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What to Expect When You Are Expecting (to File under HSR)

Key Details from Recent Reports

By Tod A. Northman

Large mergers and acquisitions can be *high-risk, company-changing affairs. Besides the hefty filing fee of $45,000 or more and the onerous work required to complete the form, transactions that require filing under the Hart–Scott–Rodino Antitrust Improvements Act of 1976 are, by design, required in especially important transactions. Tod Northman details lessons from the recent reports.*

Besides the hefty filing fee of $45,000 or more and the onerous work required to complete the form, making a filing under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act) is stressful for many businesses because they are unfamiliar with the process. By definition, the filing is required in high-stakes situations: where businesses have agreed to undertake a merger or acquisition for consideration of $84.4 million or more (effective February 28, 2018), among other criteria.

Waiting for regulatory clearance can delay or imperil the closing of a transaction; failure to do so can result is large fines or, in extraordinary circumstances, judicial intervention. However, because the Federal Trade Commission (FTC) and the Department of Justice (DOJ) report each year on the disposition of merger notifications filed the previous fiscal year, we can learn quite a bit about the typical disposition of a filing by delving into the data. Below are lessons from the recent reports.

M&A activity is high, but deal size was down slightly.

In each of the past three years, more than 1,800 transactions were reported under the HSR Act. Fiscal year 2017, with 2,052 transactions, was the busiest year for reporting transactions since fiscal year 2007, which had 2,201 reported transactions. The aggregate value of reported transactions in fiscal year 2017 was $1.8 trillion, down slightly from 2016's $1.9 trillion, despite 12 percent more transactions in fiscal year 2017.

Most reported transactions are not subject to agency investigation beyond reviewing the filed form.

It varies by year, but in fiscal year 2017, only 10.3 percent of transactions reported under HSR were assigned to either the FTC or the DOJ to undertake more searching investigation beyond the information provided in the HSR form. That was the lowest percentage in the past decade, but not significantly below fiscal year 2016's 13.6 percent or fiscal year 2015's 15 percent. Previous years had been as high as 18 percent.

In only 2.6 percent of reported transactions did either the FTC or the DOJ issue a second request for additional information in fiscal year 2017; approximately three-quarters of transactions in which an agency chooses to investigate beyond the filed HSR form are approved within the initial 30-day window from filing.

Early termination is requested and granted frequently.

One of the concerns with reporting a transaction under HSR is the delicate timing – waiting long enough to increase confidence that all parties to a transaction will want to close, but not waiting so long as to delay closing. Filers can request early termination of antitrust investigation in exchange for public notice of termination. Any filing party can request early termination; although the timeline is publicized to be within 15 days of receipt of all required materials, a well-prepared filing in a transaction that doesn't raise any evident antitrust issues can receive notice of termination in half that time, if volume is light at the Premerger Notification Office (the administrative arm of the FTC that administers the premerger notification process under the HSR Act). However, early termination is discretionary. In the three most recent fiscal years, early termination was requested in approximately 77.5 percent of reported transactions. Granting early termination is not assured, even for transactions that do not appear to raise anti-competitive issues, but it was granted in approximately 80 percent of

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requested reporting transactions the last three fiscal years (78.6 percent in fiscal year 2017).

Enforcement activity is uncommon but nearly always fatal to the original transaction structure.

The DOJ challenged 18 transactions in fiscal year 2017: 15 cases were resolved by restructuring; the parties abandoned six transactions; and one case was tried to verdict, with the DOJ winning. The FTC challenged 15 transactions, and it reached consent decrees with the parties in 14 transactions; it filed an administrative complaint in the remaining transaction, which caused the parties to abandon the transaction. Viewed in this context, the recent District Court ruling to permit the merger of AT&T, Inc. and Time Warner, Inc. is a high-profile reminder that both the DOJ and FTC can be successfully challenged. However, the cost to the parties was enormous – the deal was announced in October 2016 and didn't close until June 2018. It is impossible to quantify the distraction for both businesses in preparing and trying such a complicated, high-stakes case over eight weeks. All in, it is easy to understand why most parties capitulate – at a minimum restructuring the transaction – when antitrust officials object to a transaction.

Larger transactions draw heavier scrutiny.

In 2017, over half of the transactions that drew a second request investigation were valued at over $1 billion. Nearly 10 percent of reported transactions of $1 billion or more received a second request. By contrast, less than 1 percent of reported transactions valued at $200 million or less drew a second request, and in only 2.6 percent of all transactions overall was a second request issued. Notably, over the past decade, the FTC and the DOJ issued second requests at roughly the same rate – approximately 1.6 percent – although the percentage varied widely by year.

A violator gets one mulligan.

U.S. antitrust authorities are forgiving – to a point. First-time violators of the HSR Act who voluntarily correct their errors, demonstrate that failure to comply was unintentional and agree to implement procedures to comply in the future are unlikely to be penalized. Footnote 15 of the 2017 annual report states that the "agencies generally will not seek penalties." Identical footnotes appear in earlier reports. Even inadvertent second offenses will generally result in penalties, however. For example, a hedge fund manager agreed to pay a $180,000 penalty even though the FTC concluded the manager's second HSR violation in two years was inadvertent.

Repeat offenders and sophisticated violators risk steep penalties.

In 2017, the agencies brought four enforcement actions, resulting in $2.2 million in civil penalties; in 2016, the agencies brought three enforcement actions, resulting in $12.1 million in civil penalties. Three of the 2017 actions addressed repeat offenders, and one of the actions demonstrates that the agencies have a long memory. The FTC alleged that an investor violated the HSR Act in October 2011 by failing to report voting shares acquired by his wife (which were imputed to him) that pushed him over a reporting threshold. Because the investor had paid civil penalties to settle an earlier HSR action – in 1991 – the FTC sought a $720,000 penalty even though the investor contended the violation was inadvertent.

Another bugaboo for the agencies is violation of the "investment only" exemption, which exempts acquisitions of up to 10 percent of voting securities if they are made solely for investment purposes. To be eligible, the investor cannot exercise control over the company, either as a shareholder or as a director. In 2016, an activist investment firm agreed to the largest-ever penalty of $11 million to resolve a lawsuit; in addition, in 2017, an investor-director agreed to the $720,000 penalty (a separate case from the $720,000 penalty described above). Also of note, in 2016, the maximum penalties for violations of the HSR Act increased to more than $40,000 per day, an amount that is escalated annually ($41,484 per day as of February 2018).

In sum, while the United States merger clearance process can appear mysterious and high risk, most transactions are cleared within 15 days of the HSR Act filing without any additional information being requested. However, for the relatively few transactions that are challenged – which are disproportionately the largest transactions – the chance that the transaction will close on the negotiated terms is slim.

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