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Secretary
Federal Trade Commission
6th Street & Pennsylvania
Ave., N.W. - Room 136
Washington, D.C. 20580

Assistant Attorney General
Antitrust Division
Department of Justice
Room 3214
Washington, D.C. 20530

Re: Comments Submitted on Behalf of the Antitrust Section of the American Bar Association Regarding Proposed Amendments to the Hart-Scott-Rodino Improvements Act* of 1976, 53 Fed. Reg. 36,831 (Sept. 22, 1988)

Gentlemen:

On September 22, 1988, the Federal Trade Commission (the "FTC" or "Commission") published a Notice of Proposed Rulemaking (the "Notice") soliciting comment on proposed *de minimis* exemptions to the reporting and waiting period obligations of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. §18a (the "Act"). 53 Fed. Reg. 36,831. Specifically, the Commission invited comment on what it labelled its "principal proposal," embodied in proposed §802.24, which would exempt from the Act's reporting and waiting period obligations all acquisitions of ten percent or less of an issuer's voting

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* These views are being presented only on behalf of the Section of Antitrust Law and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association, and should not be construed as representing the position of the ABA.

securities, regardless of dollar value. The Commission also put forward for comment two alternate proposals regarding acquisitions of ten percent or less of the voting securities of an issuer. The first, embodied in proposed §801.34, would permit the purchase of such securities without first filing a reporting form but would require that the securities be held in escrow pending antitrust review. The second would permit the filing of an optional notification form by the acquiring person only for acquisitions of up to ten percent of an entity which makes certain public filings.

According to the Notice, these proposals stem from the Commission's desire, consistent with its antitrust responsibilities, to eliminate unnecessary notification burdens, avoid any unneeded interference both with the regulatory scheme established by the securities laws and the market for corporate control, and to reduce non-antitrust-related incentives to evade the Act's requirements. Id. at 36,833. Thus, all three proposals seek to avoid, among other things, disclosure of the acquisition of its stock to the target issuer before such disclosure would otherwise be required under the securities laws.

The Section of Antitrust Law of the American Bar Association (the "Section") applauds the Commission's efforts to evaluate critically the Act's regulatory scheme in order to reduce any non-antitrust-related effects that the Act might impose. Clearly, the Notice is a product of much hard work, analysis, and creative thinking by the Commission to eliminate such unintended results while remaining true to the Act's Congressional purpose: "To give the antitrust agencies an opportunity to determine whether a proposed acquisition might violate the antitrust laws and an opportunity to challenge any such transaction prior to consummation." Id. at 36,834.

For the reasons discussed more fully below, the Section agrees with the Commission's well founded conclusion that acquisitions of ten percent or less of an issuer's voting securities are unlikely to violate Section 7 of the Clayton Act and, thus, recommends that the Commission adopt the "principal proposal," §802.24, which exempts such acquisitions from the Act's requirements. We believe that the two alternative proposals have significant disadvantages and that the complexity and regulatory burden they entail are not outweighed by any improvements in antitrust enforcement.

A. The Principal Proposal

The Commission has carefully analyzed the antitrust significance of acquisitions of ten percent or less of an issuer's voting securities. According to the Notice, the Commission has found that antitrust problems created by such acquisitions have been "rare or non-existent." Id. at 36,837. Not surprisingly, neither the FTC nor the Department of Justice ("DoJ") has ever challenged such an acquisition as a violation of Section 7. Indeed, no second requests have ever been issued where the acquisition involved ten percent or less of an issuer's voting securities. Id., at 36,838. Congress, too, has recognized that the acquisition of ten percent or less of an issuer's voting securities is unlikely to confer control or create competitive problems. As a result, Congress has created a number of statutory presumptions supporting the view that such acquisitions are not problematic from an antitrust perspective. Id., at 36,839. Thus, the Commission concludes, there is no antitrust-related reason for requiring the parties to such transactions to observe the premerger filing and waiting period requirements. The Section agrees with these conclusions.

To the extent that a small number of such transactions may have the potential to run afoul of the antitrust laws, several points should be borne in mind. First, the Act was not designed to insure premerger reporting of all transactions that may violate the antitrust laws. (For example, a company with $90 million in sales or assets can acquire another company of similar size without falling within the Act's requirements.) Rather, the Act was designed to require reporting of the transactions that are most likely to have antitrust consequences, while leaving other transactions outside its scope. Transactions that fall outside the Act are in no way exempt from the antitrust laws, and the Commission and the DoJ typically become aware of them through the press, Securities and Exchange Commission filings, and complaints of competitors and customers.

