

FEDERAL TRADE COMMISSION

16 CFR Parts 801, 802 and 803

RIN 3084-AB46

Premerger Notification; Reporting and Waiting Period Requirements

AGENCY: Federal Trade Commission.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Federal Trade Commission (“FTC” or “Commission”) is issuing this advance notice of proposed rulemaking (“ANPRM”) to gather information, related to seven topics, that will help to determine the path for future amendments to the premerger notification rules (“the Rules”) under the Hart-Scott-Rodino Antitrust Improvements Act (“the Act” or “HSR”). This ANPRM relates to Parts 801, 802, and 803 of the Rules.

DATES: Comments must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: Interested parties may file a comment online or on paper, by following the instructions in the Invitation to Comment part of the **SUPPLEMENTARY**

INFORMATION section below. Write “16 CFR Parts 801-803: Hart-Scott-Rodino Rules ANPRM, Project No. P110014” on your comment. File your comment online at *https://www.regulations.gov* by following the instructions on the web-based form. If you prefer to file your comment on paper, mail your comment to the following address:

Federal Trade Commission, Office of the Secretary, 600 Pennsylvania Avenue NW, Suite CC-5610, (Annex J), Washington, DC 20580, or deliver your comment to the following

address: Federal Trade Commission, Office of the Secretary, Constitution Center, 400 7th Street SW, 5th Floor, Suite 5610 (Annex J), Washington, DC 20024.

FOR FURTHER INFORMATION CONTACT: Robert Jones (202-326-3100), Assistant Director, Premerger Notification Office, Bureau of Competition, Federal Trade Commission, 400 7th Street SW, Room CC-5301, Washington, DC 20024.

SUPPLEMENTARY INFORMATION:

Invitation to Comment

You can file a comment online or on paper. For the Commission to consider your comment, we must receive it on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Write “16 CFR Parts 801-803: Hart-Scott-Rodino Rules ANPRM, Project No. P110014” on your comment. Your comment – including your name and your state – will be placed on the public record of this proceeding, including, to the extent practicable, on the <https://www.regulations.gov> website.

Because of the public health emergency in response to the COVID-19 outbreak and the agency’s heightened security screening, postal mail addressed to the Commission will be subject to delay. We strongly encourage you to submit your comment online through the <https://www.regulations.gov> website. To ensure the Commission considers your online comment, please follow the instructions on the web-based form.

If you file your comment on paper, write “16 CFR Parts 801-803: Hart-Scott-Rodino Rules ANPRM, Project No. P110014” on your comment and on the envelope, and mail your comment to the following address: Federal Trade Commission, Office of

the Secretary, 600 Pennsylvania Avenue NW, Suite CC-5610, (Annex J), Washington, DC 20580, or deliver your comment to the following address: Federal Trade Commission, Office of the Secretary, Constitution Center, 400 7th Street SW, 5th Floor, Suite 5610 (Annex J), Washington, DC 20024. If possible, please submit your paper comment to the Commission by courier or overnight service.

Because your comment will be placed on the publicly accessible website, <https://www.regulations.gov>, you are solely responsible for making sure your comment does not include any sensitive or confidential information. In particular, your comment should not include sensitive personal information, such as your or anyone else's Social Security number; date of birth; driver's license number or other state identification number, or foreign country equivalent; passport number; financial account number; or credit or debit card number. You are also solely responsible for making sure your comment does not include any sensitive health information, such as medical records or other individually identifiable health information. In addition, your comment should not include any "trade secret or any commercial or financial information which . . . is privileged or confidential," – as provided by Section 6(f) of the FTC Act, 15 U.S.C. 46(f), and FTC Rule 4.10(a)(2), 16 CFR 4.10(a)(2) – including in particular competitively sensitive information such as costs, sales statistics, inventories, formulas, patterns, devices, manufacturing processes, or customer names.

Comments containing material for which confidential treatment is requested must be filed in paper form, must be clearly labeled "Confidential," and must comply with FTC Rule 4.9(c). In particular, the written request for confidential treatment that

accompanies the comment must include the factual and legal basis for the request, and must identify the specific portions of the comment to be withheld from the public record. *See* FTC Rule 4.9(c). Your comment will be kept confidential only if the FTC General Counsel grants your request in accordance with the law and the public interest. Once your comment has been posted publicly at www.regulations.gov – as legally required by FTC Rule 4.9(b) – we cannot redact or remove your comment, unless you submit a confidentiality request that meets the requirements for such treatment under FTC Rule 4.9(c), and the General Counsel grants that request.

Visit the FTC website to read this Notice and the news release describing it. The FTC Act and other laws that the Commission administers permit the collection of public comments to consider and use in this proceeding as appropriate. The Commission will consider all timely and responsive public comments it receives on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. For information on the Commission’s privacy policy, including routine uses permitted by the Privacy Act, *see* <https://www.ftc.gov/site-information/privacy-policy>.

Overview

The Act and Rules require the parties to certain mergers and acquisitions to file notifications with the Commission and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice (“the Assistant Attorney General”) (collectively, “the Agencies”) and to wait a specified period of time before consummating such transactions. The reporting and waiting period requirements are intended to enable the Agencies to determine whether proposed mergers or acquisitions

may violate the antitrust laws if consummated and, when appropriate, to seek injunctions in federal court to prohibit anticompetitive transactions prior to consummation.

Section 7A(d)(1) of the Clayton Act, 15 U.S.C. 18a(d)(1), directs the Commission, with the concurrence of the Assistant Attorney General, in accordance with the Administrative Procedure Act, 5 U.S.C. 553, to require that premerger notification be in such form and contain such information and documentary material as may be necessary and appropriate to determine whether the proposed transaction may, if consummated, violate the antitrust laws. In addition, Section 7A(d)(2) of the Clayton Act, 15 U.S.C. 18a(d)(2), grants the Commission, with the concurrence of the Assistant Attorney General, in accordance with 5 U.S.C. 553, the authority to define the terms used in the Act, exempt classes of transactions that are not likely to violate the antitrust laws, and prescribe such other rules as may be necessary and appropriate to carry out the purposes of Section 7A.

Since the enactment of the Act, the Commission has updated and refined the Rules many times. Indeed, the Agencies have a strong interest in making sure the Rules are as current and relevant as possible. Certain rules interpreting and implementing the Act, some of which have not been changed since they were first promulgated in 1978, may need additional updating. In this ANPRM, the Commission proposes to gather information on seven topics to help determine the path for potential future amendments to numerous provisions of Parts 801, 802, and 803 of the Rules under the Act.

PART 801 - COVERAGE RULES

§ 801.1f(1)(ii) Non-corporate interest.

§ 801.1(i)(1) *Solely for the purpose of investment.*

§ 801.10(c)(2) *Acquisition price.*

§ 801.10(c)(3) *Fair market value.*

§ 801.90 *Transactions or devices for avoidance.*

PART 802 – EXEMPTION RULES

§ 802.2 *Certain acquisitions of real property assets.*

§ 802.5 *Acquisitions of investment rental property assets.*

§ 802.9 *Acquisition solely for the purpose of investment.*

§ 802.21 *Acquisitions of voting securities not meeting or exceeding greater notification threshold (as adjusted).*

§ 802.31 *Acquisitions of convertible voting securities.*

§ 802.64 *Acquisitions of voting securities by certain institutional investors.*

PART 803 – TRANSMITTAL RULES

Appendix A to Part 803 Notification and Report Form for Certain Mergers and Acquisitions

Appendix B to Part 803 Instructions to the Notification and Report Form for Certain Mergers and Acquisitions

Background

Although it regularly reviews the Rules and revises them on a rolling basis, the Commission is issuing this ANPRM to solicit information to support review of the Rules on a more unified basis as part of its systematic review of all FTC rules and guides. The Commission is aware that market and business practices are constantly evolving, and that these changes make it especially important to evaluate whether the Rules are still serving their intended purpose or if they need to be amended, eliminated, or supplemented.

