KnowledgeVision | Q & A Session 2- The Exemption in the Notice of Proposed Rulemaking - HSR Rulemaking Initiative

TARA KOSLOV: Good afternoon, everyone. And welcome to the second Q&A session for The FTC's rulemaking initiative related to Hart-Scott-Rodino premerger notification. My name is Tara Kozlov. And I am a deputy director in the FTC's Bureau of Competition.

On behalf of the FTC's HSR rulemaking team, I want to welcome you to the second of three question and answer sessions. Our goal is to provide a forum to answer questions in hopes that the Commission will receive a robust set of comments on its proposed changes to the HSR rules. By way of background, on September 21, the Commission announced that it would seek public comments on proposed changes to the rules and interpretations that implement the HSR act.

That initiative has two parts. The first is a notice of proposed rulemaking that would, if adopted, make two changes to existing rules. The first proposed change, which was the topic of our discussion yesterday, would require filers to disclose additional information about their associates and to aggregate acquisitions in the same issuer across those entities. The second change, which we will discuss today, is a new proposed rule that would exempt the acquisition of 10% or less of an issuer's voting securities unless the acquiring person already has a competitively-significant relationship with the issuer. And then next Monday, November 16, we will be hosting our third and final Q&A session to discuss topics in the Commission's advanced notice of proposed rulemaking.

Before I introduce our panelists, I will quickly review a few administrative details. First, a video recording of today's session and our later sessions and our previous session will be available on the FTC's website shortly after each event. Second, as with any virtual event, we may experience technical issues. If these occur, we ask for your patience as we work to address them as quickly as possible. We will also try to keep you informed of any significant delays.

Finally, as we did yesterday, we will be accepting questions during this event, so please send your questions to HSRrulereview@FTC.gov. You can also submit questions related to the final Q&A session to the same address. Due to time constraints and due to the fact that we've already received quite a number of

questions relating to today's topic, we may not be able to address all questions that we receive live. But we will review every question that we receive, and we will make them part of the record for this rulemaking.

And now let me introduce our panelists. First is Ken Libby. Ken is an attorney in the Bureau's Compliance Division. And he has been involved in enforcing the HSR rules for over 30 years. Ken will be providing a brief overview of the proposed exemptions to give some context for our discussion today.

Our other panelist is Kate Walsh, the Deputy Assistant Director of the Bureau's Premerger Notification Office. Kate has been with the FTC for over 13 years, and in private practice for many years before that. After 20 years of focusing on HSR, she's a specialist in HSR rules.

So before I turn it over to Ken for those introductory remarks, what we'd like to do is go back to a question that came in at the very end of yesterday's session. And we wanted to go back and respond to that. So this question relates to the proposed aggregation rules that we discussed yesterday.

And the question was, did the Commission consider any alternative aggregation approaches, including aggregation based on concepts similar to the SCC's beneficial ownership definition? And that's the possession of voting power or investment power. And if so, why were those approaches rejected? And I think Kate, you're going to address that question for us.

KATHRYN WALSH: I am. Thank you, Tara. I appreciate the opportunity to do one more aggregation-related question.

We understand that investors are aware of their obligations to comply with SCC regulations, and that those regulations focus on a different concept of beneficial ownership. That concept at the SCC is mainly focused on voting rights. We did consider using voting power as the basis for determining whether entities should be within the same person, but believe that the right to make the buy and sell decisions is more relevant because Section 7 of course the statute that underpins HSR, is concerned about acquisitions.

And in addition, we're concerned that using voting power to guide aggregation

might lead to evasion by segregating the voting rights from the rights to buy, sell, or hold. Of course, as we made very clear yesterday, we welcome comments. And we would be particularly appreciative of knowing whether this is the right approach.

TARA KOSLOV: Great. Thanks, Kate, for that clarification. I'm glad we were able to go back and address that question. And now, for our main event, I will turn it to Ken, who will do a brief overview on the exemptions that we're discussing today-- the proposed exemptions, I should say.

