Clients&FriendsMemo

One-Two Punch: FTC Does About-Face on Treatment of Debt for HSR Purposes and Casts Doubt on Informal Interpretation Program

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In a recent blog post, the Acting Director of the Federal Trade Commission Bureau of Competition announced the reversal of the Federal Trade Commission's ("FTC") decades-long position regarding the treatment of debt repayment when determining whether a premerger notification filing under the Hart-Scott-Rodino ("HSR") Act is required. Effective September 27, 2021, companies and individuals that do not file HSR based on excluding retired debt from the transaction value may face enforcement action. Perhaps even more concerning, the FTC also cast doubt in general on whether HSR practitioners may rely on past informal guidance from the FTC's Premerger Notification Office ("PNO"), stating that "[t]hese informal interpretations are not reviewed or authorized by the Commission, and do not carry the force of law." This is just the latest in a string of destabilizing blows to the framework of the HSR program, potentially raising the costs of doing mergers for both the parties and the government.

Background Information

Under the HSR Act, parties may not close transactions that meet certain dollar thresholds (adjusted annually) before filing a notification with the FTC and the Antitrust Division of the U.S. Department of Justice ("DOJ") and then observing a mandatory waiting period (typically 30 days) during which the agencies review the deal. The first test requires that the value of the voting securities, noncorporate interests or assets being acquired meets a minimum "size of transaction" threshold of $50 million (adjusted to $92 million for 2021). Transactions valued at or below this threshold are not reportable. If a transaction meets the "size of transaction" threshold, but is valued at or below $200 million (adjusted to $368 million for 2021), then a second "size of parties" test must be met. If both the "size of transaction" and "size of parties" tests are met, or if the transaction value is greater than $200 million (as adjusted), then the parties must make an HSR filing under the HSR Act unless an exemption applies.

The question of whether a particular transaction is reportable is complex and often cannot be resolved through reference to the HSR Act and its implementing regulations (the "HSR Rules") alone. When parties are unsure how the HSR Act and Rules apply to their transaction, they may contact PNO staff on a "no names" basis for guidance. The PNO fields "hundreds of inquiries each

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week, and thousands every year, asking for interpretations of the HSR statute and rules." Some informal interpretations with broad applicability are selected by staff for inclusion in the FTC's searchable database to be used as "a reference tool [by those] with similar questions." Although the PNO always has cautioned that its informal guidance does not constitute legal advice, parties and HSR practitioners counseling clients generally have been able to rely on interpretations included in the FTC's database, often contacting staff only to confirm that the FTC's position on a particular issue is consistent with the most recently published interpretations.

Reversal with Regard to Treatment of Debt Payoffs

In determining the transaction value of an equity acquisition, the FTC historically has not included amounts used to retire debt of the target company. So, for example, the $100 million acquisition of a target carrying $25 million in debt would be valued at $75 million and would not require an HSR filing. This makes sense as the repayment of the $25 million in debt does not flow to the sellers and thus is not treated as part of the consideration received in exchange for the sellers' stock. The FTC now has reversed its longstanding position, stating that, starting September 27, 2021, "the Bureau will begin to recommend enforcement action for companies that fail to file when retirement of debt is part of the consideration for the deal." The about-face with regard to debt payoffs appears to stem from a concern that parties are "sidestepping the law" by structuring deals to have the target take on debt before the acquisition so that the value of the debt retired by the acquiring party can be excluded from the transaction value. However, this scenario already would be prohibited by HSR Rule 801.90 as a "device for avoidance," so it is unclear why the FTC deemed it necessary to reverse course on the treatment of debt payoffs.

The Acting Director's blog post refers readers to another FTC webpage for more details regarding the policy change. On this page, the FTC acknowledges that "not all debt retired as part of a proposed transaction is consideration," and narrows the debt that must be included in calculating the HSR transaction value to any full or partial retirement of debt "where selling shareholder(s) benefit from the retirement of that debt." No guidance is given, however, as to what types of debt would and would not be included in the transaction value for HSR Act purposes.