To accomplish this, the Commission is publishing in this ANPRM a number of questions related to seven different topics about which questions frequently arise in discussions of the Rules: Size of Transaction, Real Estate Investment Trusts, Non-Corporate Entities, Acquisitions of Small Amounts of Voting Securities, Influence

outside the Scope of Voting Securities, Devices for Avoidance, and Filing Issues.

Answers to questions on these topics will provide information that may facilitate drafting of new or revised rules.

The Commission welcomes comments on all of these topics, or on any sub-topic within them. The Commission, however, does not expect that every commenter will address all seven topics, or even every question relating to each topic. The Commission notes that comments it receives in response to this ANPRM may also inform the Notice of Proposed Rulemaking regarding the proposed change in the § 801.1(a)(1) definition of “person” and proposed exemption § 802.15 published in the Federal Register at the same time as this ANPRM.

I. Size of Transaction

Section 7A(a)(2) of the Clayton Act mandates an HSR filing when a transaction meets the Size of Transaction (“SOT”) test, subject to other provisions of the Rules, including exemptions.¹ To determine whether a transaction meets the SOT test, filing parties must look to Acquisition Price (“Acquisition Price”) under 16 CFR 801.10 or, in some cases, Fair Market Value (“FMV”) under 16 CFR 801.10(c)(3). As it is the filing parties’ responsibility to conduct these calculations, the Commission would benefit from additional information on how filing parties engage in the calculation for both Acquisition Price and FMV.

A. Acquisition Price (16 CFR 801.10)

¹ *Steps for Determining Whether an HSR Filing is Required*, FTC.GOV, <https://www.ftc.gov/enforcement/premerger-notification-program/hsr-resources/steps-determining-whether-hsr-filing> (last visited July 07, 2020).

Under 16 CFR 801.10(c)(2), the Acquisition Price “shall include the value of all consideration for such voting securities, non-corporate interests, or assets to be acquired.”² The FTC’s Premerger Notification Office (“the PNO”) has long taken the position that, when a transaction has a determined Acquisition Price, debt may be excluded from the Acquisition Price in certain circumstances. For example, if a buyer pays off a target’s debt as part of the transaction, the buyer may deduct the amount of the retired debt from the Acquisition Price. This position dates from the earliest days of interpreting the HSR Rules in the late 1970s and early 1980s and is based, in part, on the analysis of a target’s balance sheet liabilities in the context of an acquisition of voting securities.

The PNO has also allowed the deduction of certain expenses when calculating the Acquisition Price. For example, where the purchase price in the parties’ transaction agreement includes funds earmarked to pay off the seller’s transaction expenses, the PNO has permitted the parties to deduct that amount when calculating the Acquisition Price based on the view that such payments do not reflect consideration for the target.

The Commission is aware that these informal PNO staff positions can have a significant impact on the calculation of the Acquisition Price and, in turn, on whether a transaction is reportable under the Act. Given the potential for these positions to affect the structure of a transaction, the Commission believes these informal PNO staff positions may need revision. As a result, the Commission aims to understand the

² 16 CFR 801.10(c)(2).

decision-making involved in the deduction of retired debt or other amounts or categories of expenses from the Acquisition Price through responses to the following questions:

1. When negotiating a transaction, does a buyer ever offer to pay off or retire debt as part of the deal? Under what circumstances? How have these circumstances evolved since the late 1970s/early 1980s?
 - a. Why might a buyer offer to pay off or retire debt as part of the deal now as opposed to in the late 1970s/early 1980s? Have the competitive implications of the deal ever been a factor in this decision?
 - b. Why might a buyer decline to pay off or retire debt as part of the deal now as opposed to in the late 1970s/early 1980s? Have the competitive implications of the deal ever been a factor in this decision?
 - c. Does a seller prefer a buyer that is willing to pay off or retire debt as part of the deal? Why or why not? Are seller preferences different now than in the late 1970s/early 1980s?
 - d. In a multiple bid situation, is a buyer's willingness to pay off or retire debt as part of the deal ever a factor in the seller's selection of the winning bid? Was it a factor in the late 1970s/early 1980s? And if it is evaluated differently today versus the 1970s/early 1980s, why is it evaluated differently?
 - e. Do sellers ever reject a buyer's offer to pay off or retire debt as part of the deal? Under what circumstances? How have these circumstances evolved since the late 1970s/early 1980s? Have the competitive implications of the deal ever been a factor in this decision?

- f. Are there any limitations (legal or otherwise) on a buyer's ability to pay off or retire debt as part of the deal? If so, what are they? How do these limitations differ from limitations in place in the late 1970s/early 1980s?
 - g. Are buyers more or less likely to pay off or retire debt as part of the deal now than they were in the late 1970s/early 1980s? Why or why not?
2. When negotiating a transaction, does a buyer ever offer to pay other expenses of or within the seller (e.g., legal or banking fees, change of control payments, etc.) as part of the deal? Under what circumstances? How have these circumstances evolved since the late 1970s/early 1980s?
- a. Why might a buyer offer to pay such expenses as part of the deal now as opposed to in the late 1970s/early 1980s? Have the competitive implications of the deal ever been a factor in this decision?
 - b. Why might a buyer decline to pay such expenses as part of the deal now as opposed to in the late 1970s/early 1980s? Have the competitive implications of the deal ever been a factor in this decision?
 - c. Does a seller prefer a buyer that is willing to pay such expenses as part of the deal? Why or why not? Are seller preferences different now than in the late 1970s/early 1980s?
 - d. In a multiple bid situation, is a buyer's willingness to pay such expenses as part of the deal ever a factor in the seller's selection of the winning bid? Was it a factor in the late 1970s/early 1980s? If it is evaluated differently today versus the 1970s/early 1980s, why is it evaluated differently?

- e. Do sellers ever reject a buyer's offer to pay such expenses as part of the deal?
Under what circumstances? How have these circumstances evolved since the late 1970s/early 1980s? Have the competitive implications of the deal ever been a factor in this decision?
 - f. Are there any limitations (legal or otherwise) on a buyer's ability to pay such expenses as part of the deal? If so, what are they? Do these limitations differ from limitations in place in the late 1970s/early 1980s? If they differ, how do they differ?
 - g. Are buyers more or less likely to pay such expenses as part of the deal now than they were in the late 1970s/early 1980s? Why or why not?
3. How do parties currently calculate the Acquisition Price? How has the calculation changed since the late 1970s/early 1980s?
- a. Under what conditions is the Acquisition Price different from the purchase price or consideration identified in the transaction agreement? Have these conditions changed since the late 1970s/early 1980s? If they have changed, how have they changed?
 - b. Do transaction agreements ever lack a firm or certain purchase price? Under what conditions? Have these conditions changed since the late 1970s/early 1980s? If they have changed, how have they changed?
 - i. Why would parties negotiate a deal without a firm or certain purchase price? What factors have affected such a decision or deal structure? Have these factors evolved since the late 1970s/early 1980s? If they have

changed, how have they changed? Have the competitive implications of the deal ever been a factor in this negotiating a deal without a firm or certain purchase price?

- ii. What are the limits on the scope of the undetermined payments or deductions? Have these limits changed since the late 1970s/early 1980s? If they have changed, how have they changed?
- c. Can an Acquisition Price be subject to undeterminable deductions or deductions of undeterminable value? Under what conditions? Have these conditions evolved since the late 1970s/early 1980s? If they have changed, how have they changed? What are some examples of each kind of deduction and how have they changed since the late 1970s/early 1980s?
- d. Are there certain categories of consideration that are commonly deducted or added when calculating the Acquisition Price? Have these categories changed since the late 1970s/early 1980s? If they have changed, how have they changed?
- e. Is the ultimate recipient of a payment ever a factor in whether such payment is included when calculating the Acquisition Price? Why or why not? In what circumstances? Has this determination changed since the late 1970s/early 1980s? If it has changed, how has it changed?
- f. Is employee compensation (e.g., bonus payments, retention payments, payments for contingent employee compensation) ever included when calculating the Acquisition Price? Why or why not? In what circumstances? Has this

- determination changed since the late 1970s/early 1980s? If it has changed, how has it changed?
- g. Does the form of employee compensation affect whether it is included in the Acquisition Price? Under what circumstances? Has this determination changed since the late 1970s/early 1980s? If it has changed, how has it changed?
 - h. Is the value of employee compensation ever deducted from the Acquisition Price? Why or why not? Under what circumstances? Has this determination changed since the late 1970s/early 1980s? If it has changed, how has it changed?
 - i. Is there a “control premium” associated with the acquisition of control? How does an Acquiring Person determine that “control premium”? Has this determination changed since the late 1970s/early 1980s? If it has changed, how has it changed?
4. When calculating the Acquisition Price, do parties include all consideration paid for the target? How has this approach changed since the late 1970s/ early 1980s?
- a. How do parties define “consideration?” Has this changed since the late 1970s/early 1980s? If it has changed, how has it changed?
 - b. Do parties rely on a standard legal definition for “consideration?” If so, what is it and from what is it derived? Has this changed since the late 1970s/early 1980s? If it has changed, how has it changed?
 - c. Is consideration defined any differently for the purposes of calculating Acquisition Price than it is for non-HSR purposes? Why or why not? Has this changed since the late 1970s/early 1980s? If it has changed, how has it changed?

