the breadth of documents that could potentially be

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[6] U.S. DEP'T OF JUSTICE & FEDERAL TRADE COMM'N, COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES, at v (2006); *see also* Federal Trade Comm'n Website, An FTC Guide To Mergers, *available at* *http://www.ftc.gov/bc/antitrust/mergers*.shtm ("Each year, the FTC and Department of Justice review many merger filings. Fully 95% of merger filings present no competitive issues."). Other statistics released by the Agencies show that under the current HSR Rules, historically, early termination was granted for approximately 75% of all transactions where it was requested by the parties.

[7] Id at 1.

[8] Id.

covered by Item 4(d), there is no meaningful limitation on the scope of individuals who would need to be searched, which also creates potential for inadvertent mistakes and the possibility of civil penalties.

Item 4(d)

Currently, Item 4(c) of the Form requires the production of documents created "by or for an officer or director" for the purposes of evaluating or analyzing the transaction with respect to "market shares, competition, competitors, markets, potential for sales growth or expansion into new product or geographic markets."[9] While the requirements of Item 4(c) remain unchanged under the proposed amendments, they are supplemented by several new categories of documentary attachments under proposed Item 4(d). This revision would require all filing parties (even for transactions that present no competitive overlap) to broaden substantially the scope of their search for documents to be submitted with a filing in order to gather: (1) offering memoranda (including documents that serve an equivalent function), regardless of whether such materials were prepared in connection with the proposed transaction; and (2) third-party analyses that are unrelated to the transaction. Requiring that an initial filing include documents that have no nexus whatsoever with the transaction at hand is an unprecedented change that is troublesome for a number of reasons, as summarized below.

Increased burden on filing parties: The proposed amendments to Item 4 would require all filing parties, even for transactions that present no competitive overlap, to substantially broaden the scope of their search for documents to be submitted with a filing. In the NPRM, the FTC states that these additional categories of documents are necessary "because parties have differing interpretations as to whether they are called for under current Item 4(c). The Commission thus propose[d] new Item 4(d) to enumerate these documents and require their submission with the Form." With all due respect, the authors of these comments take issue with this statement. The proposed Item 4(d) goes far beyond simply clarifying what is required to be submitted under Item 4(c). In fact, 4(d) would establish substantively new requirements for companies to submit with their HSR filings documents of the type that the Agencies currently request via access letters during the initial 30-day waiting period, or through second requests. In addition, the scope of the 4(d) document search would need to be extended outside of the deal team across far more company personnel, many of whom may know nothing about the proposed transaction during the time it is being negotiated. All materials identified and gathered as "potential 4(d) documents" must then be reviewed and processed by attorneys representing the parties, which would add significant costs to all reportable transactions, even those that are pro-competitive, or competitively neutral.

Potential for delay: The search necessitated by proposed Item 4(d) is likely to cause significant delay to the filing, as well to the consummation of a transaction. Many of our clients file under the HSR Act based on letters of intent or immediately following the signing of a definitive agreement (indeed, it is typical that parties agree to submit their HSR filings within five or ten business days following signing, a practice that is unlikely to remain a viable option if Item 4(d) is adopted as currently proposed). Currently, a preliminary but effective search for Item 4(c)

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[9] *See* 16 C.F.R. § 803 App. Item 4(c).

documents can be conducted well in advance of a filing, which allows the parties to later file in an expedited manner in order to more quickly consummate a transaction. Under proposed sub-parts (i) and (ii) of Item 4(d), employees who are not privy to a transaction at its earlier stages must be searched for responsive material prior to filing. The result is a significant delay in the consummation of a transaction, as such a search cannot be effectively conducted until the latter stages of negotiation – or indeed until after the transaction has been publicly announced – due to the confidentiality concerns discussed herein.

Confidentiality concerns: Under the current Rules, it is possible to complete and submit an HSR filing by working with a defined set of individuals within the company (*i.e.*, transaction teams and involved officers and directors). Given that the range of employees who could potentially have documents responsive to Item 4(d) is significantly broader than the team of executives involved in negotiating the transaction, conducting searches for Item 4(d) documents can and will increase the risk of leaks about non-public transactions, which has implications under securities law, and could increase transaction costs as the company may require many more employees to sign confidentiality agreements simply to submit an HSR filing.

