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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

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Working Party No. 3 on Co-operation and Enforcement

DEFINITION OF TRANSACTION FOR THE PURPOSE OF MERGER CONTROL REVIEW

-- United States --

18 June 2013

The attached document is submitted to Working Party No. 3 of the Competition Committee FOR DISCUSSION under item IV of the agenda at its forthcoming meeting on 18 June 2013.

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1. Introduction

1. The Hart-Scott-Rodino ("HSR") Act, 15 U.S.C. §18a, requires that parties to certain mergers or acquisitions notify the Federal Trade Commission and the Department of Justice (collectively, "the Agencies") before consummating the proposed acquisition. In general, the HSR Act requires premerger notification for acquisitions of "voting securities" or "assets" that meet a certain size of transaction threshold – that is, if, as a result of the acquisition, the acquiring person will hold in excess of $50 million (as adjusted[1]) in assets or voting securities of the acquired person.[2] In addition, if the acquisition is valued between $50 million (as adjusted) and $200 million (as adjusted), a "size of person" test must also be met under which one party has sales or assets of $100 million (as adjusted) or more and another party has sales or assets of $10 million (as adjusted) or more.[3] Thus, coverage of a transaction under the U.S. premerger notification system does not depend on whether control or material influence is obtained.

2. Although the U.S. premerger notification system subjects most mergers of significant size to premerger competitive review, a transaction does not have to be subject to such review for the Agencies to be able to challenge it under the antitrust laws. Under Section 7 of the Clayton Act,[4] the Agencies can challenge almost any acquisition of stock or assets, without regard to whether the acquisition requires premerger notification under the HSR Act, and such challenges can be brought either before or after a transaction is consummated. Indeed, the Agencies have investigated and challenged a number of transactions that were not reportable under the HSR Act.[5]

2. Responses to Suggested Issues and Questions for Consideration

2.1 Acquisitions of Shares

3. As noted above, for acquisitions of voting securities, premerger reporting requirements do not hinge on whether "control" or "material influence" of the issuer is obtained. Acquisitions of minority interests may be reportable if they result in an acquiring person holding greater than $50 million (as adjusted) in voting securities of an issuer. The HSR Act and Rules do, however, exempt acquisitions that result in holding 10 percent or less of an issuer's voting securities if made solely for the purpose of investment.[6] Under the authority that the HSR Act grants the Agencies to promulgate rules, including to

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1 Since 2005, the jurisdictional thresholds are adjusted annually to reflect changes in gross national product. The current thresholds (http://ftc.gov/os/2013/01/130110claytonact7afrn.pdf) are approximately 42 percent above the 2005 thresholds. For example, the size of transaction threshold that had been $50 million in the baseline year is now $70.9 million.

2 15 U.S.C. §18a(a)(2)(B)(i).

3 15 U.S.C. §18a(a)(2)(B)(ii).

4 15 U.S.C. §18.

5 There have been a number of recent examples. *See, e.g., FTC and State of Idaho v. St. Luke's Health Sys., Ltd.*, 1:12-cv-00560-BLW-REB (D. Id. filed March 13, 2013), www.ftc.gov/opa/2013/03/stluke.shtm; *U.S. v. Bazaarvoice, Inc.*, C13-0133 (N.D. Cal., filed Jan. 10, 2013), www.justice.gov/atr/public/press_releases/2013/291185.htm; *U.S. and State of New York v. Twin America LLC*, 12 CV 8989 (S.D.N.Y., filed Dec. 11, 2012), www.justice.gov/atr/public/press_releases/2012/290136.htm.

6 15 U.S.C. §18a(c)(9) and 16 CFR §802.9.

define terms used in the statute, the HSR Rules provide that "[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."[7]

4. Suggestions have from time to time been made to the Agencies that this "investment only" exemption as defined and applied by the Agencies is too narrow, subjecting too many acquisitions of ten percent or less of an issuer's voting securities that are not likely to raise competitive issues to premerger reporting. As described below in response to question 4, the Agencies have the authority to exempt from premerger reporting classes of transactions that are not likely to violate the antitrust laws, and have, through rulemaking, created such exemptions for various classes of transactions.

5. Interlocking directorates are not acquisitions of voting securities or assets under the HSR Act and do not trigger any reporting requirements. Section 8 of the Clayton Act, as amended by the Antitrust Amendments Act of 1990, however, prohibits certain director and officer interlocks between competing business corporations.

2.2 Acquisitions of Assets

6. In addition to acquisitions of securities, the HSR Act explicitly covers acquisitions of assets. The acquired assets may include an entire business unit, tangible assets that do not comprise an entire business unit and/or intangible assets such as patents or licenses.