- d. Are any categories of payments excluded from the above definition of “consideration?” Why or why not? Has this changed since the late 1970s/early 1980s? If it has changed, how has it changed?
 - e. Is the ultimate recipient of the payment ever a factor in whether such payment is included as consideration? Why or why not? Has this changed since the late 1970s/early 1980s? If it has changed, how has it changed?
5. When calculating the Acquisition Price, how does debt affect the calculation? How has this approach changed since the late 1970s/early 1980s?
- a. Does the debt reported on the target’s balance sheet affect the calculation of the Acquisition Price? Why or why not? In what circumstances? Should it? Why or why not? Has this changed since the late 1970s/early 1980s? If it has changed, how has it changed?
 - b. Does the buyer’s pay off or retirement of debt affect the calculation of the Acquisition Price? Why or why not? In what circumstances? Should it? Why or why not? Has this changed since the late 1970s/early 1980s? If it has changed, how has it changed?
 - c. Does the treatment of debt (either reported on a balance sheet or being paid off or retired by the buyer) differ based on whether the acquisition is of (1) voting securities, (2) non-corporate interests, or (3) assets? Why or why not? Should it? Why or why not? Has this changed since the late 1970s/early 1980s? If it has changed, how has it changed?

- d. Should the calculation of Acquisition Price focus on the total amount paid by the Acquiring Person (including debt that is paid off or retired) or the net amount received by the Acquired Person (excluding debt that is paid off or retired)? Why? Has this changed since the late 1970s and early 1980s? If it has changed, how has it changed?
- 6. Where an acquisition is of voting and non-voting securities, how is the Acquisition Price allocated between the voting securities and the non-voting securities? How has this approach changed since the late 1970s/early 1980s?
 - a. Are the voting securities and non-voting securities separately valued? Why or why not? Has this changed since the late 1970s/early 1980s? If it has changed, how has it changed?
 - b. Are each of the voting securities and the non-voting securities valued? Why or why not? Has this changed since the late 1970s and early 1980s? If it has changed, how has it changed?

B. Fair Market Value (16 CFR 801.10(c)(3))

Sometimes a transaction does not have a determined Acquisition Price. This is often due to the fluctuation in stock prices or the inability to calculate the exact amount of contingent future payments. As a result, the Fair Market Value (“FMV”) of the transaction becomes critical to determining reportability under the Act.

Per § 801.10(c)(3), FMV “shall be determined in good faith by the board of directors of the ultimate parent entity included within the Acquiring Person, or, if unincorporated, by officials exercising similar functions; or by an entity delegated that

function by such board or officials.” Once the Acquiring Person, or its delegate, has determined the FMV, there is no requirement to share with the Agencies the details of how that FMV was determined. The Commission would like to understand better the determination of FMV through responses to the following questions:

1. When an Acquiring Person is evaluating the potential acquisition of voting securities, non-corporate interests, or assets, what methodologies does that Acquiring Person use to support valuation in the ordinary course of due diligence and negotiation of the acquisition? How have these methodologies changed since the late 1970s/early 1980s?
 - a. If an acquisition involves the acquisition of non-voting securities, what methodologies does the Acquiring Person use to value the non-voting securities? Have these methodologies changed since the late 1970s/early 1980s? If they have changed, how have they changed?
 - b. In an acquisition of both voting securities and non-voting securities, does the Acquiring Person ever use one methodology to value the voting securities and a different methodology to value the non-voting securities? Why or why not? Have these methodologies changed since the late 1970s/early 1980s? If they have changed, how have they changed?
 - c. Where the Acquiring Person receives board appointment or board designation rights (or their non-corporate equivalent) in conjunction with the acquisition of voting (or non-voting) securities, do those rights affect the FMV of the voting (or

non-voting) securities acquired? Has this changed since the late 1970s/early 1980s? If this has changed, how has it changed?

2. How does the determination of FMV under 16 CFR 801.10(c)(3) differ from the Acquiring Person's determination of value in the ordinary course of due diligence and negotiation of an acquisition? How has this determination changed since the late

1970s/early 1980s?

- a. What factors go into determining FMV? Do these factors vary by industry, type of acquisition (asset, non-corporate interest, intellectual property), size of the target, or for other reasons? Describe each of the ways these factors vary and how each one varies. How have these factors changed since the late 1970s/early 1980s? Are there difficulties involved in performing FMV analyses? If so, what are those difficulties? Have these difficulties changed since the late 1970s/early 1980s? If they have changed, how have they changed? What additional guidance, if any, might the Commission provide to eliminate these difficulties?
- b. How often and for what purposes do boards of directors rely on third-party bankers and other appraisers to provide FMV analysis? Do boards of directors evaluate the accuracy of those results compared to their own calculations? If so, how does the board of directors evaluate the accuracy of those results? Has this process changed since the late 1970s/early 1980s? If it has changed, how has it changed?
- c. Should the Commission require an independent FMV analysis for some transactions to ensure consistency with standard valuation practices? If so, for

what type of transactions should the Commission require independent FMV analysis? If the Commission requires an independent analysis, who should conduct the FMV analysis?

3. When calculating the FMV because the Acquisition Price is not determined as a result of future or uncertain payments, what financial or valuation concepts are used to determine the value of those future or uncertain payments? Have these concepts changed since the late 1970s/early 1980s? If they have changed, how have they changed?
4. How does an Acquiring Person determine the present FMV of assets that are not yet commercialized? For example, how does an Acquiring Person determine the present FMV of intellectual property surrounding a product that currently is under development? Has this determination changed since the late 1970s/early 1980s? If it has changed, how has it changed?
5. In determining the FMV, how does the Acquiring Person account for the value of any assumed liabilities (or liabilities of the Acquired Entity)? What impact do such liabilities have on the FMV? Has this determination changed since the late 1970s/early 1980s? If it has changed, how has it changed?
6. Should the Commission require the Acquiring Person to provide the basis for its FMV determination? If so, why? If not, why not?

II. Real Estate Investment Trusts (Section 7A(c)(1) of the Clayton Act)

Congress created real estate investment trusts (“REITs”) in 1960 to allow for the pooling of funds from many small investors to invest in real estate, and gave REITs preferential tax treatment. The legislative history indicates that REIT status was meant to

be limited to “clearly passive income from real estate investments, as contrasted to income from the active operation of businesses involving real estate,” and those real estate trusts engaging in active business operations would not be afforded REIT tax status.³

As a result, the PNO has long taken the informal staff position that when a REIT acquires real property (and assets incidental to the real property), the acquisition is exempt from HSR reporting under section 7A(c)(1) of the Clayton Act, the statutory ordinary course of business exemption. This position is based on the presumption that REITs are solely buying, owning, leasing, and selling real property, and therefore any acquisition of real property is exempt because it is done in the ordinary course of the REIT’s business and is unlikely to violate the antitrust laws.