Increased liability: Failure to fully provide Item 4(d) documents could form a new basis for civil penalties and other punitive agency action. As discussed below, the sub-parts to proposed Item 4(d) call for broad, and sometimes vague, classes of documents from individuals who have had little or no involvement in the proposed transaction. For a large, multinational company, the resulting search for documents responsive to these sub-parts may involve, in some cases, hundreds or even thousands of persons on a worldwide basis. In this scenario, there is a real risk that a filer could inadvertently omit an Item 4(d) document, which could result in the company's filing being "bounced" and the waiting period being restarted. Moreover, if such a document is located following the consummation of a transaction, the company and/or the certifying officer could be subject to civil penalties of $16,000 per day for the violation.[10] As a result, many officers who would typically sign a declaration or certification for an HSR filing may now be unwilling or unable, for fear of personal liability,[11] to personally verify a search of that magnitude.

Document Retention: The Commission notes in the NPRM that, "without a date cutoff, a search for these documents could be extremely burdensome. Accordingly, the Commission propose[d] a limit of two years before the date of filing for documents responsive to [Item 4(d)(i)]." This same limitation applies to proposed Item 4(d)(ii). The authors of these comments disagree with the Commission that the two-year time limitation significantly reduces the burden on potential filers. Instead, we note that proposed Item 4(d) would, in many cases, still require a burdensome, worldwide search to determine which documents in the company's possession "reference" a target entity or assets. A two-year search period will also likely capture multiple

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[10] *See* 74 Fed. Reg. 857 (Published Jan. 9, 2009); *see also* 15 U.S.C. § 18a(g)(1); Federal Civil Penalties Inflation Adjustment Act of 1990, 65 Fed. Reg. 69,665 (FTC Nov. 20, 2000).

[11] *See, e.g.,* Final Order and Judgment, *United States v. Blackstone Capital Partners II Merchant Banking Fund, LP, et al.*, No. 99CV00795 (D.D.C. March 30, 1999) (imposing personal liability of $50,000 on an individual company official for failure to provide documents to the antitrust enforcement Agencies prior to making an acquisition).

drafts of the same document, which also may need to be submitted with the filing. Moreover, many of our clients have well-defined document retention policies that generally identify classes of documents and corresponding document retention periods. As a result of the proposed amendments to Item 4(d), our clients' policies may need to be restructured to ensure that responsive documents are retained for two years, or else risk liability under the HSR Act or the need to submit a lengthy and detailed statement of reasons for non-compliance. In this connection, for example, we do not believe it is productive, efficient or appropriate to effectively require a company to retain *every* offering memorandum it receives – even if unsolicited – for a minimum of two years on the off chance that the memorandum contains a "reference" to a business that the company will later seek to acquire. In short, because the proposed Item 4(d) is ambiguous and overly broad, it would require the collection of a large, loosely-defined, volume of documents at great expense to the filing company.

The additional burdens and other issues associated with the individual sub-parts of Item 4(d) are further discussed below.

Item 4(d)(i) – Offering Memoranda

Under the current Rules, an offering memorandum must be included with a filing only if it was prepared in connection with the proposed transaction. The FTC's proposed Item 4(d)(i) would significantly expand the scope of search and production to include all offering memoranda prepared within the preceding two years that merely "*reference*" the acquired entity or assets, even if the document was not prepared in connection with the proposed transaction, does not contain "4(c)" content, and was not prepared by or for an officer or director. Under proposed Item 4(d)(i), documents that "served [the] function" of offering memoranda must also be attached, though the phrase is not defined.

We believe that proposed Item 4(d)(i) is extremely burdensome, and far too broad to accomplish the goals stated in the NPRM. First, proposed Item 4(d)(i) does not require that a document be relevant to the transaction under investigation by the government, nor does it require that a document be created by or for an officer or director of the entity filing notification. Requiring the production of documents with the initial filing that have no nexus whatsoever with the transaction at hand would force filing parties to gather and review all offering memoranda prepared or received during the prior two years for "reference(s)." Dropping the requirement that the document have been created "by or for an officer or director" would, in a great many cases, significantly expand the scope of a company's search for relevant documents to include business people who do not qualify as officers or directors, and potentially to outside third-party advisors. As a result, the Agencies are likely to receive documents that were never acted upon, but are simply present in the files of lower-level executives. For the vast majority of filings, it is difficult to understand how a category of documents that merely "reference" the target entity or assets, are completely unrelated to the transaction, and may never have been seen by officers and directors, would "significantly assist" the Agencies in analyzing the competitive effects of the proposed transaction during the initial review period.