7. Questions sometimes arise as to whether certain types of business arrangements involving assets (such as leases, management contracts, and exclusive licenses of intellectual property), constitute acquisitions of assets. Such questions are often resolved through informal interpretations rendered by the Premerger Notification Office of the FTC,[8] and in some instances through rulemaking.[9]

8. Exemptions from premerger reporting, as described in response to question 4 below, have proved to be an important way of assuring that premerger reporting is not required for categories of asset acquisitions that are unlikely to raise significant antitrust issues. The HSR Act, for example, exempts acquisitions of goods or realty transferred in the ordinary course of business.[10] And the Agencies have used their authority to exempt other classes of transactions unlikely to violate the antitrust laws, including acquisitions of unproductive real property, office buildings and residential property, hotels and motels, and agricultural property.[11]

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7 16 C.F.R. §801.1(i)(1).

8 The Premerger Notification Office (PNO) answers thousands of inquiries each year and is prepared to provide prompt informal advice concerning the potential reportability of a transaction. See http://ftc.gov/bc/hsr/staffphone.shtm. Many of the PNO's informal interpretations are available on its website at http://ftc.gov/bc/hsr/informal/index.shtm.

9 An example of a recent rulemaking can be found at www.ftc.gov/opa/2012/08/hsr.shtm.

10 15 U.S.C. §18a(c)(1).

11 See 16 C.F.R. §802.2.

2.3 Joint Ventures

9. Premerger reporting may be required for the formation of certain types of joint ventures. Section 801.40 of the HSR Rules provides specific rules regarding the formation of corporate joint ventures, treating such formations as acquisitions of voting securities of the venture by the venturers.[12]

10. Section 801.50 provides specific rules regarding formations of non-corporate joint ventures, such as partnerships and limited liability companies (LLCs).[13] Premerger reporting of the formation of non-corporate joint ventures is required only when one of the venturers will "control" the new entity – in which case, it is deemed to be acquiring the assets of the joint venture that it did not previously hold. Although change of control of an entity is generally not a prerequisite for reportability of a voting securities or asset transaction, it is a key factor in determining when an acquisition of an interest in an unincorporated entity must be reported. "Control" is defined in Section 801.1(b) of the HSR rules.[14] In the case of an entity that has no voting securities (*e.g.*, a partnership or LLC), control means having the right to 50 percent or more of the profits of an entity, or having the right in the event of dissolution to 50 percent or more of the assets of the entity.[15]

11. The rules regarding acquisitions of interests in existing corporate and non-corporate joint ventures build on the concepts involved in determining reportability of joint venture formations in that the acquisition of an interest in a partnership or LLC is unreportable if it does not convey control of the entity.

12. Although there is some difference in the treatment of joint venture formations and acquisitions of joint venture interests depending on whether the venture is corporate or non-corporate in nature, those differences flow from the HSR Act's coverage of acquisitions of "voting securities" and "assets," and the Agencies have not deemed interests in partnerships or LLCs to be either voting securities or assets within the meaning of the HSR Act. The Agencies treat joint ventures – whether corporate or non-corporate – as consistently as possible, as reflected by the 2005 rulemaking involving noncorporate entities described in the answer to question 6 below.

2.4 Exemptions

13. Exemptions from HSR play an important role in refining the parameters of the United States premerger notification program. Some of these exemptions are mandated by the HSR Act.[16] These statutory exemptions are based on either of two broad rationales: the transactions are of a category unlikely

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12 16 C.F.R. §801.40.

13 16 C.F.R. §801.50.

14 16 C.F.R. §801.1(b).

15 For corporate entities, control is defined as either holding 50 percent or more of the outstanding voting securities of an issuer or having the contractual power presently to designate 50 percent or more of the directors of a corporation. The concept of control, while generally not relevant to the question of whether a transaction is reportable under HSR, is relevant, in addition to reportability of non-corporate joint venture formations, to determining what entities are included in the acquiring and acquired persons when calculating whether the statutory size-of-person test is met. It also is relevant to determine whether the Section 802.30 exemption for intraperson transactions applies. (The "intraperson" exemption exempts acquisitions in which the acquiring person and at least one of the acquired persons are the same by reason of control. 16 C.F.R. §802.30. Examples of exempted transactions include an acquiring person who already holds 50 percent or more of the voting securities of an issuer acquiring the remaining shares, and the merger of, or the transfer of assets between, two subsidiaries controlled by the same parent.)

16 See 15 U.S.C. §18a(c).

to raise significant antitrust issues (*e.g.*, acquisitions of goods or realty in the ordinary course of business); or the transactions are subject to premerger competitive review by another federal agency (*e.g.*, bank mergers, which are reviewed by one of the bank regulatory agencies).

14. In addition to creating statutory exemptions from premerger reporting, Congress built additional flexibility into the premerger notification system for determining which transactions must be notified by granting the Agencies the rulemaking authority to exempt from premerger notification classes of transactions "which are not likely to violate the antitrust laws."[17] The Agencies, with input from the public, have used this authority in several important areas.[18] For example, exemptions have been created through agency rulemaking for acquisitions of foreign voting securities or foreign assets that lack a sufficient nexus with U.S. commerce,[19] certain types of real property such as office and residential property, agricultural property and hotels,[20] and acquisitions of voting securities of issuers holding assets the acquisition of which would be exempt.[21]

2.5 Objective Criteria and "Gaming the System"

15. The U.S. premerger notification program is based on clear and objective criteria and thresholds, enabling parties to determine whether the transaction they are planning requires premerger notification.