The Commission is aware that the Internal Revenue Service (“IRS”) subsequently made changes in tax law to remove restrictions on REITs and expand the beneficial tax treatment. As a result, many REITs are no longer solely buying, owning, leasing, and selling real property.⁴ In fact, many REITs are now engaged in the active operation of businesses. For instance, REITs operate assisted living and other healthcare businesses, as well as companies that own cell towers and billboards, located on REIT-owned real property. Due to these changes, the Commission believes it is possible that a REIT’s acquisition of real property may no longer be suitable for the blanket exemption offered under section 7A(c)(1) of the Act. The Commission would like to understand in more

³ H.R. Rep. No. 86-2020, pt. 2, at 3-4 (1960).

⁴ Proposed Rulemaking Notice, 79 FR 27508 (May 14, 2014); Correction to Proposed Rulemaking Notice, 79 FR 38809 (July 9, 2014); Final Regulations, 81 FR 59849 (Aug. 31, 2016).

detail the current structure and operation of REITs through responses to the following questions:

1. Have REITs evolved from entities that own only real property to entities that can hold operating companies?
 - a. If so, what has led to the evolution of REITs becoming entities that can hold operating companies?
 - b. How have changes in tax laws or regulations influenced this evolution?
2. How does an operating company convert to a REIT?
 - a. Do REIT structures involve one Ultimate Parent Entity (“UPE”)? Two UPEs? How often is each type used? Why?
 - b. If a REIT has more than one UPE, what is the relationship between those UPEs?
 - c. If a REIT has more than one UPE, is there an entity above the UPEs that makes decisions for both of them?
3. Is there a way to distinguish REITs that own only real property from those that hold operating companies? If yes, what are the ways to distinguish REITs that own only real property and those that hold operating companies? For instance, are there differences in how they are structured? How else are they different?
4. Assume the PNO’s informal staff position exempting REITs did not exist and REITs had to rely solely on the real property exemptions, §§ 802.2 and 802.5.
 - a. Are there situations in which REIT transactions would no longer be exempt? If so, what kinds of situations?
 - b. How often would the §§ 802.2 and 802.5 exemptions come into play?

- c. Would it be easy for REITs to apply §§ 802.2 and 802.5 to transactions? If so, why? If not, why not?

III. Non Corporate Entities (16 CFR 801.1f(1)(ii))

The Act applies to acquisitions of voting securities or assets. The rise of non-corporate entities, such as partnerships and limited liability companies, has presented challenges under the Act because the PNO had long taken the position that interests in unincorporated entities were neither voting securities nor assets. Thus, any acquisition of interests in such entities had not been a reportable event unless 100% of the interests was acquired, in which case the acquisition was deemed to be that of all of the underlying assets of the partnership or other unincorporated entity.”⁵

At first, this approach did not present significant issues, because non-corporate entities were created as acquisition vehicles and used to effectuate transactions, not to separately hold operating businesses.⁶ But the role of non-corporate entities evolved. As the Commission noted in its 2004 Notice of Proposed Rulemaking, “[t]he use of unincorporated entities is expanding, and such entities are increasingly engaging in acquiring interests in other corporate and unincorporated entities. For example, the number of corporate income tax filings increased from 4,630,000 to 5,711,000 (23%) between 1994 and 2002, while the number of partnership returns, including LLCs taxed as partnerships, increased from 1,550,000 to 2,236,000 (44%) during the same period. In

⁵ 69 FR 18686, 18687 (Apr. 8, 2004).

⁶ Formal Interpretation 15, 63 FR 54713 (Oct. 13, 1998) (amended 1999) (amended 2001).

addition, a number of states have amended their statutes in recent years to allow limited liability companies to merge with other types of legal entities.”⁷ As a result, the Commission determined in its 2005 Final Rule that the acquisition of control, 50% or more of the non-corporate interests (“NCIs”) in a non-corporate entity (“NCE”), would henceforth be reportable.⁸

The Commission is aware that NCEs have continued to evolve. For instance, acquisitions of NCIs are often captured in Securities Purchase Agreements, which imply that NCIs are now deemed to be more like voting securities. Thus, the Commission believes that it is appropriate to re-evaluate the nature of NCEs and NCIs to determine whether NCEs are the equivalent of corporate entities and NCIs function more as voting securities. To that end, the Commission would like to understand in more detail the evolution of NCEs and NCIs since its 2005 Final Rule,⁹ through responses to the following questions:

1. Have NCEs evolved in form and substance since 2005? If they have evolved, what significant changes have occurred to shape the evolution of NCEs between 2005 and now?
 - a. Have the distinctions between NCEs and corporate entities evolved since 2005? If they have evolved, what significant changes have occurred to make NCEs and corporate more or less distinct between 2005 and now?

⁷ 69 FR at 18688.

⁸ 70 FR 11502, 11504 (Mar. 8, 2005).

⁹ 70 FR 11502 (Mar. 8, 2005).

- b. Have the distinctions between NCIs and voting securities evolved since 2005? If they have evolved, what significant changes have occurred to make NCIs and voting securities more or less distinct between 2005 and now?
 - c. Are NCIs currently the same as voting securities? If so, how? If not, how are they different? Is this different from 2005? If so, how? What has changed between 2005 and now?
 - d. Does any category of NCIs currently carry a right equivalent to the right to vote for the election of the board of directors of a corporate entity? Is this different from 2005? If so, how? What has changed between 2005 and now?
 - e. Should the reporting obligations for the acquisition of an interest in a corporate entity and non-corporate entity differ? Is this different from 2005? If so, how? What has changed between 2005 and now?
2. Have the benefits and drawbacks of becoming an NCE evolved since 2005? If they have evolved, have the incentives to become an NCE changed since 2005? If so, how? If not, why not? What has changed between 2005 and now?

IV. Acquisitions of Small Amounts of Voting Securities (16 CFR 801.1, 802.9, 802.64)

Since the implementation of the HSR program, there has been a significant expansion of the holdings of investment entities, including investment funds and institutional investors, as well as expanded interest and ability of such shareholders to participate in corporate governance.¹⁰ In addition, changes in investment behavior have

¹⁰ See, e.g., Edward Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. Pa. L. Rev. 1907 (2013).

resulted in some investment entities holding small stakes in a large number of firms, including competitors. This has caused some to raise concerns about the competitive effects of common ownership – that is, the competitive effect of an investor holding small minority positions in issuers that operate competing lines of business.¹¹

In light of these developments, the Commission is using this ANPRM to take a fresh look at the rules that apply to acquisitions of voting securities by investment entities to determine whether updates may be necessary. The Commission seeks information on the following rules:

A. Definition of “solely for the purpose of investment” (16 CFR 801.1, 802.9)

Section (c)(9) of the HSR Act exempts from the requirements of the Act “acquisitions, solely for the purpose of investment, of voting securities, if, as a result of such acquisition, the securities acquired or held do not exceed 10 per centum of the outstanding voting securities of the issuer.” To implement this statutory limitation, 16 CFR 802.9 exempts from the requirements of the Act an acquisition of voting securities if made solely for the purpose of investment and if, as a result of the acquisition, the Acquiring Person would hold 10% or less of the outstanding voting securities of the issuer, regardless of the dollar value of the voting securities so acquired or held. Under 16

¹¹ Matthew Backus, Christopher Conlon, & Michael Sinkinson, *Common Ownership in America: 1980-2017*, forthcoming, American Economic Journal (forthcoming 2020) https://chrisconlon.github.io/site/common_owner.pdf. (These concerns (and their validity) were discussed at the Federal Trade Commission’s Hearings on Competition and Consumer Protection in the 21st Century, Hearings on Common Ownership (Dec. 6, 2018). The transcript of that session is available on the FTC’s website, here: https://www.ftc.gov/system/files/documents/public_events/1422929/ftc_hearings_session_8_transcript_12-6-18_0.pdf, and the slide presentations of the participants are available here, https://www.ftc.gov/system/files/documents/public_events/1422929/cpc-hearings-nyu_12-6-18.pdf).

