

Indexing Comes to the HSR Act

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When Congress amended the Hart-Scott-Rodino Act in 2000,² it raised the minimum threshold for premerger notification filings to \$50 million. The intention was to make up for more than twenty years of inflation, which had eroded the initial \$15 million statutory threshold and over time effectively made the HSR Act applicable to smaller and smaller transactions. The 2000 amendments provide ongoing inflationary correction of this kind through annual indexing of several provisions that define the applicability of the Act to specific acquisitions of assets or voting securities. These indexing provisions will affect premerger notification obligations for the first time beginning sometime in February 2005. The statutory changes will require additional changes in the rules implementing the Act.³ It turns out that a relatively simple idea has relatively far-reaching results.

The Statutory Indexing Requirements

The 2000 amendments require indexing of four provisions in the HSR Act: the \$50 million size-of-transaction test,⁴ the \$200 million size-of-transaction test,⁵ and the \$10 million and \$100 million size-of-person tests.⁶ The indexing provision requires adjustment and publication “for each fiscal year beginning after September 30, 2004, in the same manner as provided in section 8(a)(5) to reflect the percentage change in the gross national product for each fiscal year compared to the gross national product for the year ending September 30, 2003.”⁷

The reference to “section 8(a)(5)” is to the Clayton Act provision for indexing the thresholds used to determine whether interlocking officers or directors are unlawful. That provision says:

¹ The author wishes to thank Michael Verne of the FTC’s Premerger Notification Office for an ongoing dialogue on many of these issues and for sharing the intentions of the FTC staff concerning the indexing proposals.

² The Hart-Scott-Rodino Antitrust Improvements Act (HSR Act) is Section 7A of the Clayton Act, 15 U.S.C. § 18a. The 2000 amendments in Pub. L. No. 106-553, 114 Stat. 2762, were effective February 1, 2001.

³ The rules implementing the HSR Act are codified at 16 C.F.R. Parts 801–803 and the Notification and Report Form, which is an Appendix to Part 803.

⁴ 15 U.S.C. § 18a(a)(2)(B)(i) requires premerger notification filings for transactions that result in the acquiring person’s holding assets or voting securities of the acquired person valued in excess of \$50 million (but not exceeding \$200 million), providing the statutory size-of-person tests are met.

⁵ 15 U.S.C. § 18a(a)(2)(A) requires premerger notification filings for transactions valued in excess of \$200 million, regardless of whether the statutory size-of-person tests are met.

⁶ 15 U.S.C. § 18a(a)(2)(B)(ii) requires premerger notification filings for transactions valued between \$50 million and \$200 million, providing the annual net sales or total assets of either the acquiring or the acquired person are at least \$100 million and the annual net sales or total assets of the other person are at least \$10 million. (The \$10 million test for an acquired person not engaged in manufacturing ignores that person’s annual net sales.)

The 2000 amendments also change the HSR Act filing fee thresholds, but not the amounts of the fees payable under those thresholds. The filing fee regime is found at 15 U.S.C. § 18a note.

⁷ 15 U.S.C. § 18a(a)(2)(A).

For each fiscal year commencing after September 30, 1990, the \$10,000,000 and \$1,000,000 thresholds in this subsection shall be increased (or decreased) as of October 1 each year by an amount equal to the percentage increase (or decrease) in the gross national product, as determined by the Department of Commerce or its successor, for the year then ended over the level so established for the year ending September 30, 1989. As soon as practicable, but not later than January 31 of each year, the Federal Trade Commission shall publish the adjusted amounts required by this paragraph.⁸

Traditionally, this information becomes available after the September 30 close of the federal fiscal year and is ready for implementation early in the ensuing calendar year.⁹ The first indexing applicable under the HSR Act will likely be announced in January 2005 and become effective thirty days after publication in the Federal Register.¹⁰

The relevant multiplier adopted by the Commission for the first round of indexing is an increase of 6.13 percent, rounded up to the nearest \$100,000. The result will look like this: Acquisitions of assets or voting securities valued in excess of \$212.3 million will be reportable without regard to size-of-person tests. Acquisitions valued between \$53.1 million and \$212.3 million will be reportable if either the acquiring or the acquired person has annual net sales or total assets of at least \$106.2 million and the other has annual net sales or total assets of at least \$10.7 million.

But it's not nearly that easy.

The natural effect of the indexing will be to increase the statutory filing thresholds and thus to make nonreportable certain transactions that were reportable under the Act and rules applicable before the indexing.