Second, the antitrust agencies will receive filings under the Act from many parties whose initial purchases of another company's shares will fall within the proposed exemption. This is because many parties eventually seek to acquire in excess of ten percent of the voting securities of the target company in circumstances not qualifying for exemption from reporting requirements.

Third, a primary purpose of the Act was to provide the antitrust authorities with an effective remedy upon successfully challenging an illegal merger or acquisition. By permitting the authorities to seek a preliminary injunction before the parties to a merger or acquisition consummate it, the Act avoids the difficulty associated with "unscrambling" assets after a merger has taken place. However, the congressional concern with effective remedies is not implicated here. If the principal proposal is adopted and, following an acquisition of ten percent or less of an issuer's voting securities, the Commission or the DoJ successfully challenges the acquisition as a violation of Section 7, divestiture of the voting securities should be a simple and adequate remedy for the Clayton Act violation.

Because the Act is designed to enable the Commission and the DoJ to enforce the antitrust laws more effectively and because, as the Notice points out, "[t]he Act was never intended to generate public disclosure of stock acquisitions," id., at 36,834, we believe that the disclosure issues relating to purchases of stock should be the province of the securities laws. Accordingly, although disclosure to targets may be reduced or delayed if proposed §802.24 is adopted, we do not think that this is a relevant consideration for the Commission in promulgating regulations pursuant to the Act.

The Notice raises four questions regarding the principal proposal. The first concerns when the antitrust agencies would learn of an acquisition of ten percent or less of the voting securities of an issuer if the acquisition were anticompetitive. The answer is twofold.

First, articles in newspapers, securities' filings, as well as complaints from competitors or customers are ready sources for learning such information. Second, as pointed out above, filing will be made for some acquisitions where the initial purchases fall within the proposed exemption because these parties may seek subsequently to acquire <u>more</u> than ten percent of an issuer's voting securities.

The second question asks whether the Commission should place some limitation on the ten percent exemption. The Section thinks not. Since the acquisition of ten percent or less of an issuer's stock generally raises no antitrust problem, imposing any limitation on the voting of such stock is unjustified on antitrust grounds and would treat such acquisitions differently than all others falling within the scope of the Act for no reason.

The third question asks whether the "group" concept should be reconsidered. Again, the Section believes not. Efforts to determine when parties are in some sense acting "in concert" would complicate compliance with and administration of the Act without the likelihood of significant benefit to substantive antitrust enforcement.

The fourth question raises the issue of a five percent threshold. As the question itself recognizes, use of such a threshold will only complicate compliance with the Act; the Section believes that simplicity of administration is particularly important here where the potential exists for inconsistency with the securities laws. Moreover, given the Commission's determination that antitrust concerns are rarely implicated at a ten percent level, the Section believes that a five percent threshold is unwarranted from a substantive antitrust standpoint.

B. <u>The Escrow Alternative</u>

The escrow approach in §801.34 in effect defines the statutory term "acquisition" to exclude transactions (other than tender offers) resulting in holdings of up to ten percent of an issuer's voting securities, provided they are "immediately" placed into escrow. The escrow arrangement requires that the "escrow agent" vote (and withhold from voting) shares placed in escrow "in the same proportion that all other voting securities of the issuer are voted and withheld from voting." Subsection (b) of the proposed rules states that the release of voting securities from such an escrow is to be considered as the consummation of an acquisition within the meaning of Section 7A.

While the Section has a strong preference for the Commission's "principal proposal" of an unrestricted ten percent exemption, we endorse the alternative "escrow proposal" in the event that the principal proposal is not adopted. However, we have a number of observations and suggestions concerning this proposal.

First, compliance with §801.34(a) requires that the acquiring person "immediately" place into escrow "any voting securities whose acquisition is subject to the notification obligations of the Act." We suggest that the statement of basis and purpose make clear that the word "immediately" requires creation of an escrow arrangement and transfer of shares into escrow as soon as the acquiring person: (i) becomes the beneficial owner of a sufficient number of shares to trigger a filing requirement; and (ii) obtains the right to transfer such shares to a third party. We assume that these concepts are implicit in the proposed rules.