Second, because the terms "reference" and "serve an equivalent function" are not defined in the Form or Instructions, this amendment is likely to have the effect of capturing unnecessarily broad classes of documents. Given the risk of a "bounced" filing and/or civil penalties, the

authors believe that many companies would err on the side of caution and be excessively over-inclusive when considering whether documents satisfy these requirements. For instance, while the proposed Form and Rules fail to further define what other types of documents could serve the purpose of offering memoranda, the Notice explains that "[a]ny such study, survey, analysis or report will . . . be responsive to Item 4(d)(i) if it also contains some reference to the acquired entity(s) or assets." The Notice also states that, "[i]f a seller circulates an existing presentation to provide an overview of the company to a prospective buyer(s), this type of document would be the equivalent of an offering memorandum . . . and must be submitted." Taken together, the language in the Rules and Notice appears to seek documents of a scope far beyond what would traditionally be deemed "offering memoranda" by the business community, including a broad range of "ordinary course" materials located within a due diligence dataroom. Further, and because the term "reference" is not limited or further explained in the proposed Rules, Item 4(d)(i) provides no bright-line standard as to how substantive a "reference" must be made in order to qualify the document for attachment to the Form. On the whole, we believe that the broad scope and lack of guidance regarding proposed Item 4(d)(i), the Rules, and Instructions will only result in confusion and questions of noncompliance.

Finally, we believe that the high volume of marginally useful documents that would undoubtedly be submitted with HSR filings under the vague criteria proposed for 4(d)(i) will hinder, rather than assist, the Agencies' efforts to conduct quick, efficient and thorough reviews during the initial 30-day waiting period.

We respectfully suggest that proposed Item 4(d)(i) be amended to limit the attachment of documents to those created or used for the purposes of evaluating or analyzing the proposed transaction, and that the FTC eliminate the requirement to provide documents that serve an equivalent function, or, at a minimum, provide a more specific definition of which types of documents serve the function of offering memoranda.

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As an example of the potential burdens associated with proposed Item 4(d)(i) compliance, the authors offer the following hypothetical:

Hypothetical 1

> Company A and Company B are preparing their respective HSR filings for A's acquisition of B. Company B retained an investment bank to prepare a Confidential Information Memorandum (CIM) describing the company, and Company A (as well as Company B) will submit the CIM as a 4(d)(i) document. However, 20 months earlier, the Corporate Development Manager of Company A (who is not an officer, and is unaware of the transaction negotiations between Company A and Company B) received an unsolicited CIM from an investment bank touting Company C as an acquisition candidate. The Corporate Development Manager typically receives dozens of unsolicited CIMs each month.
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> There is no competitive overlap between Company A and either Company B or Company C, but there is an overlap between Company B and Company C.

Because of the overlap between Company B and Company C, the offering memo for C identifies B as a competitor in this overlapping market.

Under the proposed changes, Company A would have to locate the offering memo in the files of the Corporate Development Manager (who does not know about the transaction and may not recall receiving a CIM about Company C that references Company B), review it for possible references to Company B, and submit it as a 4(d)(i) document, despite the irrelevance of the overlap between Company B and Company C in assessing the competitive effects of Company A's acquisition of Company B.

Item 4(d)(ii) – Third-Party Analyses

Proposed Item 4(d)(ii) would require filing parties to provide "all studies, surveys, or analyses" prepared by third-party advisors if they: 1) "were prepared for any officer(s) or director(s)" for the purpose of "evaluating or analyzing market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets;" and 2) "contain[] some reference to the acquired entity(s) or assets." We believe this proposed revision would *significantly* increase the burden associated with preparing an HSR filing. While our concerns are explained in greater detail below, our essential point is this: Item 4(d)(ii) would require that parties to *all* transactions submit with their initial filing the very extensive industry/market data, which could amount to several boxes of documents with each filing, currently provided only by companies in response to Agency access letters or second requests for transactions that raise some competitive questions or issues.

First, the burden associated with the search and production of Item 4(d)(ii) documents is significant. As the NPRM notes, "[i]f [Item 4(d)(ii) documents] are found in the files of any officer(s) or director(s) . . . they should be deemed to have been prepared for that individual." Many documents responsive to this item are distributed widely throughout a company, and are available in several forms (*e.g.*, market research studies, third-party reports, presentations and internal memoranda based on the opinions of third parties). The result of Item 4(d)(ii) and associated Instructions is that filers will be required to search both the electronic[12] and paper files of all officers and directors, regardless of their involvement in the proposed transaction, for files that merely "reference" the target company or assets. In our collective experience, which also includes thousands of hours spent on complex litigation matters, the search for 4(d)(ii) documents will be akin to traditional document discovery and is likely to cost some filers several hundred thousand dollars. Moreover, the increased burden of the proposal will be disproportionately levied on officers and directors of filing parties because the personal involvement of these individuals will be even more essential to a full and accurate search for responsive material than is currently the case under Item 4(c).