KENNETH LIBBY: Thanks, Tara. So as noted, the Commission proposes to create an exemption for transactions of de minimis holdings that are unlikely to violate Section 7. The agencies have an incentive to reduce unnecessary filings where the risk of competitive harm is low. This reduces the burden on filers from having to make the filings, and on the agencies, as well, from having to process and review the filings. In the history of HSR, there has never been a challenge of a standalone acquisition of 10% or less of stock of an [INAUDIBLE] insurer.

Many of you may know that previously, in 1988, the Commission proposed a blanket exemption of all acquisitions of 10% or less. However, the Commission did not issue a final rule. Since that time, the agencies have 30 years of additional history looking at such transactions. Given this history, the Commission thinks it's appropriate to create an exemption for such small holdings. As discussed yesterday, the proposed rule would require aggregation of holdings among the associates of the acquiring person to determine whether the combined holdings are less than the 10% limit in the new exemption.

And if the slide can be put up on the exemption? This is not a complete exemption. It is subject to exceptions.

In these situations, a filing may still be required even for holdings below 10%. The exceptions are if the acquirer is a competitor of the issuer, if the acquirer holds 1% or more of a competitor of the issuer, if the acquirer or someone associated with the acquirer is an officer or director of the issuer, if the acquirer or someone associated with the acquirer is an officer or director of a competitor of the issuer, and finally, if there is a vendor-vendee relationship between the acquirer and the issuer of at least $10 million. Exceptions are designed to preclude the use of the

exemption where there is a competitively-significant relationship between the acquirer and the issuer.

Now, the one thing I wanted to discuss at a little length is the exception where the acquirer has holdings in a competitor of the issuer. And that relates to the common ownership issue. As noted in the NPRM, there has been an ongoing discussion of the impact of a single entity holding small percentages of voting securities in competitors within the same industry. And that's sometimes referred to as common ownership.

The debate is not yet settled, but it has raised concerns about the competitive effect of common ownership because investors with small minority stakes may influence the behavior of an issuer. The Commission is not trying to take a position one way or the other on the merits of the common ownership issue, but wants to make sure that if it is ultimately determined that there is a lessening of competition from ownership of competitors, that the rules have not exempted such acquisitions from the filing requirements. I further want to note that even if the new 802.15 does not apply, the exemption for acquisitions made solely for the purpose of investment will still apply. Thus, if an acquirer holds 2% of a competitor of the issuer, but it has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuers, it can still rely on the 802.9 exemption and make acquisitions up to 10% in the issuer without filing.

Now, because the proposal talks about a competitor, it contains a new definition of competitor. And that is a two-part test. A firm is a competitor if it resorts in the same six-digit NAICS industry code or if it competes in any line of commerce as the issuer.

NAICS codes are a useful initial screen, and are already reported in the HSR form, but they are not perfect. Companies can compete, but report in different NAICS codes. Accordingly, the rule also looks at whether the firms compete in any line of commerce, which is the test under the Clayton Act.

TARA KOSLOV: Great, Ken. Thank you so much for that very helpful background. And I believe we'll now turn to our questions.

And we did receive many questions. Thank you all for submitting them. Ken, I'm going to throw this first one to you. Does the FTC intend the proposed 802.15

exemption to cover acquisitions of voting securities of an issuer by the issuer's officers and directors?

KENNETH LIBBY: So as written, the exemption would not apply to acquisitions by officers and directors. And having an officer or director of the issuer is inherently a competitively-significant relationship that we think warrants the ability to review the acquisitions in advance. For example, Section 8 prohibits interlocks of officers or directors because of the special relationships they have with the companies. They have a say in developing competitive strategy and have access to competitively-sensitive information. However, we do welcome comments on whether this is the right approach.

TARA KOSLOV: Great. Thanks. Let's see. Kate, I'm going to throw the next question to you.