However, there could be a gap between the time when an acquiring person obtains the practical ability to exercise voting rights and the time when that person obtains the right to transfer the shares to an escrow agent. The Commission might consider including either a flat prohibition on the acquiring person's direct or indirect exercise of voting rights during any such interim period, or an affirmative requirement (as in proposed §801.34(a)(1)(iii)) that all such shares be voted in a manner that mirrors the votes cast or withheld by all other shares. Indeed, an expansion of this approach might obviate the need for any escrow arrangement.

Second, proposed §801.34 does not define the term "escrow," except that the arrangement must satisfy the voting requirements of subsection (a)(1)(iii). Thus, there is no restriction on who may serve as an "escrow agent" or what the agent's relationship to the acquiring person may be. Nor is any degree of formality (e.g., a written agreement) required in order to create the escrow. We see no particular difficulty with this degree of informality especially in light of present §801.31(d). We would suggest, however, that, insofar as possible, the language of proposed §801.34 and present §801.31(d) be identical to avoid possible suggestions that differences between those provisions was intended.

In particular, we believe that the strictures in proposed §801.34 concerning voting rights are more appropriate than those in present §801.31(d). For example, it is conceivable that the absolute prohibition on voting in §801.31(d) could work to the advantage of one party to an acquisition (e.g., if shareholders of the issuer were considering adoption of anti-takeover provisions), whereas the restrictions in proposed §801.34 appear more difficult to manipulate. Therefore, amendment of present §801.31(d) may be appropriate.

Third, we also assume that proposed §801.34(b) means that release of voting securities from escrow would be considered an acquisition by the acquiring person only if the acquiring person thereby obtains beneficial ownership of the shares. If, for example, the shares were released from escrow because the acquiring person had sold the shares, the release would obviously not constitute an acquisition by the original acquiror. Again, clarification in the statement of basis and purpose would seem sufficient. We suggest that the language of proposed §801.34(b) be identical with that contained in present §801.33, again in order to avoid any suggestion that differences in language are significant. Proposed §801.34(b) might be reworded to say: "The release of such voting securities from escrow is the consummation of an acquisition of those shares within the meaning of the Act."

Fourth, while proposed §801.34 would not be available to acquisitions resulting from tender offers, we assume that shares placed in escrow may remain there, and thus not require notification, even if a tender offer is made thereafter. Shares acquired as a result of a tender offer could not be added to the escrow although shares acquired during a tender offer (or after public announcement of a tender offer) could be added, so long as their acquisition is not as a result of the tender offer, and so long as the ten percent limitation is §801.34(a)(1)(i) is not exceeded. (Of course, there may be securities law limitations on the ability of a tender offeror to make such purchases.) Similarly, shares may presumably be acquired during a Hart-Scott-Rodino waiting period or after public or private disclosure of the acquiring person's holdings, as long as they are placed in escrow and do not exceed the proposed ten percent limitation.

Fifth, we do not believe it a weakness of this proposal that antitrust review of an acquisition occurs only after separation of voting securities from their prior owners. This separation is limited to holdings of ten percent of the issuer's voting securities (although two or more acquiring persons might simultaneously take advantage of the escrow provision). We believe the Commission's Notice convincingly demonstrates that holdings of this magnitude are not likely to raise significant antitrust problems. Second, there are many instances in which such separation presently occurs. Once a proposed acquisition or tender offer for shares of a publicly-traded company is announced, arbitrageurs typically purchase significant percentages of the issuer's stock, which then must be sold to new purchasers in the event the transaction does not take place. Thus, while an injunction may prevent the acquiring person from purchasing shares, it typically cannot restore the status quo ante. The proposed rule will at least not exacerbate this situation, and the Commission's -- or the courts' -- ability to order effective relief in antitrust litigation is therefore not at issue.

Sixth, we agree with the Commission's conclusion that there is only limited likelihood of anticompetitive harm during the period when shares would be held in escrow under this proposal. First, the holdings are limited to ten percent, a level now permitted for acquisitions valued at less than $15 million, acquisitions made solely for purposes of investment, and acquisitions by persons not meeting the size-of-person test. Second, the time period during which shares are held in escrow is likely to be short since the typical acquiring person is likely either to purchase additional shares and file notification or to sell the shares if it decides not to make additional purchases.