[12] It is unclear from the proposed Rules and associated Instructions whether such a search would need to include a search for responsive documents in any location, including company intranets, to which an officer or director has access. Many of our clients have huge amounts of information on internal servers, and a requirement to search company intranets would exponentially increase the compliance burden on these parties.

Second, and like proposed Item 4(d)(i), Item 4(d)(ii) calls for unnecessarily broad categories of documents, the majority of which are unlikely to provide the Agencies with information relevant to their antitrust analyses. Because Item 4(d)(ii) does not require that there be a nexus between the documents and the proposed transaction, the amendment would likely require the production of large volumes of materials that would be of little use to the Agencies. Further, the types of documents described in Item 4(d)(ii) are often requested during the initial 30-day waiting period if either the FTC or DOJ opens a preliminary investigation of a proposed transaction. Under the newly proposed Rules, all parties would be required to submit these materials at the outset with their HSR filing, even if the proposed transaction poses no conceivable competitive concern. Further, many parties receive unsolicited documents that would be responsive to proposed Item 4(d)(ii), the analysis of which by the antitrust Agencies will increase the chance of unwarranted and otherwise unnecessary investigations.

We believe the following examples are illustrative of the classes of documents the Agencies might receive in response to Item 4(d)(ii):

- **Unsolicited bankers books**: Many large, sophisticated corporations, as well as private equity groups, regularly receive unsolicited financial and market analyses from investment banks and other third parties. Such documents may not have been acted upon or even read by anyone at a filing entity, and may reference the target company or assets only in passing.

- **Subscription periodicals and market studies**: Many of our clients subscribe to voluminous multi-client reports which analyze market shares and trends with reference to specific competitors (*e.g.*, Chemical Market Associates and Spears and Associates in the oil and gas industry). In some cases, the Agencies could receive several boxes of documents relating to a single industry report.

- **Legal memoranda**[13]: The authors of these comments regularly prepare market and competitor analyses in the course of our antitrust and intellectual property practices. As 4(d)(ii) is not tied to a specific transaction, these analyses would be responsive regardless of whether overlapping product offerings are addressed, which would create the need to produce an extensive privilege log for the 4(d)(ii) schedule.

- **Industry databases**: Officers or directors of many filers have access to marketplace-monitoring research databases (*e.g.*, Nielsen or IRI for consumer packaged goods), the production of which would require the delivery of tens of boxes to the Agencies if printed.

- **Market research**: Many of our clients regularly pay third-party consultants to conduct market studies and other research for entire industries. The results of such research may be several volumes of spreadsheets with detailed data and other competitor information.

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[13] Legal memoranda are likely not to be disclosed to the FTC, but rather to be reviewed and withheld based on a claim of attorney-client privilege. Regardless, the time spent searching and logging outside counsel documents will put a significant burden on filing parties.

For the foregoing reasons, we respectfully request that the FTC not adopt proposed Item 4(d)(ii). In the alternative, we suggest that the FTC limit Item 4(d)(ii) to documents created or used for the purposes of evaluating or analyzing the proposed transaction, and explicitly exclude the production of draft documents, privileged documents, databases, and other shared electronic files.

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To further illustrate the potential burdens and pitfalls associated with proposed Item 4(d)(ii) compliance, we offer the following hypotheticals:

Hypothetical 2

> Employee A is a Senior Vice President for Marketing of Company Y, a large consumer packaged goods company. Company Y intends to acquire Company Z, a small consumer packaged goods company which overlaps with Company A in the provision of a single consumer product. Each year, Employee A receives the following documents from third parties: (1) monthly market data (including share information) and pricing summaries from two consumer data companies, including data covering 20 distinct consumer product areas; (2) voluminous multi-client industry studies from four separate third-party analysts; and (3) several boxes of solicited and unsolicited investment banker business pitches, all of which analyze competition in a market in which Company Y competes, in an attempt to solicit Company Y's interest in various investments, joint ventures and acquisitions. Employee A also has access to several hundred gigabytes of marketing information via Company Y's various subscriptions. More than 40% of Employee A's files make reference to Company Z.
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> From a filing standpoint, proposed Item 4(d)(ii) would likely require the search and production of a large volume of Employee A's files, comprising several hundred boxes of documents. Moreover, Company A would also need to somehow provide the Agencies with access to the several industry databases to which Employee A has access.