Impact of Indexing on HSR Act Waiting Periods

The Commission will need to provide guidance for filing parties with transactions pending at the time the indexing becomes effective. The natural effect of the indexing will be to increase the statutory filing thresholds and thus to make nonreportable certain transactions that were reportable under the Act and rules applicable before the indexing.¹¹ There are three possible scenarios: (1) filings have been made, the waiting period has expired, but the transaction has not been closed; (2) filings have been made for a transaction, and the waiting period has not expired; (3) filings have been made, a second request has been issued, and the waiting period therefore has not expired. What happens in these three situations if, as a result of indexing, the previously reported transaction is rendered nonreportable?

The first case is straightforward. The parties have fully complied with the HSR Act, no further obligations arise as a result of the indexing, and the indexing has no impact on the transaction or the parties.

In the second case, as long as the waiting period has not expired, the parties' obligations under the HSR Act have not been fully satisfied. Thus, if indexing were to render a previously reported transaction nonreportable before the waiting period expires, the HSR Act does not apply to the transaction, and the parties would have the right to withdraw their filings and close the transac-

⁸ 15 U.S.C. § 19(a)(5). Note that the resulting adjustment is not really for inflation, as it is based on annual comparisons of gross national product, not consumer or other price-related index.

⁹ For example, on January 16, 2004, the FTC issued a press release containing the following statement:

The Commission has approved the publication of a Federal Register notice announcing changes in the two threshold figures that define when it is unlawful for an individual to serve as an officer or director of two or more competing corporations. Under the new thresholds, effective immediately, Section 8 of the Clayton Act is applicable to such arrangements (with certain exceptions) if each of two companies has capital, surplus, and undivided profits in excess of \$20,090,000, and the competitive sales of each corporation exceed \$2,009,000.

¹⁰ The FTC staff has recommended that the indexing be made effective for transactions closing on or after 30 days following publication of the changes in the *Federal Register*.

¹¹ Note that in the relatively unlikely event of a GNP decline, the jurisdictional reach of the HSR Act would *increase*, at least temporarily.

tion immediately. This would be true even in the third case, where the waiting period had not expired because it had been extended by issuance of a second request, and even where the parties had responded to a second request but the ensuing thirty-day extension of the waiting period had not run out.¹²

Impact of Indexing on HSR Act Filing Fees

The amounts of the filing fees applicable to reportable transactions as a result of the 2000 amendments will not be affected by indexing, but the thresholds that determine those fees will be indexed.

Currently, acquiring persons are required to pay filing fees of \$45,000 for reportable transactions valued above \$50 million up to \$100 million, \$125,000 for transactions valued from \$100 million up to \$500 million, and \$280,000 for transactions valued at \$500 million or more.

The effect of indexing will be that acquiring persons will pay filing fees of \$45,000 for transactions valued above \$53.1 million up to \$106.2 million, \$125,000 for transactions valued from \$106.2 million up to \$530.7 million, and \$280,000 for transactions valued at \$530.7 million or more.

Indexing will raise another set of issues relating to filing fees. As the discussion above indicates, indexing may render certain transactions nonreportable after notifications have already been filed. The Commission is likely to rely on existing Rule 803.9(e), which says that filing fees once paid are refunded only if it is determined that the transaction was not reportable *at the time the notification was originally filed*. If a transaction that is reportable at the time notification is filed subsequently becomes nonreportable (because, for example, newly issued financial statements reveal that the parties no longer satisfy the size-of-person test or the value of publicly traded stock being acquired declines), the parties may withdraw their filings, but the acquiring person cannot recover its filing fee.

Impact of Indexing on the HSR Rules

The statutory indexing requirement will necessitate or induce changes in a number of the HSR rules.

1. Notification Thresholds. Rule 801.1(h) defines five notification thresholds, which correspond roughly to the statutory reporting thresholds. Presently, where size-of-person tests are satisfied or are inapplicable, filings are required for transactions as a result of which the acquiring person will hold stock or assets of the acquired person (1) valued in excess of \$50 million, or (2) valued at \$100 million or more, or (3) valued at \$500 million or more, or (4) constituting at least 25 percent of the issuer's outstanding shares, and valued at more than \$1 billion, or (5) constituting 50 percent of the issuer's outstanding shares, valued at more than \$50 million. Notifications are required for each acquisition as a result of which the acquiring person's holdings meet or exceed the next higher (or indeed any higher) notification threshold.