Finally, we believe the escrow proposal should be adopted with a ten percent limitation, rather than five percent, for several reasons. First, the Commission's Federal Register notice adequately documents the lack of need to require filings at the higher ten percent level. Second, it seems potentially and unnecessarily confusing to have both an escrow arrangement available up to the five percent level and a statutory investment exemption available up to ten percent. Finally, the Hart-Scott-Rodino rules are less likely at the ten percent level to disrupt acquisitions not requiring a filing of Form 13D since the Hart-Scott-Rodino waiting period would less likely be triggered during the five days following the purchaser's acquisition of a five-percent interest which must be publicly disclosed.

C. The Optional Notification Proposal

The Section does not support implementation of the optional notification proposal. This proposal provides for the filing by the acquiring person only of an optional notification form for acquisitions of up to ten percent of an entity which makes certain public filings. There is no requirement that, pursuant to §803.5(a)(1), notice must be sent to the target. Under this proposal, the person filing notification must provide certain information about the entity to be acquired; the Commission may, at its discretion, opt to contact the target during its investigation.

This proposal has a number of critical difficulties. First, the acquiring person is still required to report and wait before exceeding the $15 million threshold, even to acquire less than ten percent of the target's voting securities. As the Commission itself has recognized, since the likelihood is small that such a purchase might create an antitrust issue, the filing requirement is unjustified. Moreover, this proposal still requires that acquiring persons engage in careful consideration of the timing and disclosure provisions of both the securities laws and the Commission's rules. Therefore, this interface between the two sets of regulations continues to provide a non-antitrust incentive to violate the Commission's rules.

Second, although eliminating the need to notify the target of a filing, this proposal still permits the antitrust agencies to contact the target during the waiting period in order to obtain information deemed necessary to analyze the competitive effect of the transaction. Although the Commission states that it expects such instances to be rare, the uncertainty about what criteria each antitrust agency will apply to this decision creates significant counseling concerns. Such uncertainty might convince parties not to use this alternative which, in turn, would not resolve the problems the Commission seeks to address with this proposal. Moreover, to the extent that the Commission seeks information from third party sources, the possibility that news of the acquisition will leak out (or even prompt trading on material non-public information) inevitably increases.

Third, the acquiring person's obligation to provide information about the target entity on the Optional Notification and Report Form is burdensome and probably unrealistic. The acquiring person can readily provide copies of the target entities' Securities and Exchange Commission filings in response to proposed Item 4(d). Providing the target's annual report in response to proposed Item 4(e) is also feasible. However, it is not at all certain that acquiring persons can provide the annual audit reports, if different, and most recent regularly-prepared balance sheet of the targets, despite the fact that the Commission makes providing such information a prerequisite to exercising this option.

The difficulty faced by acquiring persons of locating information about the target entity are even more pronounced in proposed Item 6(d), (e), and (f). As most practitioners know, providing the name and headquarters mailing address of entities, even within their clients' control worldwide, requires close consultation with corporate personnel. Providing such information about target entities from publicly-available data for proposed Item 6(d), especially about controlled partnerships, will be extremely difficult, if not impossible. The same is true for proposed Item 6(f) since the information concerning the target's five percent -- or greater -- holdings of voting securities in United States or foreign corporations is not necessarily publicly available and, even when disclosed publicly, is extremely difficult to locate.

These difficulties are equally evident in requiring a response to proposed Item 7(d). The acquiring person could have some difficulty in identifying the overlapping SIC codes, no less identifying the states in which the target conducts operations, has customers, or has establishments from which it derives revenues. This is even more true with respect to proposed Item 7(b)(iv), which requires the identification of the state, county and city or town of each of the target's retail, banking or certain other service establishments.

Further, the proposed rule does not address how non-compliance pursuant to §803.3 will be addressed, nor does the proposed rule discuss how early termination of, and the statutorily-required Federal Register notice for, such optional form transactions would be handled. Finally, the proposal could increase burden in that it does not permit incorporation by reference. Moreover, by requiring the acquiring party to supply information beyond that which it would under the present form, it may take the acquiring party longer to file the optional form. Accordingly, the Commission is not accomplishing its goal of decreasing non-antitrust incentives to evade the Act's requirements.