So this is a question that relates to the 1% threshold. So under the proposed rules, the de minimis exemption is not available if the filing person holds a 1% or greater interest in a competitor. And the question is, is the Commission considering whether a higher threshold may be appropriate?

KATHRYN WALSH: Well, I think Ken has already touched on this topic because it really relates to, as he said, the academic debate concerning common ownership. And again, I'll just reiterate, the Commission is not trying to take a position on that debate. But it's our understanding that the 1% is really a level at which even holding something in a common space would not present a competitive concern.

So that's really where the 1% comes from, is that it's low enough to not create an issue regardless of what the outcome is on the common ownership debate. Of course, we welcome input on that level. We'd very much like to know if higher level should be more appropriate and what folks think about the 1% in and of itself.

TARA KOSLOV: Great. So here's another question that relates to a different threshold. So under the proposed rules, the de minimis exemption will not be available if the acquiring person and the issuer are in a vertical relationship valued at $10 million or greater. And so the question is, is there any consideration to raising the threshold or using a percentage of total sales or purchases test? Kate, I believe you're going to cover that one.

KATHRYN WALSH: Sure. Thank you. So we have invited input on this point. And we welcome comments suggesting alternatives. It's important to note that one issue with using a percentage test is that an acquirer may be a competitively-significant supplier to one unit of the issuer, but because the issuer is so large, it is insignificant on a percentage basis.

That said, we are absolutely aware that there might be other easily-applied metrics that would also indicate a significant vertical relationship. And any suggestions that folks have, we would welcome those in comments. So please think about that and put them in your comments.

TARA KOSLOV: So I think we have a recurring theme here, which hopefully our audience is picking up on. We welcome all of your comments on all of these points. All right. So there's a next question that relates to the vendor-vendee carveouts.

So here's how the question reads. Under the proposed rules, the acquiring person could include many separate entities, and multiple separate entities could have a vendor-vendee relationship with the issuer. As a result, the analysis of whether the $10 million threshold for the vendor-vendee relationship carveout is met would be burdensome in that it would require asking every entity within the acquiring person whether they have a relationship with the issuer and aggregating the values. And so the question that was raised is, has the PNO considered whether a better approach to capturing transactions that could potentially raise vertical issues would be to make the exemption not available only if any single entity within the acquiring person meets the threshold? And Ken, I believe you're going to take that one.

KENNETH LIBBY: Yes. Thank you. And as [INAUDIBLE] a common theme, we welcome comments on this.

And in determining whether the exemption applies, we should focus on the basis of individual UPEs and not aggregate across all associates. That is, one possible approach is that the exemption applies unless any one UPE within the acquiring person has a vendor-vendee relationship above $10 million. But again, that's only one possible approach. And we welcome comments on any other possible approaches, or even whether that is workable or not.

TARA KOSLOV: Ken, here's a follow-up question, also about the vendor-vendee relationship. So the

question was, why does having a vendor-vendee relationship with the issuer preclude the use of the exemption?

KENNETH LIBBY: So we all know that vertical relationships can be competitively significant. And as a result, the Commission has proposed that not exempting such acquisitions so that the agencies are able to review them in advance. Not all competition and not all cases are brought on a horizontal basis. The agencies have both brought a number of vertical cases. And we want to make sure we continue to get a chance to review those.

TARA KOSLOV: Ken, how was the $10 million level set?

KENNETH LIBBY: So that level was set to try and eliminate the requirement for ordinary course purchases, but capture potentially-significant relationships. $10 million was chosen as a round number that would eliminate the vast majority of ordinary course purchases. We did ask for and would welcome comments to whether a different monetary threshold amount is appropriate.

TARA KOSLOV: And Ken, here's another question also relating to the $10 million level. So the question was, will the $10 million level be adjusted annually similarly to the size of transaction test?

KENNETH LIBBY: So as currently written, the level is not adjusted annually, but we would welcome comments on whether or not that would it be appropriate to do so.