The Commission will amend these notification thresholds to reflect the effect of the statutorily required indexing. Thus, the five notification thresholds will require filings for transactions (1) val-

¹² This is also true under present HSR rules. If the jurisdictional criteria in the HSR Act will not be met at the time a transaction is to be consummated, the Act does not apply, and the parties have no obligation to comply with either the filing or the waiting period requirements, even if they have already filed notification. The original notification is not automatically void, since the parties may choose to leave the notification on file, for example to provide insurance against the possibility that they will again satisfy the jurisdictional filing criteria prior to closing.

ued in excess of \$53.1 million, or (2) valued at \$106.2 million or more, or (3) valued at \$530.7 million or more, or (4) constituting at least 25 percent of the issuer's outstanding shares, and valued at more than \$1,061.3 million. The final threshold (5) would be 50 percent of the issuer's outstanding shares, valued at more than \$53.1 million.

2. Formations of Joint Venture Corporations and Unincorporated Entities. Rule 801.40 imposes special filing requirements where certain corporations are formed by two or more forming shareholders. Rule 801.40(c) creates a special three-way size-of-person test applicable to acquisitions by forming shareholders of the voting securities that are issued by the new corporation and valued at less than \$200 million. That three-way test looks to the annual net sales and total assets of any two of the forming shareholders and to the anticipated total assets of the new corporation.¹³ Either the new corporation or at least one of the forming shareholders must meet a \$100 million-size test, and the other two must meet a \$10 million test. Because these tests are analogous to the HSR Act's jurisdictional size-of-person tests that will be indexed, the \$100 million and \$10 million numbers in the three-way size-of-person test¹⁴ will be indexed.

Similarly, proposed rule 801.50,¹⁵ which will make formations of certain partnerships, limited liability companies, and other unincorporated entities reportable, has a special two-way size-of-person test, which is applicable where the value of a controlling interest in the new entity is less than \$200 million. Each forming person's acquisition of a controlling interest in the new entity will be subjected to a \$100 million/\$10 million test that is applied to the sales and assets of the acquiring person and to the total assets of the newly formed entity. The proposed special size-of-person test will be amended so that these dollar figures will also be indexed.

3. Rule 802.4 Exemption. Rule 802.4 exempts acquisitions of voting securities of issuers whose assets would be exempt if acquired directly. The exemption is available as long as the issuer does not hold more than \$50 million worth of "other non-exempt assets." At present the exemption is generally limited to issuers whose assets consist of exempt real estate. Proposed rules would expand the exemption to acquisitions of both voting securities of corporations and controlling interests in unincorporated entities, where the underlying assets of those entities could be directly acquired under any exemption available under the HSR Act or rules. Indexing will affect this exemption by increasing the current \$50 million limit on non-exempt assets to \$53.1 million.

4. Foreign Commerce Exemptions. Current rules exempt the acquisition of assets located outside the United States to which no more than \$50 million of sales in or into the United States are attributable,¹⁶ and certain acquisitions of voting securities of a foreign issuer that does not have assets located in the United States valued at more than \$50 million and did not make sales in or

¹³ Rule 801.40(d) is used to determine the assets of the new corporation. It requires inclusion of any assets that any of the forming shareholders have agreed to contribute at any time, and the amount of any credit or loans that any of the forming shareholders have agreed to extend to the new corporation or to or guarantee at any time.

¹⁴ The \$200 million number, above which size-of-person tests do not apply, will also be indexed. See discussion above.

¹⁵ In April 2004, the Commission issued for public comment a series of proposed amendments to the HSR rules. The proposed rules were published in the *Federal Register* at 69 Fed. Reg. 18,685 (Apr. 8, 2004). Among other things, these proposed rules would extend HSR Act reporting requirements to formations of certain unincorporated entities and to acquisitions of interests that confer control of certain unincorporated entities. The public comment period closed in June 2004, and it is expected that final rules will be promulgated sometime in early 2005 and become effective thereafter.

¹⁶ Rule 802.50(a).

into the United States of more than \$50 million in its most recent year.¹⁷ The \$50 million limitations in each of these rules will be indexed and the exemptions thereby expanded.¹⁸

5. Five-Year Exemption for Acquisitions Not Crossing a Higher Threshold. For five years following the acquiring person's notification of an acquisition of voting securities,¹⁹ Rule 802.21 exempts acquisitions of additional voting securities of the same issuer, so long as the acquiring person's resulting holdings do not cross a higher notification threshold. Thus, for example, a person that acquires and files for an acquisition of the stock of an issuer valued at \$60 million can thereafter acquire additional shares of the same issuer, so long as the shares held as a result of the subsequent acquisition(s) are valued at less than \$100 million (the next higher threshold). New filings are required if the resulting holding would exceed \$100 million in value, and the acquisition of any additional stock of the issuer more than five years after expiration of the original waiting period would also require notification.