As to concerns about "insider trading," we believe those to be largely unfounded. The Commission staff generally has kept sensitive information confidential in other circumstances. The Section does not believe that these practices will change if this proposal is adopted. Nevertheless, in light of the objections noted above to the Optional Notification and Report Form, the Section believes that this proposal could be little used if adopted. On balance, the burdens of providing information about the target and the uncertainty of whether the target will, in fact, learn of the acquisition outweigh any benefits which might be gained from employing this option.

D. Questions Regarding All Proposals

The Notice asks four questions regarding the propriety of adopting any of the proposed *de minimis* exemptions. We will respond to each *seriatim*. The first question asks if adoption of any of the proposals will prompt a change in existing patterns of acquiring voting securities. The Section believes that the number of persons making acquisitions of more than $15 million but less than ten percent of the voting securities of an issuer is likely to increase if any of the proposals are promulgated but that any such increase is unlikely to be significant to antitrust enforcement. Indeed, as the Notice points out, there were only 145 transactions falling within the ten percent and under category during the six-year period, so even if there is an increase in that number, it is unlikely that the absolute number will be very large.

What is involved is the undisclosed acquisition of a small percentage of target stock, which is almost certainly incapable of affecting competition. After the initial undisclosed accumulation, the acquirer would generally determine either to seek control -- in which case it would file under the Act -- or to dispose of its shares if a competing bid or restructuring by the target made that economically advantageous. In the first situation, the antitrust agencies can then conduct their review; in the latter case, there is no need for antitrust review and government resources will not have been spent in analyzing a combination of companies which will not occur.

The class of acquisitions which the proposals would particularly affect are situations where an acquirer not having investment intent wishes to purchase voting stock of the target without disclosing those purchases to the target or the public. Typically, as the Notice recognizes, the reason for avoiding disclosure is to prevent a target from taking anti-takeover measures and to prevent a run-up in the market price of target stock until such time as the acquirer announces its intention to seek control. Such an acquirer now may not exceed the $15 million threshold without observing the Act's notification and waiting period requirements, including the requirement that notice of the acquirer's intentions be given to the target.[1]

As to the second question, the Section agrees with the Commission's observation that few purchasers seek to acquire more than ten percent of the voting securities of an issuer before notifying the target. Just as purchasers with investment intent are required to file before exceeding ten percent, so can purchasers -- without investment intent -- reasonably be required to file at that point.

The third question relates to the effect, if any, that proposed changes in the securities laws should have on these proposals. The Section considers any action by Congress to eliminate the "ten day window" largely irrelevant to the antitrust-driven determination of when to require a filing under the Act. The basis for adopting a ten percent blanket exemption must properly be a determination that acquisitions below that level are unlikely substantially to lessen competition. (The Act -- at subsection (d)(2)(B) -- authorizes the antitrust agencies to exempt by rule only those classes of acquisitions which are "not likely to violate the antitrust

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1. Note, however, that it is today possible for such an acquirer, directly or indirectly, to "lock-up" present or future rights to significantly more than $15 million of target stock without complying with the Act. For example, it may acquire an unlimited amount of options, warrants and convertible voting securities of the target, as well as enter into agreements to acquire an unlimited amount of target voting stock. Also, the acquirer might be a 49-percent participant in a newly-formed entity which itself does not meet the "size of person" test so that its first acquisition may not be subject to the Act. The acquisition of such rights may, of course, be subject to disclosure under §13(d) of the Exchange Act and the rules promulgated thereunder by the Securities and Exchange Commission which employ a different concept of "beneficial ownership" than that in §801.1(c) of the Rules.

laws.") The statistics and analysis set forth in the Notice amply support the conclusion that ten percent is an appropriate initial filing threshold. The burden -- on both the acquirer and the antitrust agencies -- of requiring a filing below the ten percent level, appears to outweigh any potential benefit to antitrust enforcement.

Finally, as to the fourth question, the Section urges that the existing fifteen percent threshold be replaced by a ten percent threshold and that the existing twenty-five and fifty percent thresholds be retained. Thus, the initial threshold would be the greater of $15 million or ten percent of an issuer's outstanding voting securities.[2] Under these circumstances, an additional fifteen percent threshold appears unnecessary and deviation from the twenty-five percent threshold (which has in the past functioned efficiently) seems unwarranted.

Sincerely yours,

Irving Scher
Chair
Section of Antitrust Law

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2. In this vein, the Commission may wish to examine whether an increase in the $15 million threshold in §802.20 is appropriate.