Hypothetical 3

> Company R is a large multinational corporation. Employee Z, an officer of Company R, reviews the acquisition of certain assets of Company S. As part of Employee Z's review, she requests that Company R's outside antitrust counsel review the potential acquisition for potential competitive concerns. Antitrust counsel's analysis contains a single reference to Company T, a small competitor of Company S. Six months later, Company S discontinues negotiations with Company R.
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> One year later, Company R enters into a letter of intent to purchase Company T, with which it has no overlapping product offerings. Under proposed Item 4(d)(ii), Company R would need to search the files of all its officers, including Employee Z, regardless of whether the officers had any knowledge of the proposed

transaction. Because of the single reference to Company T, the outside counsel memorandum created for Employee Z would be responsive to Item 4(d)(ii). To protect the privileged nature of the memorandum, Company R would need to assert its claim in the HSR filing and log the document on a privilege log. As a result, the extremely burdensome search of officers who are otherwise uninvolved the proposed transaction yields no additional information for the Agencies' review of the transaction

Item 4(d)(iii)

Item 4(d)(iii) proposes to require the submission of all studies, surveys, analyses or reports evaluating or analyzing synergies or efficiencies that were prepared by or for an officer or director in connection with the transaction. We agree with the FTC that "[d]ocuments that discuss synergies and/or efficiencies likely to result from a transaction can be very useful in the Agencies' initial review." We do, however, note that the requirements of Item 4(d)(iii) represent additional time and expense for every filer, even in the absence of a competitive overlap. Thus, information regarding efficiencies and synergies may prove largely irrelevant in the vast majority of transactions that raise no competitive concerns. Further, it is important to point out that a filer may inadvertently omit or fail to fully account for potential synergies and efficiencies in certain documents (*e.g*., target valuations or growth projections). For this reason, we request that the FTC amend the Rules to make clear that these filers will not be prejudiced by such omissions if a filer later discovers or accounts for such synergies and efficiencies.

Item 5

Item 5 currently requires reporting of revenue from the reporting party's "operations conducted in the United States" classified by North American Industrial Classification System ("NAICS") codes for the "base year" (currently 2002) and the most recently completed fiscal or calendar year, as well as additional revenue data for products added or deleted between the base year and the most recent year ("add-delete").

The NPRM proposes to (1) remove the requirements to report "base year" revenues and the addition or deletion of products between the base and most recent year; (2) eliminate the $1 million exemption from reporting revenues for non-manufacturing operations; and (3) require submission of revenue information at the 10-digit NAICS manufacturing code level for products that are produced outside the United States, but sold in or into the U.S.

The authors support the elimination of the base year and add-delete requirements, but believe that the benefit in eliminating those two sections of the Form is more than offset by the increased burdens associated with the new foreign manufacturing reporting requirements and elimination of the $1 million exemption.

The proposed revisions to Item 5 are discussed in detail below.

Item 5 – Deletion of the "Base Year" and Added or Deleted Products

Under the proposed amendments, the FTC has removed the requirements to report the "base year," as well as the addition or deletion of products between the base and most recent year. We concur with the Commission that the limited usefulness of the base year data does not justify the time and effort that can sometimes be necessary to compile this information. However, we must also point out that many large, sophisticated filers conduct several transactions each year and are now extremely adept at gathering and reporting base year and add-delete information. And, because base year data often requires no significant changes for a period of five or more years, the cost associated with Item 5(a) and 5(b) compliance can be spread out over multiple years and several transactions. Thus, for many of our clients, gathering and reporting of base year and add-delete information represents much less of a burden than, in the aggregate, any of the current-year revenue reporting requirements.

Item 5 – Elimination of the De Minimis Exception of Current Item 5

Revenue for the most recently completed year in any individual non-manufacturing NAICS code is currently exempt from reporting under Item 5 when that revenue is less than $1 million. In the NPRM, the FTC proposes to eliminate this *de minimis* exemption because it "often creates confusion about whether there is a need to report an overlap in Item 7" of the Form, where NAICS codes overlap between the acquiring and the to-be-acquired entity or assets must be listed.

Elimination of the *de minimis* exemption would increase the burden on all filing parties, many of whom may have extremely limited revenue from a specific, non-manufacturing operation. Furthermore, reporting of *de minimis* revenue is of minimal value, especially in the absence of a NAICS code overlap, as transactions in which one party has less than $1 million in sales are extremely unlikely to raise serious antitrust concerns. For these reasons, believe that the FTC's concerns may be adequately addressed through an amendment to the Instructions specifically instructing filers that the Item 5 *de minimis* exemption is not applicable to Item 7 of the Form.

Item 5 – Revenue Information for Foreign Manufactured Products

Currently, revenues from a filing person's foreign manufacturing operations need only be reported under Item 5 if the products pass through the "U.S. operations" of the filing person, such as warehouses, and then only under relatively simple wholesaling codes. Direct shipments from foreign manufacturing operations to U.S. customers currently fall outside Item 5 reporting because there are no relevant "operations conducted within the United States." Under the proposed Rules and Instructions, direct shipments would have to be reported under 10-digit NAICS manufacturing codes, as would shipments from a company's foreign manufacturing plants to its U.S. sales operations. These changes would significantly increase the compliance burden on companies that have foreign manufacturing operations selling into the U.S., and are not in line with the Commission's previous findings.