16. "Gaming the system" by structuring transactions to avoid premerger reporting has not been a systemic or widespread problem in the United States. Parties recognize that even if their transaction does not require premerger reporting, it can still be subject to substantive antitrust challenge by the Agencies, and the Agencies recognize that transactions are often structured primarily for tax or other business reasons rather than to avoid premerger reporting. The HSR Rules address potential instances of gaming the system by providing that "[a]ny transaction(s) or other device(s) entered into or employed for the purpose of avoiding the obligation to comply with the requirement of the act shall be disregarded, and the obligation to comply shall be determined by applying the act and [the] rules to the substance of the transaction."[22] The Agencies can seek civil penalties for failures to make premerger filings, and a handful of such cases brought over the 35 years that the HSR system has been in place have been based on this avoidance rule and have resulted in substantial civil penalties.[23]

2.6 Changes in the Merger Regime

17. What constitutes a transaction requiring premerger reporting is largely dictated by the HSR statute – "assets" and "voting securities" are statutory terms, and a number of HSR exemptions are

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17 15 U.S.C. §18a(d)(2)(B).

18 See generally 16 CFR Part 802.

19 For the acquisition of foreign assets to be reportable, the assets must have generated sales of more than $50 million (as adjusted) into the United States in the most recent fiscal year. For an acquisition of voting securities of a foreign issuer to be reportable, the issuer must have either $50 million (as adjusted) in assets located in the United States or $50 million (as adjusted) in sales in or into the United States in the most recent fiscal year; an additional requirement, if the acquiring person is foreign, is that a controlling interest must be acquired in the issuer. See 16 CFR §§802.50-51.

20 See 16 CFR §802.2.

21 See 16 CFR §802.4.

22 16 CFR 801.90.

23 See, e.g., *U.S. v. Sara Lee Corp.*, 1996-1 Trade Cas. (CCH) ¶ 71,301 (D.D.C. 1996); *U.S. v. Honickman*, 1992-2 Trade Cas. (CCH) ¶ 70,018 (D.D.C. 1992).

contained in the statute. Although Congress has not changed these basic underpinnings regarding the type of transactions that may require premerger reporting, it has changed the *thresholds* for premerger reporting. The centerpiece of those amendments, which took effect in February 2001, was an increase in the "size of transaction threshold" to $50 million, from $15 million.[24] The legislation also created an annual automatic adjustment mechanism, which took effect in 2005, whereby the thresholds are adjusted annually to reflect the percentage change in gross national product.

18. As described in response to question 4 above, the Agencies have created a number of premerger reporting exemptions that play an important part in determining the types of transactions requiring premerger reporting.

19. In addition, the Agencies have on occasion promulgated rules, after notice to and comment from the public, that affect the types of transactions for which premerger reporting may be required.

20. For example, in 2004-2005, the Agencies solicited comments and adopted a series of rules aimed at addressing, to the extent possible under the statute, the disparate treatment or corporate and non-corporate entities, such as partnerships or limited liability companies, particularly in the areas of formation of these entities, acquisitions of interests in them, and the application of certain exemptions.[25] The central thrust of these rules changes, as discussed in response to question 3 above, is that meaningful antitrust review should occur at the point at which control of an unincorporated entity changes. In adopting these rules, the Agencies agreed to track their impact on premerger notifications received and, over the next two years, found that the changes worked very well.[26] The Agencies' experience since the adoption of these rules in 2005 is that although they do not capture every formation of an LLC or partnership that may raise antitrust issues, they have done a better job at doing so than had the previous rules and interpretations.

21. The rulemaking process that is required for creating exemptions or adopting other types or rules involves a notice and public comment period, after which the Agencies must address points raised in the comments. The rulemaking must also include an analysis of the impact of the rulemaking under various other statutes, such as the Paperwork Reduction Act, which requires that information collected from the public minimizes burden and maximizes public utility. Thus, the Agencies implicitly engage in a cost/benefit analysis in every rulemaking.

2.7 Alternatives

22. As is highlighted in the Introduction above, an important feature of the United States system is the Agencies' ability under section 7 of the Clayton Act to reach transactions that are not reported under the premerger reporting program. In addition, the Agencies can challenge transactions as agreements in restraint of trade under Section 1 of the Sherman Act.

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24 15 U.S.C. 18a(a)(2).

25 69 FR 18686 (April 8, 2004) (proposed rules); 70 FR 11502 (March 8, 2005) (final rules).

26 See HSR Annual Reports, Fiscal Year 2006, p.9 (www.ftc.gov/os/2007/07/P110014hsrreport.pdf) and Fiscal Year 2007, pp.8-9 (www.ftc.gov/os/2007/07/P110014hsrreport.pdf).