Based on the Acting Director's blog post, it is reasonable to assume that the transaction value should include debt owed to or guaranteed by shareholders of the target (or affiliates or parent entities of either the target or the entity selling the shares) and debt incurred by the target to make distributions to selling shareholders (*e.g.*, in leveraged recapitalizations). In addition, parties likely should include debt that was incurred recently or outside of the "ordinary course." Without additional guidance from the FTC, the only type of debt parties may feel comfortable excluding from the transaction value may be long-term debt owed to unrelated third parties that has not been guaranteed by a selling shareholder or its parents/affiliates. Otherwise, with HSR compliance missteps potentially resulting in fines of up to $43,792 per day, merging parties can fully mitigate

risk only by including all other debt into consideration, resulting in more filings to staff that already is overwhelmed with a record number of HSR notifications.

Risky to Rely on Informal Interpretations?

Along with the HSR Act and Rules, the FTC's database of prior interpretations is an invaluable resource for HSR practitioners and the antitrust community. The FTC always has made clear that its informal advice does not have the force of law, but its interpretations generally represent the current thinking of PNO staff, who field thousands of requests for guidance on a "no names" basis in a given year. The published informal interpretations are an integral part of the HSR program, providing predictability and clarity for parties when determining their filing obligations and reducing the volume of questions to the PNO when recent informal guidance has been published for fact situations analogous to proposed transactions.

In her recent blog post, however, the Acting Director suggested that reliance on the informal interpretations provided by PNO staff "outside of the formal rules" may be misplaced, going so far as to rebuke those that rely on the FTC's prior interpretations "as a substitute or supplement for their own legal analysis." Stating the FTC's concern that some of the informal guidance "may not reflect modern market realities or the policy position of the Commission," the Acting Director stated that the FTC is "reviewing the voluminous log of informal interpretations to determine the best path forward." It is unclear what that path forward will entail, but it appears to be part of the FTC's broader effort to revise its guidance to the public, including updating the HSR Rules (as we previously discussed in connection with the Advance Notice of Proposed Rulemaking announced in September 2020). It also is unclear whether the Acting Director's rebuke means that parties who directly solicit advice from PNO staff should not rely on staff's response, which, while specific to the facts of their transaction, still would be informal, "not reviewed or authorized by the Commission" and "not carry the force of law."

We hope that parties and HSR practitioners do not lose the ability to seek informal guidance from PNO staff, who are steeped in and are experts on HSR nuances, either directly by email or indirectly by reference to interpretations published on the FTC's website. Losing the informal interpretation program, or effectively gutting it, will make the HSR process less certain for potential filers and less efficient for the agencies which will have to handle even more HSR filings.

Key Takeaways

- Proposed transactions involving debt payoffs should be evaluated carefully to determine reportability under the HSR Act. The FTC will begin enforcing its new interpretation relating to the retirement of debt for deals closing on or after September 27, 2021. In the absence of additional guidance from the FTC, parties should consider including in the HSR "size of transaction" all debt other than long term-debt to third parties unrelated to the selling shareholders or their parents and affiliates.

- Reliance on informal interpretations may not shield parties from scrutiny or enforcement in proposed deals presenting analogous facts. Until the FTC has completed its review of the informal interpretation program and determined “the best path forward,” parties may wish to err on the side of filing, even where prior guidance might indicate that their transaction is not reportable or exempt.

Taken together with other recent FTC actions, these latest announcements may be further evidence of the HSR framework’s “death by a thousand cuts” as recently warned by Republican FTC Commissioner Christine S. Wilson. The “temporary” and “brief” suspension in February of the granting of requests for early termination of the waiting period for transactions that raise no substantive concerns still continues. At the time, the agencies cited to the “unprecedented volume” of merger filings as one of the reasons for the suspension. Again citing to a “tidal wave of merger filings,” the FTC announced in early August that for deals it cannot fully investigate within the timeframes designated in the HSR Act, it will send form letters alerting merging parties that its investigations remain open, and that parties choosing to close those transactions do so at their own risk. Now, the FTC’s about-face on the treatment of debt payoffs and its disavowal of the value of its own informal interpretations will inevitably lead to more HSR filings, increasing the burden on its already overwhelmed staff, and also inject further uncertainty into the HSR review process, increasing costs to merging parties and their customers.

How can Cadwalader help?
Cadwalader’s antitrust team, located in key jurisdictions in the United States (New York, Washington, D.C., Charlotte and London), is composed of specialists that offer ‘end-to-end’ advice on HSR compliance, investigations and related litigation. Our practitioners are available to counsel on these recent developments and the full HSR premerger notification process.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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