The proposed amendments to Item 5 depart from a basic, long-standing tenet of the HSR Rules of Practice; specifically, that revenue data provided pertain to relevant "operations

conducted within the United States." Original Item 5(c), as proposed in 1978, would have required a reporting entity to provide, by 7-digit product categories, the dollar value of products imported into the United States for resale.[14] According to the Commission, "[a] large number of comments criticized this requirement," noting that "few companies kept segregated data concerning imports," and that, "even if such data existed, it would not be maintained by 7-digit product categories."[15] Thus, the FTC reexamined the issue and determined that "should a separate breakdown of imports be desired, either agency may request such information or documentary material pursuant to section 7A(e) and § 803.20."[16]

The tremendous burdens associated with providing foreign manufactured product data broken down into detailed U.S. Census codes have not significantly changed over the past 30 years. In practice, we know of no companies that track foreign manufactured product revenue data by NAICS code. Moreover, foreign operations personnel are not generally familiar with the NAICS code system, particularly at the 10-digit level, and corporations rarely have records convenient to report direct sales of manufactured products. In order to fully comply with the amendments to Item 5, many of our clients would be required to alter their accounting systems or spend thousands of cumulative hours manually capturing NAICS code information for each product or product component shipped into the U.S.

We believe that the FTC should not abandon the view that Item 5 properly relates only to operations conducted in the U.S. As the FTC previously determined, any other requirement would be too burdensome for its initial review. Instead, the authors respectfully suggest that information concerning foreign manufactured products shipped direct to U.S. customers should not be required on the Form, but rather should be the subject of a voluntary submission or a request for additional information that would focus on the exact product categories under investigation by the reviewing Agency. This would postpone any burden on parties until a point at which the Agency's investigation is more focused, and a point at which more narrowly tailored requests might alleviate the need for significantly larger volumes of information. It would also leave intact the ability to capture foreign manufactured product sales that flow through U.S. operations of the filing person.

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To further illustrate the likely issues associated with proposed Item 5 compliance, we offer the FTC the following hypothetical example:

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[14] Premerger Notification; Reporting and Waiting Period Requirements; Proposed Rules, 43 Fed. Reg. 33451, 33530 (published July 31, 1978).

[15] *Id.*

[16] *Id.*

Hypothetical 4

Company K, an electronics manufacturer headquartered in Korea, will submit an HSR filing for its proposed acquisition of a computer chip manufacturer located in California. Company K sells dozens of different types of electronics products in or into the United States. Such sales are made to both consumers and corporate customers. Consumer products are shipped from Company K's foreign manufacturing plants to company-owned distribution centers in the U.S. The distribution centers, in turn, distribute the products to independent retail dealers, who sell to consumers. Commercial products, on the other hand, are sold directly to U.S. corporate customers.

All of Company K's consumer products are assembled in Mexico and then sold on an intra-company basis to K's U.S. distribution centers. K's commercial products are assembled in Korea and then shipped directly to U.S. corporate customers.

Under the current HSR Form, Rules and related Instructions, Company K would not report revenue from its direct sales of commercial products to U.S. corporate customers, but would report its intra-company sales of consumer products under the appropriate NAICS wholesaling codes.

Under the proposed revisions to Item 5, Company K would have to report revenues for all of its products that are manufactured outside the United States and then sold in or into the U.S. Products sold directly to corporate customers would be reported under numerous relevant 10-digit manufacturing codes, while intra-company sales to distribution centers would be reported under both manufacturing codes and under the appropriate wholesaling codes.

The financial accounting personnel at Company K's Mexican and Korean manufacturing facilities have no prior experience with NAICS codes. In addition, K's accounting systems track foreign intra-company transfer revenue only in the aggregate, not at the individual product level. Thus, in order to fully comply with proposed Item 5, Company K would have to train its Mexico- and Korea-based accounting staff in the complexities of NACIS 10-digit manufacturing codes and also either: (1) institute an accounting and distribution system overhaul to track and report subsidiary intra-company sales by 10-digit NAICS code; or (2) manually decipher NAICS code information for all products manufactured outside the U.S., something which would likely cost thousands of hours and potentially hundreds of thousands of dollars. Moreover, this process would have to be repeated each year, as K's manufacturing strategy changes from year to year, and component sourcing may shift to various other of K's production facilities that were not previously involved in selling into the United States.