CFR 801.1(i)(1), “[v]oting securities are held or acquired ‘solely for the purpose of investment’ if the person holding or acquiring such voting securities has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.”¹²

In light of changing investor engagement with issuers, the Commission is interested in knowing if it is appropriate to rethink the definition of “solely for the purpose of investment” in 16 CFR 801.1(i)(1) and the exemption in 16 CFR 802.9. To that end, the Commission seeks to understand the incentives involved in applying the exemption in 16 CFR 802.9 through responses to the following questions:

1. The ability to rely on 16 CFR 802.9 depends on whether a potential filing person “has no intention of participating in the formulation, determination, or direction of basic business decisions of the issuer.”¹³
 - a. Are there benefits to this approach? If so, what are the benefits?
 - b. Are there drawbacks to this approach? If so, what are the drawbacks?
 - c. How could this approach be changed? How would such a change impact investors and issuers?
 - d. What are the “basic business decisions” of the issuer?
 - i. Is it clear what decisions comprise the “basic business decisions” of the issuer?

¹² 16 CFR 801.1(i)(1).

¹³ 16 CFR 801.1(i)(1).

- ii. Are there activities that clearly do not relate to the basic business decisions?
 - iii. Are there activities that clearly do relate to the basic business decisions?
 - iv. Is there uncertainty about whether an activity relates to the basic business decisions? If so, why is there uncertainty? To what extent is there uncertainty about whether an activity relates to the basic business decisions?
- e. Should the Commission define the “basic business decisions of the issuer” as used in the existing Rule?
- i. What should the definition include?
 - ii. Should specific items be excluded from the definition? Which items?
 - iii. What are the benefits of providing a definition?
 - iv. What are the risks of providing a definition?
- f. Is it clear what is meant by “no intention of participating” in the formulation, determination, or direction of the basic business decisions?
- i. What type of activity related to determining whether to participate in business decisions currently takes one out of the exemption, or at what point in the process of deciding whether to participate in business decisions is one no longer within the exemption?
 - ii. What type of activity related to determining whether to participate in business decisions should result in the exemption no longer applying, or at

what point in the process of deciding whether to participate in business decisions should one no longer be within the exemption?

- iii. Should the language be changed to allow reliance on the exemption until the Acquiring Person has made an affirmative decision to participate in the basic business decisions? If so, what would constitute an affirmative decision to participate in the basic business decisions?

2. In general, for HSR purposes, what differentiates the activities of investors who invest solely for the purpose of investment and investors who do not invest solely for the purpose of investment? Have these activities changed since 1978? If so, how?
 - a. In what activities do investors who invest solely for the purpose of investment engage? Have these activities changed since 1978? If so, how?
 - b. What categories of interaction with management indicate an investor's intention is not to hold voting securities solely for the purpose of investment? For example, would those categories include things like discussions of governance issues, discussions of executive compensation, or casting proxy votes? Have these categories changed since 1978? If so, how?
 - c. Does the market capitalization of the issuer affect the determination of whether an investment is solely for the purpose of investment or not solely for the purpose of investment? Has this changed since 1978? If so, how?

3. How does the Commission’s interpretation of “solely for the purpose of investment” compare to the Securities and Exchange Commission’s (“SEC”) approach to “passive” investors?¹⁴
- a. Assuming no change in the SEC approach, could the Commission adopt the SEC approach? If yes, why? If no, why not?
 - b. What would be the benefits of adopting the SEC approach? Why?
 - c. What would be the drawbacks of adopting the SEC approach? Why?
 - d. Does the different role of each agency justify different approaches for investors who hold positions solely for the purpose of investment? If yes, why? If no, why not?
4. How does the Commission’s interpretation of “solely for the purpose of investment” compare to the elements that must be disclosed in Item 4 of Schedule 13D filed with the SEC?¹⁵

¹⁴ Under SEC Rule 13d-1(c), certain beneficial owners may file a short form statement on Schedule 13G in lieu of a 13D statement if that person “has not acquired the securities with any purpose, or with the effect, of changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having that purpose or effect, including any transaction subject to 17 CFR 240.13d-3(b), other than activities solely in connection with a nomination under 17 CFR 240.14a-11.” 17 CFR 240.13d-1(c). The SEC relies on a “control purpose” test to identify “passive” investments; that is, beneficial owners that acquired shares “not with the purpose nor with the effect of changing or influencing the control of the issuer.” The SEC has a broad view of the types of activities that could show such a “control purpose,” and that determination is assessed based on a totality of the circumstances. For instance, a shareholder that fails to qualify as an investor solely for the purpose of investment under the HSR Act may nonetheless be eligible to use Schedule 13G depending on various factors, such as the subject matter of the shareholder’s discussions with the issuer’s management. *See* Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting, Compliance and Disclosure Interpretations (“C&DIs”), Question 103.11 (July 14, 2016) <https://www.sec.gov/divisions/corpfin/guidance/reg13d-interp.htm#103.11>.

¹⁵ Item 4 of Schedule 13D requires filers to “[s]tate the purpose or purposes of the acquisition of securities of the issuer and to describe any plans or proposals which they might have which relate to or would result in:

- a. Assuming no change to the SEC rule, could the Commission adopt the SEC elements? If yes, why? If no, why not?
 - b. What would be the benefits of adopting the SEC elements?
 - c. What would be the drawbacks of adopting the SEC elements?
 - d. Does the different role of each agency justify different approaches for investors who hold positions solely for the purpose of investment?
5. How do the activities of investment firms differ from those of operating companies?
- a. Should the Commission treat different types of acquirers differently for the purpose of the exemption? If yes, why? If no, why not?

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- (a) The acquisition by any person of additional securities of the issuer, or the disposition of securities of the issuer;
 - (b) An extraordinary corporate transaction, such as a merger, reorganization or liquidation, involving the issuer or any of its subsidiaries;
 - (c) A sale or transfer of a material amount of assets of the issuer or any of its subsidiaries;
 - (d) Any change in the present board of directors or management of the issuer, including any plans or proposals to change the number or term of directors or to fill any existing vacancies on the board;
 - (e) Any material change in the present capitalization or dividend policy of the issuer;
 - (f) Any other material change in the issuer's business or corporate structure, including but not limited to, if the issuer is a registered closed-end investment company, any plans or proposals to make any changes in its investment policy for which a vote is required by section 13 of the Investment Company Act of 1940;
 - (g) Changes in the issuer's charter, bylaws or instruments corresponding thereto or other actions which may impede the acquisition of control of the issuer by any person;
 - (h) Causing a class of securities of the issuer to be delisted from a national securities exchange or to cease to be authorized to be quoted in an inter-dealer quotation system of a registered national securities association;
 - (i) A class of equity securities of the issuer becoming eligible for termination of registration pursuant to section 12(g)(4) of the Act; or
 - (j) Any action similar to any of those enumerated above.” 17 CFR 240.13d-101.

- b. Should the Commission treat different types of investment companies differently for the purpose of the exemption (for example, mutual fund companies versus hedge fund companies)? If yes, why? If no, why not?
6. Should the Commission preclude parties from using the exemption only if they have taken certain specified actions? If yes, why? If no, why not?
- a. What actions should disqualify an Acquiring Person from being able to use the exemption?
 - i. Should the actions be limited to actions that facilitate or encourage coordination among competitors?
 - ii. Should actions that affect competition, even if aimed only at a single competitor, preclude the use of the exemption? If yes, why? If no, why not?
 - iii. Should actions that change the incentives to compete, even if aimed only at a single competitor, preclude the use of the exemption? If yes, why? If no, why not?
 - iv. What other actions should preclude utilizing the exemption?
 - b. Would allowing the Acquiring Person to acquire 9.9% of the voting securities of the Issuer prior to taking the specified action undercut the ability to obtain filings early enough to ascertain potential competitive harm before a transaction is consummated? If yes, why? If no, why not?