TARA KOSLOV: OK. Switching gears a little bit, we got some questions about determining who is a competitor. So this next question was, what if the acquiring person does not have access to the NAICS codes of the issuer? How should it determine if it is a competitor of the issuer?

KENNETH LIBBY: So as with many aspects of the program, we would expect firms to make a good faith effort to determine whether it is a competitor of the issuer. And that is why there is an alternative test, including in the proposed rule.

TARA KOSLOV: And Ken, here's a follow-up question also about the NAICS codes and this determination. So what if the acquiring person does not have access to the NAICS codes of its other holdings? How should it determine whether the firms in which it

has more than a 1% holding are competitors of the issuer?

KENNETH LIBBY: So this is essentially the same answer. As with many aspects of the program, we would expect firms to make a good faith effort to determine whether any of its portfolio companies is a competitor of the issuer.

TARA KOSLOV: OK. Ken, this is question about line of commerce. So how should it be determined whether the acquiring person is in the same line of commerce as the issuer?

KENNETH LIBBY: So the line of commerce test is the same one as under Section 7 of the Clayton Act. Parties and their counsel should perform their standard antitrust analysis to assess the proposed acquisition and make this determination.

TARA KOSLOV: OK. All right. This next question is a little bit long. I'm going to just go ahead and read it.

So under the proposed rule, any investor with a well-diversified portfolio would need to discern the NAICS codes for every entity in which it has an investment of more than 1% to determine whether the de minimis exemption may be applicable to a pending investment. Given the substantial increase in the time and costs associated with investments monitoring and the fact that many entities may not be willing to share such information with a minority investor, has the Commission considered a less restrictive de minimis exemption that relies on the premise that at some de minimis level, even investments in competing entities are unlikely to have any anticompetitive effects? Ken, I think you're going to take that?

KENNETH LIBBY: Yes. So as noted in the NPRM, we invite comments as to whether the 1% level is the appropriate level for making the exemption inapplicable. However, as noted, the Commission has proposed that the exemption will not apply if the parties are in a competitive relationship, and as additionally proposed, that the 1% stake is the appropriate threshold due to the concerns raised about common ownership. But we certainly welcome additional comment on that. But any comments on that should reference the common ownership concerns.

TARA KOSLOV: OK. Kate, we haven't forgotten about you. I have a question for you.

Let's see. In terms of the proposed definition of competitor that applies to proposed rule 802.15, how broadly would the second prong of this definition be interpreted?

For example, Home Depot and CVS may not report revenues under the same NAICS codes, but under the language of the second prong, could they be deemed competitors if they both sell holiday decorations? Also, has any limiting threshold for competing sales, either revenues or percentage of sales, been considered?

KATHRYN WALSH: So really, the first thing to say is that we really do not intend the line of commerce test to be some sort of gotcha to trip people up who are acting in good faith or filers who are acting in good faith. We would expect that persons would make a realistic assessment of competitive issues to determine whether the firms compete based on Section 7 principles. We really want folks to use their common sense and do the analysis. And we're not trying to get anybody in some new broad interpretation.

Let's see. The second part of the question, limiting threshold for competing sales-- right. We haven't looked at any limiting threshold for competing sales.

Section 7 doesn't have any de minimis exception. Of course, firms can be significant competitors in an important market even if their overlapping activity represents a small portion of each of their sales. However, again, to go with the theme, we would welcome comments on whether this is the right approach, and what people think.

TARA KOSLOV: OK. Ken, I'm going to go back to you with another question relating to the vendor-vendee relationship. So the question was, please confirm that the type of vendor-vendee relationship relevant for the de minimis exemption is only that between the acquired person and entities within the acquiring person, i.e., entities under control of the acquiring UPEs, and that one need not look to vendor-vendee relationships between the acquired person and minority, non-controlled investments of the acquiring person.

KENNETH LIBBY: So yes, that is correct, that a filing person does not have to look at vendor-vendee relationships between the acquired person and minority investments of the acquiring person. But we would note that if the proposed aggregation rule is promulgated, you would also have to look at the associates of the acquiring entity, who would now be included within the acquiring person.