Associate Requirements – Items 6(c) and 7

The proposed amendments will require a filing party to provide information about "associate" entities, a newly defined term. An entity will be considered an "associate" of the filing party where it: (A) has the right, directly or indirectly, to manage, direct or oversee the affairs and/or 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.

In the NPRM, the FTC suggests that the new associate classification is necessary because the "current Form may . . . 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 NPRM similarly indicates that the new associate requirements address the fact that "entities that are *commonly managed* with the acquiring person are not included because these 'associated' entities are not controlled . . . by the acquiring Ultimate Parent Entity." While we acknowledge that the current Form may include these gaps, we believe that the amendments to the Rules go far beyond what is needed to remedy this situation.

Most importantly, the definition of "associates" is unduly vague and overbroad. As quoted above, the NPRM emphasizes a need to identify entities under "common management," and the extent to which such entities may already have minority holdings in the target. Yet the definition of "associates" is not limited to entities exercising or subject to common management, but also entities that exercise or are subject to a common ability to "direct or oversee," suggesting (without defining) a different standard from management. Most business entities would likely concede experience identifying who within the organization has management rights, but have no framework for identifying persons who do not exercise such rights but somehow "direct or oversee."

The problem is exacerbated when it comes to ascertaining what it means to manage, direct or oversee "affairs," that by definition must be different from "investments." The Agencies' desire to identify persons who manage investments across associated funds may be relatively justifiable, but a goal of identifying persons or entities that arguably "direct or oversee . . . affairs" that have nothing to do with managing investments is difficult to comprehend.

The disproportionality of the burdens imposed to any benefits obtained is also obvious in relation to the specific requirements of new Item 6(c)(ii). As currently drafted, Item 6(c)(ii) requires much more information than needed to identify, as the FTC suggested in the NPRM, "minority holdings [in] the acquired entity(s) or assets." Item 6(c)(ii) would require a filing party to list not only the holdings of associate companies in the target entity, but of holdings of an associate in an entity that derives revenues in the same 6-digit NAICS industry code as the target. Persons given traditional responsibility for monitoring minority investments generally are not charged with a level of knowledge needed to identify whether those minority shareholdings overlap with a proposed acquisition target. Thus, as proposed the new requirement will significantly increase the burden on general partners and investment managers or directors to be

involved in the provision of minority investment information. The need for higher level involvement may be eased by the ability to provide minority investment information for "all" associates, rather than just those with overlaps, but for anyone that follows this comprehensive approach there is clearly far less (if any) value to the information provided.

The Agencies note in the NPRM that the associate requirements outlined in Items 6 and 7 are likely to affect "acquiring persons that are private equity funds and master limited partnerships" ("MLPs")." However, there is clearly the potential to affect a much broader class of business structures. Taken literally, the proposed associate changes would apply to any entity that makes investments above the HSR threshold, and that has any part of its affairs and/or investments "managed, directed or overseen" by someone other than officers or its board of directors. Whereas most corporate entities may tend to consider themselves as "managed" primarily by their officers and directors – particularly when it comes to investments -- they may have much greater difficulty excluding the potential that other persons or entities "direct or oversee" elements of their affairs. As a result, potentially all filing persons would need to consider the existence of "associates."

Finally, the entities in possession of the key information necessary to respond to the various "associate" requirements are, by definition, <u>not controlled by the filing entity</u>. This creates significant difficulties in terms of gathering information in a timely and efficient manner. The Agencies professed to address this problem by allowing answers based upon "knowledge and belief," but this may offer little additional comfort to clients who already rely on that standard in certifying the form (given the use of "best of my knowledge" language in the certification). Absent clarification of what efforts the proposed standard is meant to exclude as to the "associate" requirements, that are required as to other items, filing persons subject to the associate requirements will likely perceive a high burden to prove a negative – i.e. that none of the hundreds if not thousands of associate entities trigger disclosure requirements due to an overlap – and significant discomfort certifying compliance with the new requirements without having carried out that burden.

In lieu of requiring "associate" information in a filing, we believe that the Agencies should continue to pursue clarifications regarding common management, direction and control through the means used previously by the Agencies (i.e., voluntary submissions and requests for additional information). In the alternative, we suggest that the Commission further tailor the associate requirements by limiting Item 6(c)(ii) to associate holdings in the target or target assets, and limit the scope of associates by defining managing entities only as those with a contractual right to manage investments. Most firms have a far greater ability to identify entities with contractual rights to manage investments, rather than identifying what it might mean to "direct or oversee … affairs." At a minimum, we would strongly urge the FTC to clarify the terms "manage," "direct," "oversee" and "affairs" to better tailor the scope of information required to meet the Agencies' expressed goals of identifying overlaps among commonly managed entities.