- c. Would such a conditioning of the loss of the exemption be consistent with the wording of the statute, including “solely” and the “purpose” of the acquisition? If yes, why? If no, why not?
 - i. Is the acquisition solely for investment if the Acquiring Person is considering taking action inconsistent with the exemption, but has not yet taken the action?
 - ii. Is the acquisition for the purpose of investment if the Acquiring Person has determined to take action inconsistent with the exemption, but has not yet taken the action?
 - d. Should the Commission require an HSR filing for past acquisitions once the specified actions have been taken? If yes, why? If no, why not?
 - i. Would this be consistent with the HSR Act’s requirement to make the filing prior to the acquisition? If yes, why? If no, why not?
 - ii. Would this be consistent with the requirement that the Acquiring Person certify that it has a good faith intent to make an acquisition requiring notification? If yes, why? If no, why not?
- B. Definition of institutional investors (16 CFR 802.64)

Under § 802.64, institutional investors are exempt from HSR reporting when making acquisitions of 15% or less of voting securities in the ordinary course of business and solely for purpose of investment. During the initial HSR rulemaking in 1978, entities were identified as institutional investors because they were viewed as constrained by law (e.g., non-profits) or fiduciary duty (e.g., pension trusts, insurance companies, etc.), or

generally uninterested in “affecting management of the companies whose stock they buy” (e.g., broker-dealers).¹⁶ The list identifying what type of entity is considered an institutional investor, which has never been updated, includes:

(1) A bank; (2) Savings bank; (3) Savings and loan or building and loan company or association; (4) Trust company; (5) Insurance company; (6) Investment company registered with the SEC; (7) Finance company; (8) Broker-dealer within the meaning of the SEC; (9) Small Business Investment Company or Minority Enterprise Small Business Investment Company as defined by the SBA; (10) A stock bonus, pension, or profit-sharing trust as defined by the IRS; (11) Bank holding company as defined by statute; (12) An entity which is controlled directly or indirectly by an institutional investor and the activities of which are in the ordinary course of business of the institutional investor; (13) An entity which may supply incidental services to entities which it controls directly or indirectly but which performs no operating functions, and which is otherwise engaged only in holding controlling interests in institutional investors; or (14) A nonprofit entity as defined by the IRS.¹⁷

It is unclear to the Commission whether this exemption should be maintained and implemented in the same manner in which it was first promulgated in 1978. In light of changes in the investor landscape since that time, the Commission may need to update the list of institutional investors that are presumed to engage in acquisitions solely for the purpose of investment. Thus, the Commission aims to understand the current institutional investor landscape in order to make that determination through responses to the following questions:

1. Given that 16 CFR 802.64 has not changed since 1978, does it need to be updated?

¹⁶ 43 FR 33450, 33503 (July 31, 1978).

¹⁷ 16 CFR 802.64.

- a. Does 16 CFR 802.64 accurately reflect the universe of entities that make investments in the ordinary course of business solely for the purpose of investment? Are there entities currently listed in the exemption that should be removed? If so, why?
- b. Are there entities not currently listed that should be treated as institutional investors? If so, why and what are they? Explain the justification for treating the entity as an institutional investor: does it fit within the paradigm identified by the Commission in first promulgating 16 CFR 802.64 (i.e., (i) constrained by law; (ii) constrained by fiduciary duty; or (iii) uninterested in affecting management of the companies whose stock they buy)? Are there other reasons the entity should be treated as an institutional investor?
- c. Should the Commission provide a list of indicia that an investor must meet to qualify as an institutional investor for purposes of the HSR Act, instead of a list of entities considered to be institutional investors? If yes, why and what should these indicia be? If no, why not?
- d. Is the 15% level for the Commission's exemption still consistent with the purpose of the HSR Act? What evidence is there that the level should be higher or lower?

The SEC has also promulgated a definition of "institutional investors" as part of its beneficial ownership disclosure requirements. When a person or group of persons acquires beneficial ownership of more than five percent of a voting class of a company's equity securities registered under the Securities Exchange Act, they are required to file a

Schedule 13D with the SEC.¹⁸ Depending upon the facts and circumstances, the person or group of persons may be eligible to file the more abbreviated Schedule 13G in lieu of Schedule 13D.¹⁹ One of the exemptions relates to acquisitions of securities in the ordinary course of business by a “qualified institutional investor” under Rule 13d-1(b).²⁰

¹⁸ Securities Exchange Act of 1934, 15 U.S.C. 78a et seq, and 17 CFR 240.13d-101.

¹⁹ Section 13(g) was added to the Exchange Act as part of the Domestic and Foreign Investment Improvement Disclosure Act of 1977. Pub. L. No. 95-214, sec. 203, 91. Stat. 1494.

²⁰ Under SEC Rule 13d-1(b)(1)(i) – (ii)(A)-(K), certain beneficial owners may file a short form statement on Schedule 13G in lieu of a 13D statement if:

- (i) “Such person has acquired such securities in the ordinary course of his business and not with the purpose nor with the effect of changing or influencing the control of the issuer, nor in connection with or as a participant in any transaction having such purpose or effect, including any transaction subject to 17 CFR 240.13d-3(b), other than activities solely in connection with a nomination under 17 CFR 240.14a-11; and
- (ii) Such person is:
 - (A) A broker or dealer registered under section 15 of the Act (15 U.S.C. 78o);
 - (B) A bank as defined in section 6(a) of the Act (15 U.S.C. 78c);
 - (C) An insurance company as defined in section 19(a) of the Act (15 U.S.C. 78c);
 - (D) An investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8);
 - (E) Any person registered as an investment adviser under Section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3) or under the laws of any state;
 - (F) An employee benefit plan as defined in Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended, 29 U.S.C. 1001 et seq. (“ERISA”) that is subject to the provisions of ERISA, or any such plan that is not subject to ERISA that is maintained primarily for the benefit of the employees of a state or local government or instrumentality, or an endowment fund;
 - (G) A parent holding company or control person, provided the aggregate amount held directly by the parent or control person, and directly and indirectly by their subsidiaries or affiliates that are not persons specified in 17 CFR 240.13d-1(b)(1)(ii)(A) through (J), does not exceed one percent of the securities of the subject class;
 - (H) A savings association as defined in Section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813);
 - (I) A church plan that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940 (15 U.S.C. 80a-3);
 - (J) A non-U.S. institution that is the functional equivalent of any of the institutions listed in 17 CFR 240.13d-1 (b)(1)(ii)(A) through (I), so long as the non-U.S. institution is subject to a regulatory scheme that is substantially comparable to the regulatory scheme applicable to the equivalent U.S. institution; and
 - (K) A group, provided that all the members are persons specified in 17 CFR 240.13d-1(b)(1)(ii)(A) through (J).”

2. How does the Commission's definition of institutional investor compare to the definition used by the SEC in identifying a person able to file a Schedule 13G?
 - a. Assuming no change in the SEC rule, should the Commission adopt the SEC definition of a person who acquires voting securities in the ordinary course of business and not with the purpose nor with the effect of changing or influencing the control of the issuer? If yes, why? If no, why not?
 - b. What would be the benefits of adopting the SEC definition?
 - c. What would be the drawbacks of adopting the SEC definition?
 - d. Does the different role of each agency justify different definitions for institutional investors?
3. What are the activities of institutional investors and how have they changed since 1978?
 - a. What activities do institutional investors engage in with the issuers whose shares they hold? Have these activities changed since 1978? If so, how have these activities changed?
 - i. What is the scope of "shareholder engagement" that institutional investors undertake? Has this changed since 1978? If so, how has it changed?
 - ii. What topics or issues are the subject of such engagement? Have these topics or issues changed since 1978? If so, how have they changed?
 - iii. How often does such engagement occur? Has this changed since 1978? If so, how has this changed?

- iv. Does the amount, degree, or type of issue discussed vary by issuer, or are there consistent themes of discussion and engagement? Has this changed since 1978? If so, how has this changed?
 - v. When do institutional investors participate in the formulation, determination, or direction of the basic business decisions of issuers? Has this changed since 1978? If so, how has it changed?
- b. How do index funds fit within the portfolios of institutional investors? Have index funds evolved since 1978? If so, how have they evolved?
- i. Why do institutional investors choose to create an index fund, exchange-traded fund, or the like? What are the benefits and drawbacks of creating such a fund?
 - ii. How does the acquisition of voting securities held by an index fund, exchange-traded fund, or the like occur? Do acquirors use an algorithm or some other automated mechanism to facilitate acquisitions?
 - iii. Who oversees an index fund, exchange-traded fund, or the like? Is there one person or entity within an investment organization tasked with overseeing such a fund? More than one? How often is it one versus more than one?
4. How do institutional investors manage holdings in the same issuer? How has this changed since 1978?