Indexing of Rule 802.21(a) raises several issues. Suppose, for example, that a person files to acquire \$51 million worth of the stock of an issuer, and the waiting period expires. Thereafter, the minimum reporting threshold is raised to \$53.1 million as a result of indexing. Would the acquiring person be required to file again if it acquired a small amount of additional stock of the issuer, but the aggregate value of its holdings exceeded the "new" \$53.1 million threshold? The answer is no. The \$50 million threshold in this example is the same threshold, even though indexing has increased its value.

Indexing over multiple years may affect application of this exemption. Assume that a 6 percent annual increase in GNP is reflected in annual HSR Act indexing. Under the Rule 802.21(a) exemption, a person who files for an acquisition of more than \$50 million worth of an issuer's stock in Year 1 (prior to any indexing) could allow acquisition resulting in a holding valued up to (but not reaching) \$100 million later in Year 1, \$106 million in Year 2, \$112 million in Year 3, \$119 million in Year 4, \$126 million in Year 5, and \$134 million up to the fifth anniversary (sometime during Year 6) of the expiration of the original waiting period. Thereafter the exemption no longer applies, and any subsequent acquisitions of the stock of that issuer would require notification if the value of the stock held by the acquiror exceeded \$67 million.

6. Examples to the Rules. The FTC staff expects to review and, as needed, to revise all of the examples to any of the HSR Rules that would be affected by indexing, and specifically to revise any examples that may be rendered incorrect or misleading as a result of indexing.

¹⁷ Rule 802.51.

¹⁸ There are additional, very seldom used foreign commerce exemptions in Rules 802.50 and 802.51. Under the former, an acquisition of foreign assets generating more than \$50 million of sales in or into the United States is nevertheless exempt if the size of transaction is less than \$200 million, both acquiring and acquired persons are foreign, the aggregate sales of the acquiring and acquired persons into the United States in the most recent year were less than \$110 million, and the aggregate total assets of both persons located in the United States are less than \$110 million. Rule 802.51 has a similar exemption, with essentially identical conditions, for an acquisition of voting securities of an issuer that had more than \$50 million of U.S. sales or assets. The \$200 million and \$110 million limitations in these exemptions would also be indexed (to \$212.3 million and \$116.8 million respectively).

¹⁹ The five years runs from the expiration or termination of the waiting period that resulted from the earlier filing.

HSR Rules Not Affected by Indexing²⁰

There are a number of other places in the HSR rules where dollar amounts are mentioned, but the Commission's intention is not to amend those rules to apply annual indexing.

1. Mineral Reserves Exemptions. Rule 802.3(a) exempts acquisitions of reserves of oil, natural gas, shale or tar sands, and certain associated exploration or production assets, so long as the total value of the assets being acquired does not exceed \$500 million. Rule 802.3(b) provides a similar exemption for acquisitions of reserves of coal and certain associated exploration or production assets valued at no more than \$200 million. The \$500 million and \$200 million limits on these exemptions are not viewed as analogous to the HSR Act's jurisdictional filing requirements and therefore will not be indexed.

2. Acquisitions of Unproductive Land. Rule 802.2(c) exempts the acquisition of certain real property, including raw land, that has not generated total revenues of more than \$5 million during the 36 months preceding the acquisition. The \$5 million revenue limitation will not be indexed.

3. Expiration of Notification. Rule 803.7 causes a notification to expire one year after the end of the waiting period resulting from that notification, if the acquiring person during that time has not completed the acquisition that was the subject of the notification. Completion of the transaction in this context means that the acquiring person's holdings of the stock or assets of the acquired person must "meet or exceed the notification threshold with respect to which the notification was filed." If during that one-year period, indexing changes the dollar value that defines that notification threshold, the threshold itself remains unchanged for purposes of applying Rule 803.7. Thus, for example, a person who files to acquire \$50 million worth of an issuer's stock must acquire only \$50 million worth of that issuer's stock during the year following expiration of the waiting period, even if during that time indexing has raised the threshold to a higher value (e.g., \$53.1 million).²¹

4. Notification Form. Other than to implement the changes discussed above and to include references, where appropriate, to adjusted notification thresholds, it is not envisioned that any items in the Form or related Instructions will be changed as a result of indexing. For example, Item 6 allows entities with total assets of less than \$10 million to be omitted from listings of controlled entities, shareholders, and minority holdings. Item 5(c) allows nonmanufacturing revenues of less than \$1 million to be omitted. These provisions will not be indexed. Item 8 requires an acquiring person to identify previous acquisitions of entities that generated revenues in any overlapping NAICS codes identified in response to Item 7(a). That rule contains various \$1 million revenue limitations that will not be affected by indexing.