* * *

To further illustrate the likely issues presented by the new associate requirements, we offer the following hypotheticals:

Hypothetical 5

Private equity Fund A plans to make a reportable minority investment in Company Z. Fund A is managed by Entity Q, which also manages 9 additional private equity funds. Each of the 10 funds managed by Entity Q has at least 30 portfolio companies. Under the proposed changes, Fund A would be required to determine whether any of the 300 portfolio companies (the "associates" of "associates") have (a) operations with a NAICS code overlap with Company Z, and (b) minority holdings in companies with a NAICS code overlap with Company Z. If Item 7 is interpreted strictly, it must be read to include within its scope all the entities controlled by those 300 companies. The information necessary to complete Item 7(b)(ii) could extend to literally thousands of companies, in almost all cases with Fund A having only a tangential relationship. Absent deletion of or significant limitations on the proposed associate changes, the burden to gather this information, to the extent possible, is immense in both time and expense. Also, the information gathered would prove only marginally useful to the Agencies in evaluating an overlap with an entity to be held at only a minority level, making the burden particularly egregious.

Hypothetical 6

Building on Hypothetical 5, Fund A has an investment committee. Because the investment committee members arguably "manage, direct or oversee" the investments of Fund A, Fund A and Entity Q expect that all members of the investment committee also appear to be associates of Fund A.[17] This in turn makes any other funds' investment committees on which those individuals sit -- even if those funds are completely outside the family of funds of which A is a member -- associates as well. If investment committee members are indeed associates of the funds they "direct or oversee," the scope of associates relevant to Fund A's minority investment in Z is now amplified exponentially. Also, most executives at Fund A and Entity Q have no existing knowledge of the activities of these tangential "associates," and likely would be uncomfortable certifying information regarding potential overlaps because they cannot exclude the possibility that investment committee members or other persons within their organizations have such knowledge.

Hypothetical 7

Company A understands that the associate requirements appear to be directed at private equity firms and MLPs, and that Company A's officers and directors are excluded from being considered managing entities. However, Company A frequently hires consultants who might be considered to "direct or oversee" the

[17] The examples to the associate requirements rule out corporate officers and directors, but encompass investment advisors of a fund. Further, informal FTC Staff interpretations also indicate that a private equity fund's investment committee members should be treated as officers or directors for 4(c) purposes. *See* Federal Trade Commission Informal Staff Opinion 0503019 (March 23, 2005).

issues upon which they are consulting. For example, Consultant B has been contracted to oversee a restructuring of Company A's payroll operations, clearly an important part of Company A's "affairs," but one that has nothing to do with any acquisitions Company A might make. Company A is concerned that Consultant B is an associate of the corporation, and as a result, that other entities who Consultant B provides similar services to might also be associates for Item 7 purposes. Likewise, Company A employs Accounting Firm C to prepare its quarterly and annual audits, and is concerned that this may make Accounting Firm C an entity that "oversees" its finances.

Company A is also a minority shareholder in a corporate joint venture ("JV") with Company D and Company E, each holding 33-1/3% of the equity. Each shareholder oversees areas of the JV's "affairs"/operations that relate to the contributions made by that shareholders to the JV. Companies A, D and E are concerned that in acquisitions by the JV all three of them are associates, even though each is already disclosed in Item 6(b), and that all the companies that they control may also need to be treated as associates. Likewise in an acquisition by any one of them that has no relevance to the JV, the JV would be an associate, even though it is already reported as a minority investment in Item 6(c).

Company A believes that all of the above situations are outside the scope of what the Agencies intended to target with the associate requirements. Company A also understands that completion of new Items 6(c)(ii) and 7 requirements for identified "associates" can be based on "knowledge or belief." Nevertheless Company A has no current basis for comfort that (i) identification of what entities are "associates" in the first instance is subject to the same knowledge and belief standard, or (ii) it can exclude Consultant B, Accounting Firm C, and JV from that scope in filings by Company A, or (iii) it and Companies D and E can be excluded from that scope in filings by the JV.

Conclusion

The authors fully appreciate the Commission's efforts in amending the HSR Form and corresponding Rules, and agree with the overall objective of attempting to reduce the burdens associated with submitting an HSR filing. Unfortunately, after careful consideration, we believe that some proposed changes will not achieve this objective and in many situations the proposed changes would *significantly increase* the burdens and expenses associated with submitting an HSR filing. In those instances, we believe the proposed amendments can be better tailored to decrease the various burdens and other concerns on filing parties outlined above while still addressing the concerns expressed in the NPRM.