- a. Do institutional investors jointly manage holdings in the same issuer? Do they separately manage holdings in the same issuer? Both? Has this changed since 1978? If so, how has it changed?
 - b. How do institutional investors make the decision to jointly or separately manage holdings in the same issuer? Has this changed since 1978? If so, how has this changed?
 - c. Do answers to any of the above questions depend on the type of issuer or the type of institutional investor or other factors? If so, what factors are relevant? How does each factor influence the actions of institutional investors? Have the factors changed since 1978? If so, how have they changed?
5. How do institutional investors apply the concept of solely for the purpose of investment? Has this changed since 1978? If so, how has it changed?
- a. Do the entities listed in 16 CFR 802.64 currently hold the voting securities of issuers solely for the purpose of investment? How does this differ from institutional investor behavior in 1978? What significant changes in institutional investor behavior have occurred between 1978 and 2020?
 - b. What kinds of entities not listed in 16 CFR 802.64 currently hold the voting securities of issuers solely for the purpose of investment? How does the current behavior of these entities differ from their behavior in 1978?
 - c. If institutional investors make certain acquisitions solely for the purpose of investment and other acquisitions not solely for the purpose of investment, is it

appropriate to provide a status exemption for all of their activities? If yes, why? If no, why not?

- d. Do institutional investors rely on 16 CFR 802.64 to exempt acquisitions in or by index funds, exchange-traded funds or the like? If so, how?

V. Influence Outside the Scope of Voting Securities (16 CFR 801.1, 802.31)

The HSR Act applies to the acquisition of assets and voting securities. “The term voting securities means any securities which at present or upon conversion entitle the owner or holder thereof to vote for the election of directors of the issuer, or of an entity included within the same person as the issuer.”²¹ The acquisition of a voting security carries with it the right to influence the business of a company through the ability to vote for the directors of that company, among other things.

The Commission is aware, however, that there are ways to gain influence over a company without the acquisition of the right to vote for the election of directors inherent in voting securities. For instance, the acquisition of convertible voting securities or the use of board observers could each result in the ability to influence a company’s business decisions. Currently, neither the acquisition of convertible voting securities nor rights to be a board observer are reportable events under the Act. The Commission, therefore, needs to ascertain whether the acquisition and exercise of these rights provide opportunities to influence an issuer’s business decisions, and thus should be reportable events.

A. Convertible Voting Securities (16 CFR 802.31)

²¹ 16 CFR 801.1(f)(1)(i).

The acquisition of convertible debentures (convertible into common stock), options, warrants, or preferred shares, even with no present right to vote for directors, may result in the ability to influence the business of a company. The Rules capture these kinds of stakes in the concept of a convertible voting security. “The term convertible voting security means a voting security which presently does not entitle its owner or holder to vote for directors of any entity.”²² Section 802.31 exempts the acquisition of convertible voting securities.

The PNO has taken the informal position that the acquisition of convertible voting securities, when accompanied by the right to designate or appoint individuals to the board of directors of the issuer equal to the percentage of voting securities that would be held upon conversion, is reportable under the Act. The Commission is considering revising § 802.31 to explicitly require compliance with the HSR Act’s reporting requirements when the acquisition of convertible voting securities is coincident with the Acquiring Person having or obtaining the right to designate or appoint any individuals to the board of the issuer. The Commission aims to understand the potential benefits and burdens of such a change through responses to the following questions:

1. Is the acquisition of convertible voting securities, when accompanied with the right of appointment or designation of individuals to the issuer’s board of directors, equivalent to the acquisition of voting securities with the present right to vote for election of the issuer’s board of directors? In what ways are they the same and in what ways are they different? What provisions could accompany the right to appoint that would make

²² 16 CFR 801.1(f)(2).

the acquisition the most like an acquisition of voting securities? What provisions make them different for competition purposes? Have these provisions changed since 1978? If so, how have they changed?

2. Why would an Acquiring Person choose one alternative over the other? Have the benefits of one alternative over another changed since 1978?

a. Is there a benefit of acquiring convertible voting securities while holding or obtaining the right to appoint or designate individuals to an issuer's board of directors, as compared to the acquisition of securities that have the present right to vote? If so, what is the benefit? Has the benefit changed since 1978? If so, how has it changed?

b. Under what situations does such a benefit arise? Have these situations changed since 1978? If so, how have they changed?

3. What are the reasons the Commission should or should not require a filing whenever the acquirer of convertible non-voting securities receives a right to designate one or more directors prior to conversion?

a. Should issuers that have cumulative voting be subject to the same requirements as issuers that do not have cumulative voting? Why should they be subject to different requirements? Is there a difference in how much influence an acquirer would have based on whether the issuer has cumulative voting? Why? How would the Commission be able to distinguish when it is a problem and when it is not?

4. What would be the burden associated with this possible change?

- a. Would the burden fall most on an identifiable class of transactions? How would such a change affect how an identifiable class of transactions is structured?
- b. Would such a change introduce significant inefficiencies into the market for corporate control? What would be the effect of that change in the market?

B. Board Observers

Another potential way to gain influence over a company, beyond the scope of acquiring voting securities, is through board observers. The Commission understands that it is becoming increasingly common for issuers and NCEs to include board observers as part of their governance structure. Issuers and NCEs often grant rights to select and appoint board observers to investors with significant equity, in addition to or in lieu of providing investors with board seats. Even though board observers lack the ability to vote on matters that come before the issuer's board, they may nevertheless have significant influence over the outcome of matters submitted to the board for approval.²³ At the very least, board observers gain insight into an issuer's strategic decision-making, which is not only useful to the investor sponsoring the board observer, but may also be useful to competitors in the market, especially when those board observers also serve as officers or directors of a competitor.²⁴ Companies likely benefit from interacting with board observers because company management can obtain additional investor insight without having to alter the composition or voting balance on the board.

²³ *Obasi Investment Ltd. et al v. Tibet Pharmaceuticals, Inc. et al*, 931 F.3d 179, 183 (3d Cir. 2019).

²⁴ See Complaint, *In re Altria Group/JUUL Labs*, Dkt. 9383, ¶ 9, at https://www.ftc.gov/system/files/documents/cases/d09393_administrative_part_iii_complaint-public_version.pdf.

Given the opportunities that board observers have to interact with corporate officers, directors, and other managers, and to gain access to confidential information related to strategic and operational decisions, the Commission would like to better understand the role of board observers. In particular, the Commission would like to know how investors might use board observers' rights to influence competitive decision-making of issuers and NCEs to ascertain whether the acquisition of rights that provide opportunities to wield this kind of influence should be reportable under the Act. To that end, the Commission seeks responses to the following questions:

1. What types of information are available to an issuer/NCE board observer?
 - a. With what frequency is a board observer invited to all meetings? Is a board observer always entitled to all info provided to board members? Is a board observer permitted to request additional information beyond what is presented at a board meeting? If so, with what frequency?
 - b. Are board observers subject to any restrictions on how they can use the information they obtain in their capacity as board observers? Are these restrictions based on contract, bylaws or regulations?
 - c. Do issuers/NCEs create formal review processes for information scheduled to be sent to a board observer? If so, with what frequency? Are outside counsel involved in monitoring compliance? If so, with what frequency?
 - d. Is the information scheduled to be sent to a board observer subject to a non-disclosure agreement that limits its dissemination to others, including officers and directors of competitors or investors in competitors?