TARA KOSLOV: OK. Here's our next question. Let's see. The assumption articulated in the NPRM that

merging parties, quote, "already compare their NAICS codes in order to respond to items in the form," is typically the case only with negotiated transactions, not the types of transactions that would result in the acquiring person holding an aggregate interest of less than 10% in the issuer.

So here's the question. What would be the consequence if the acquiring person believes in good faith that there are no NAICS code overlaps when in fact there might be one? What degree of diligence and types of supporting evidence would be needed to support a good faith assessment of the exemptions applicability? And Kate, I think you're going to take that one.

KATHRYN WALSH: Yes. So I have to say that, of course technically, that would be a violation of HSR. The general rule of statutory construction is that the person relying on an exemption to a statute of general applicability has the burden of proving that the exemption applies.

Of course the Commission has broad discretion about whether or not to seek an enforcement action. And some good advice would be the acquiring person should be prepared to show the steps it took and how it obtained the information and how it came to approach the analysis and why it felt that was reasonable. So just the diligence that goes into that analysis, just make sure it's robust, and that will probably end up speaking for itself.

TARA KOSLOV: OK. Let's see. Ken, I'm going to throw the next question to you while Kate I take a peek at some of the other ones that have come in. So some of the NAICS codes are very broad, and could prevent the use of the exemption even if there is no actual competition between the entities. Have you considered instead using a rebuttable presumption that the exemption would not apply or there is only an overlap based on these very broad codes, something similar to the treatment of competitors under the solely for purposes of investment exemption?

KENNETH LIBBY: So the use of NAICS codes was designed to be a relatively straightforward test for determining whether the exemption applies. As you know, determining the appropriate line of commerce can be a lengthy and fact-specific exercise, so it may be difficult to eliminate all use of NAICS codes. We would be open to additional information about alternatives, including the use of a rebuttable presumption, but

would need to understand how such a presumption would be rebutted and what information would be needed to rebut the presumption.

TARA KOSLOV: Helpful context if anyone is submitting a comment on that point. Let's see. Kate, I'm going to give this next question to you. What is the rationale behind the new exemption as opposed to providing clarification on the existing investment-only exemption, particularly in relation to the interpretation of solely for the purpose of investment?

KATHRYN WALSH: Sure. That's a great question. We all know that 802.9 relies on intent. And we really wanted to give folks who are truly going to have passive investments another possibility to not have to file.

That's really the point of 802.15, proposed 802.15, is that intent doesn't matter. Of course, as Ken said earlier, 802.9 will continue to be available, but it does have that intent prong. But we were hopeful that another, still-proposed, exemption that did not rely on intent would give more flexibility.

TARA KOSLOV: OK. Ken, I'm going to give this question to you. Why does the proposed exemption not include-- not exclude, sorry, any de minimis level of competition similar to Section 8?

KENNETH LIBBY: So as Kate mentioned earlier, Section 7 does not have a de minimis exception for any particular level of competition. Section 7 and Section 8 have different purposes and different remedies. For Section 8, the remedy is after-the-fact removal from the board. For Section 7, especially with the addition of HSR, the strongly-preferred remedy is to prevent the problematic acquisition before it takes place. And a de minimis exception could work against this where there is a substantial [INAUDIBLE] competition, but a small percentage of overall sales.

TARA KOSLOV: Ken, we got a question about the lack of a geographic requirement. Was the lack of any geographic requirement intentional?

KENNETH LIBBY: Yes, it was intentional. As you know, geographic market analysis is difficult and contentious exercise. Anyone who has followed the Commission's litigation of hospital mergers know that determination of the geographic market is one of the most highly-contested issues in that litigation. So the rule was designed to have

bright-line tests to the greatest extent possible.