Conclusion

Indexing is a sensible way to offset the unintended enlargement of the HSR Act's reach resulting from inflation. It introduces an additional complication, particularly for practitioners or companies that do not make frequent acquisitions and filings. The question, "What are the filing requirements this year?" is likely to be asked frequently. And the answer requires a relatively detailed recitation

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²⁰ In addition, subsection (g)(1) of the HSR Act originally provided for civil penalties of up to \$10,000 per day for violations of the Act. This provision is already subject to indexing under the Debt Collections Improvement Act of 1996, which currently provides for civil penalties of up to \$11,000 per day.

²¹ However, a filing made with respect to an index-adjusted threshold will expire after one year if the acquiring person has not met or exceeded the adjusted threshold that was in effect at the time notification was filed.

of the jurisdictional criteria relating to size-of-person and size-of-transaction tests, as well as the notification thresholds and the filing fee thresholds. Application of indexing to some, but not all, of the dollar value criteria in the HSR rules further complicates the picture, but not impenetrably.

Indexing could introduce some interesting strategy considerations in the odd case where the reportability of a transaction might be affected by an anticipated future change in the index. For example, parties planning in December for a transaction that will close the following February might find themselves guessing whether yet-to-be-announced indexing will put their transaction below the revised filing thresholds. But this problem arises elsewhere under the HSR rules, apart from indexing.

In the end, indexing will likely become second nature, once we all get used to it. ●

Effects of HSR Indexing for 2005

STATUTORY OR RULES PROVISION	CITATION	INDEXED?	NEW RATE
■ \$50 M size-of-transaction test	7A(a)(2)(B)(i)	Yes	\$ 53.1 million
■ \$200 M size-of-transaction test	7A(a)(2)(A)	Yes	212.3 million
■ \$100 M size-of-person (SOP) test	7A(a)(2)(B)(ii)	Yes	106.2 million
■ \$10 M size-of-person (SOP) test	7A(a)(2)(B)(ii)	Yes	10.7 million
■ Filing fee thresholds currently \$50 million, \$100 million, \$500 million	15 U.S.C. 18a note	Yes	53.1 million 106.2 million 530.7 million
■ Filing fee dollar amounts currently \$45,000, \$125,000, \$280,000	15 U.S.C. 18a note	No	unchanged
■ Notification thresholds currently \$50 million, \$100 million, \$500 million 25% of stock worth \$1 billion, and 50% of stock	Rule 801.1(h)	Yes	53.1 million 106.2 million 530.7 million 1061.3 million
■ SOP tests for formation of joint venture corporation currently \$100 million/\$10 million sales or assets but not applicable if SOT exceeds \$200 million	Rule 801.40	Yes	106.2 million 10.7 million 212.3 million
■ SOP tests for formation of unincorporated entities currently \$100 million/\$10 million sales or assets but not applicable if SOT exceeds \$200 million	Proposed Rule 801.50	Yes	106.2 million 10.7 million 212.3 million
■ Acquisition of stock of entities holding exempt assets current limit is \$50 million	Rule 802.4	Yes	53.1 million
■ Foreign commerce exemptions (sales in or into U.S.)	Rules 802.50, 802.51	Yes	53.1 million
■ Exemption for subsequent stock acquisitions after filing Next higher threshold, currently \$100 million, \$500 million, 25% of stock worth over \$1 billion, and 50%	Rule 802.21	Yes	106.2 million 530.7 million 1061.3 million
■ Mineral reserves exemptions currently \$500 million oil and gas, \$200 million coal	Rule 802.3	No	unchanged
■ Exemption for acquisition of unproductive land limited to \$5 million revenue in previous 36 months	Rule 802.2(c)	No	unchanged
■ Expiration of notification	Rule 803.7	No	*
■ Notification Form (references to dollar amounts)	Various items	No	unchanged

*Acquiring person must within one year meet or exceed threshold in effect at the time of its filing.