- e. Do issuers/NCEs draft formal guidance for their boards as to what topics should not be discussed in the presence of board observers? If so, with what frequency? Are outside counsel involved in monitoring compliance? If so, with what frequency?
2. What means does an issuer/NCE board observer have to influence board policies or the strategic or operational direction of the firm?
- a. Does a board observer ever enjoy any special right of notice or consultation regarding major capital expenditures or strategic decisions?
 - b. Does a board observer have access, outside of board meetings, to managers in the corporation, to investment committee members in an NCE, or to persons with similar decision-making roles regarding the operations of the business? If so, with what frequency?
 - c. Do board observers have the ability to request a meeting of the issuer's/NCE's board? If so, with what frequency?
 - d. Do issuers/NCEs impose restrictions on a board observer's speaking role during board meetings? If so, with what frequency? How common are "silent" board observers?
 - e. How frequently do board observers move into senior executive roles at issuers/NCEs?
3. What are the parameters of the board observer role?

- a. Is a board observer's relationship with the issuer/NCE always explicitly defined in a written agreement between the issuer and the investor? How common are informal board observer arrangements?
 - b. Are board observers (or those who sponsor their observation of board matters) covered by conflict of interest rules or black-out periods such as those that limit investments by board members?
4. Are there any protocols on selection/approval of board observers and/or processes in place to ensure that observers are not in a position to facilitate sharing of competitively sensitive information among competitors?
 5. For all of the questions above, do rules or practices regarding board observer rights to obtain confidential information differ substantially between issuers and NCEs? What factors account for any such differences?

VI. Transactions or Devices for Avoidance (16 CFR 801.90)

16 CFR 801.90 provides that the Commission must disregard the structure of transactions or devices used by the parties for the purpose of avoiding the HSR Act requirements and review the substance of the transaction as a whole to determine whether an HSR filing is required. The PNO often receives questions about whether specific scenarios would be violations under § 801.90, and the PNO has occasionally offered informal staff positions on § 801.90. For instance, the PNO has an informal staff position that says if a target makes a payout prior to its acquisition in the form of an extraordinary dividend, such a payment would not trigger 16 CFR 801.90 if, as a result of the dividend,

the target no longer meets the size of person test.²⁵ The PNO's informal staff position is based on the idea that if an extraordinary dividend reduces the target's cash on hand, it is unlikely to present a 16 CFR 801.90 issue.

But there are situations where the purpose of such a payout may be more complicated. For instance, if the payout involves more than the distribution of cash on hand, this could present an issue under 16 CFR 801.90. Each issuance of an extraordinary dividend or like payment must be carefully analyzed to make sure that it is not a device for avoidance under § 801.90. The Commission has questions about whether filing parties are engaging in this analysis or, instead, assuming that every extraordinary dividend is not a device for avoidance under § 801.90. In order to determine which are and are not devices for avoidance, the Commission would therefore like to understand the mechanisms by which targets engage in these and other kinds of practices through responses to the following questions:

1. What mechanisms do targets use to pay out extraordinary dividends and what are the reasons for such dividends?
 - a. Is the focus on the reduction of cash on hand or are there other motivations for issuing such dividends? If so, what are the other motivations?
 - b. Are there other ways of structuring extraordinary dividends? If so, what are they? If not, why not?
 - c. How often do targets issue extraordinary dividends in advance of being acquired? What are the reasons that targets issue such dividends?

²⁵ Am. Bar Ass'n., *Premerger Notification Practice Manual*, Interpretation 96 (5th ed.).

- d. Is the buyer ever involved in the target's decision to issue an extraordinary dividend in advance of an acquisition? Why or why not?
2. Do targets use mechanisms other than extraordinary dividends to reduce cash on hand?
 - a. If so, what are they and how are they structured? If not, why not?
 - b. Is the buyer involved? If yes, why and with what frequency? If not, why not?
3. What other actions should the Commission scrutinize as possible devices for avoidance?

VII. Filing Issues (16 CFR 802.21, 16 CFR part 803 Appendix A and B)

The Commission has a strong interest in an HSR filing process and an HSR Form that garners competitively significant information to assist the Agencies in their review of transactions. To that end, the Commission intends to explore amending (a) the 16 CFR 802.21 five-year period during which a party may acquire additional voting securities without refiling, and (b) the requirement in Item 8 of the HSR Form to disclose certain prior acquisitions.

A. Acquisitions of Voting Securities That Do Not Cross the Next Threshold (16 CFR 802.21)

Under 16 CFR 802.21, filing parties have five years from the end of the waiting period to acquire additional voting securities without making another filing, as long as the additional acquisitions do not exceed the next threshold. For instance, Party A files to cross the \$100 million threshold (as adjusted) on January 1 and receives early termination on January 20, which ends the waiting period. Party A then has five years from January

20 to continue to acquire voting securities of the same issuer up to the next threshold, in this case \$500 million (as adjusted), as long as it crosses the \$100 million threshold (as adjusted) within one year.

The time period in proposed § 802.21 was 180 days, but numerous comments persuaded the Commission this time period was too short.²⁶ In the final rules, the Commission chose a period of five years, both as a result of these comments and because it made sense to correlate the timing of the exemption with the timing of the Census and resulting updated data.²⁷ Given the changes in worldwide economic activity since 1978, Commission is now concerned that the § 802.21 five-year period may be too long. At the time of the initial filing, the transaction may not present competition concerns, but such concerns could develop as a result of changes in the lines of business of the Acquiring Person and Acquired Person during the five-year period, but those changes would not require a new filing. As a result, the Commission seeks to understand the impact of shortening the § 802.21 five-year period through responses to the following questions:

1. Have there been changes in economic activity significant enough to raise concerns that the Commission may miss important competitive effects if it does not shorten the five-year term?
2. If there are reasons to believe that the § 802.21 five-year period is too long, what period would address concerns that additional acquisitions of the Acquired Entity present

²⁶ 43 FR 33450, 33493 (July 31, 1978).

²⁷ *Id.*

competitive concerns because the lines of business of the Acquiring Person and/or Acquired Person have changed? Why would another period be more appropriate?

3. Is there is a class of Acquiring Persons for whom the decrease in the exemption period would cause significant burden? If not, why not? If so, how?

B. Prior Acquisitions

When the Acquiring Person and the Acquired Person report in the same or “overlapping” NAICS revenue code in Item 5 of the HSR Form, the Acquiring Person must report certain prior acquisitions in Item 8: (1) the acquisition of 50% or more of the voting securities of an issuer or 50% or more of non-corporate interests of an unincorporated entity (subject to \$10 million limitation) and (2) any acquisition of assets valued at or above the statutory size-of-transaction test at the time of their acquisition. Item 8 limits the Acquiring Person’s disclosure to those acquisitions within the overlapping NAICS code over the last five years.

The Commission is concerned that Item 8 does not capture all competitively significant acquisitions. There are several reasons why this might be the case. For instance, the Acquiring Person does not have to disclose prior acquisitions when it and the Acquired Person report revenue in different NAICS codes. Nevertheless, overlapping NAICS codes are imperfect predictors of whether the acquisition presents competitive concerns that need review. For instance, an Acquiring Person is not subject to the disclosure requirement if a prior acquisition involved a potential competitor with no revenue in an overlapping NAICS code at the time of the acquisition. Similarly, an Acquiring Person need not disclose a prior acquisition that involved a vertical

relationship when companies at different levels of the distribution chain report in different NAICS codes. As a result, the Commission is considering eliminating the overlapping NAICS code limitation in Item 8 so that the Acquiring Person would have to list all its acquisitions of 50% or more of the voting securities of an issuer or 50% or more of non-corporate interests of an unincorporated entity (subject to \$10 million limitation) and any acquisition of assets valued at or above the statutory size-of-transaction test at the time of their acquisition in the five years prior to filing. The Commission seeks comment on this potential change through responses to the following questions:

1. What would be the benefit or burden associated with this possible change? Are there any classes of transactions for which the benefit or burden would be greater? If there are classes of transactions for which the benefit is greater, why is the benefit greater? If there are classes of transactions for which the burden is greater, why is the burden greater?
2. Is there any way to distinguish prior acquisitions that might have competitive significance from those that do not, such that the Commission would not need to require a list of all prior acquisitions?

In addition to the topics outlined above, commenters are welcome to provide input on any other HSR Rule. As part of that input, identify the changes in investor behavior or competitive dynamics that would justify a change in the Commission's current approach.

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By direction of the Commission.

April Tabor,

Acting Secretary.