TARA KOSLOV: OK. Here is a question that has come in just a few minutes ago. It's a little long, so I'm going to just go ahead and read it directly. If the FTC consistently determined that none of the more than 1,800 acquisitions of 10% or less of an issuer's voting securities they examined from 2001 to 2017 presented competition concerns, presumably including scenarios where the acquirer had a 1% or greater position in a competing firm, doesn't that cut against the veracity of the common ownership literature?

KATHRYN WALSH: Who would you like to take that one on? Should I try?

TARA KOSLOV: Who would like to take it?

KATHRYN WALSH: Well, I'll just point out-- and Ken, feel free to jump in. But I'll just point out that those enforcement statistics, of course, were generated under current rules, where there's no aggregation. And we've, I think, made it pretty clear through our discussion yesterday and in the NPRM itself that we really do believe that firms need to aggregate holdings so that we have a better understanding of the true competitive impact of a given acquisition. [INAUDIBLE]--

KENNETH LIBBY: And I would--

KATHRYN WALSH: Yeah. Go ahead.

KENNETH LIBBY: I would just like to add that some of the literature on common ownership has taken fault with the Commission and the antitrust division over a lack of enforcement. And this is really a new analysis using new tools. And so we can't always use past as prologue for those when it's looking at something that hadn't been looked at before. So our goal is to let that play out among the academics and let them come to some consensus, and not undercut that through our action.

TARA KOSLOV: Great. All right. I'm going to pause for one sec and remind our audience that if you do want to submit any additional questions, this is your last chance, because we have now reached the end of all of the questions that have come in. Kate and Ken, I

don't know if you have any other follow-up comments while we wait and see if anything else came in that we are able to address on short notice. And just to remind everybody, if you do send questions and they're the kinds of questions that require a little bit more thought, we will certainly consider those questions as part of the record.

KATHRYN WALSH: Yes. And I'll just add that the sooner you can get us complex questions, the better. The more time we have to actually think them through is going to benefit everyone. So as we turn to our final presentation next week, our final Q&A on the ANPRM, would just encourage folks to get those questions to us sooner rather than later.

TARA KOSLOV: Ken, anything to add?

KENNETH LIBBY: No. Kate, didn't you want to say something about electronic filings?

KATHRYN WALSH: Sure. Tara, are we really good with no more questions on our exemption? May I--

TARA KOSLOV: We do not have any-- yep, go ahead. We have not had any more questions come in.

KATHRYN WALSH: OK. Well, I will take this opportunity, knowing that we have a lot of folks who think about HSR right here live with us, to say that PNO is updating the instructions to the e-filing process that we've had in place since March. And we're going to be posting that on our website page very soon.

Really, the issue is under this platform that we're using, a lot of the file names that are coming in are too long for us to deal with the files efficiently. And we told you how to do it back in March. We've learned since then. We're providing some revised guidance on that piece.

And there's other aspects to it. But basically, just new guidance that we hope everyone will take a look at. And if you have any questions, of course, all you have to do is reach out.

TARA KOSLOV: And I'll definitely give a shout-out to our heroic PNO team in collaboration with our tech folks at the FTC, and of course our colleagues at DOJ for being able to put together this e-filing option to keep us all safe during the pandemic. All right. Well,

since we have no more questions for today, I think we're all set. Let me remind you all once again that our third session will take place on Monday, November 16. That's the session where we'll be talking about the wide range of topics in the Commission's Advanced Notice of Proposed Rulemaking.

I really do encourage all of you to get your questions in earlier rather than later, especially since, as you can tell, we're all taking a fair amount of time to analyze the questions and think through the answers. And if we get them that morning, it makes it a little harder for us to do that thoughtfully. So if you can send them late the previous week, late this week, that would be fantastic. And we look forward to seeing all of you there.

Thanks so much for joining us. And Ken and Kate, thanks as always, for your expertise, and for guiding our discussion today. Thanks, [INAUDIBLE].

KATHRYN WALSH: Thank you.

KENNETH LIBBY: Thank you.