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Antitrust Tools For Dealmakers Preparing For Better Times

By **Harry Robins and David Brenneman** (April 21, 2020, 5:01 PM EDT)

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Recently, leaders of both the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission made public statements regarding their ongoing commitment to antitrust enforcement in mergers and acquisitions during the COVID-19 crisis.

What such political statements mean practically as the virus continues to wreak havoc on the financial health of companies (large and small) in the short term is of course unclear. But, what is not in doubt is that the U.S. economy will inevitably return to health, powered by its creative and hardworking citizenry and with support from the government.

Fortunately, a number of antitrust rules already on the books will help with this recovery, including the following rules related to investments.

Loans, Debt Offerings, Warrants, Convertible Securities and Minority Equity Investments

Preclosing Hart-Scott-Rodino Act approval (usually requiring 30 calendar days) is only potentially required in connection with the acquisition of voting securities (securities with the present right to vote for directors), noncorporate interests that give the buyer economic control over the noncorporate entity (i.e., right to 50% or more of its profits or assets upon dissolution), or assets.

The use of the following types of financial instruments to fund distressed companies do not require prefunding approval from the FTC and the DOJ:

- Making a loan;
- Offering debt securities;
- Grant of a warrant;
- Sale of convertible securities with no present right to vote for directors;
- Sale of voting securities valued at $94 million or less;
- Sale of other equity with no present right to vote for directors;
- Sale of less than 50% of the interests (no economic control) in noncorporate entities (e.g., limited liability corporations or partnerships).

There are of course potential antitrust concerns with such funding that should be discussed with antitrust counsel in advance. For example, when the funding party competes directly with the distressed company, it is important to evaluate whether the proposed financial arrangement may affect the incentives of the parties to compete.

Managing the flow of competitively sensitive information (e.g., customer-specific information) between the parties is also important, but there are safe ways to permit such exchanges when legitimately needed, e.g., by limiting the human eyeballs that see such information through the use of a so-called clean team.

Other Specific Structures and Exemptions to Avoid HSR Act Delay

Early Termination

The HSR Act gives parties to a reportable transaction the ability to request early termination of the HSR Act waiting period upon filing. Parties have HSR clearance to close the moment early termination is granted. And, particularly when the parties to the HSR filings do not compete, early termination is frequently granted.

In fact, in the FTC's 2018 fiscal year, early termination was granted in 78% of transactions where requested. The FTC can grant early termination any time after the parties file, although it most frequently does so around two to three weeks after filing.

A word of caution for parties that want to keep their transactions confidential: If the FTC grants early termination, it lists the names of the parties to the transaction on its website, effectively making the transaction public.

When early termination is not requested (or not granted), the waiting period (typically 30 days) will simply come and go without any publicity. Thus, parties that want their transaction to remain confidential should not request early termination.

Conversions Into Voting Securities

A funding party that ultimately wishes to acquire voting securities but cannot afford to wait for HSR Act approval can condition the conversion of debt or a warrant or equity into voting securities upon the receipt of HSR Act approval.

With respect to such a "springing" arrangement, the parties would need to evaluate in advance whether there is any risk that the HSR Act approval will be delayed, i.e., any substantive antitrust risk of a protracted investigation (so-called second-request investigation) or even that the government might seek an injunction to block the deal.

Investment-Only Exemption

The HSR Act approval relating to acquisition of voting securities regardless of value under certain circumstances does not apply if the acquisition is completely passive; this so-called investment-only exemption[1]requires two elements to be satisfied:

- As a result of the acquisition, the acquiring person holds 10% or less of the outstanding voting securities of the issuer; and

- The acquiring person "has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer."

Under the investment-only exemption, the funding party can acquire above $94 million of voting securities so long as those elements are met.

The investment-only exemption has long been a source of controversy because there are no bright-line rules on the applicability of the second element, i.e., what constitutes passivity. Although merely voting shares acquired does not make the investment-only exemption inapplicable, other FTC guidance indicates a handful of actions that create the presumption that the exemption does not apply:

- Nominating a candidate to the board of an issuer;

- Proposing corporate action requiring shareholder approval;

- Soliciting proxies;

- Having a controlling shareholder, director, officer or employee simultaneously serve as an officer or director of the issuer;

- Being a competitor of the issuer in some circumstances;

- Doing any of the foregoing with respect to any entity controlled by the issuer.[2]

Given the uncertainty here, there is special value in consulting with outside antitrust counsel before relying on the investment-only exemption.

Conversion of Debt Into Voting Securities

The HSR Act rules generally exempt the conversion of debt into voting securities when the debt holder acquired the debt in its ordinary course of business and the debt is converted to voting securities as part of a "bona fide debt workout" (the debt exemption).[3]

Historically, the FTC has interpreted the debt exemption to apply so long as (1) the debt holder held the debt before the target company announced its intention to enter bankruptcy proceedings; and (2) the debt holder (or the debt holder's private equity group) does not control a competitor.

The FTC created a large body of informal precedent during the Great Recession, including the following key points, all meant to create bright-line rules for investors to follow:

- So long as the debt holder acquires debt before a bankruptcy announcement, the debt exemption applies even if the creditor purchased the debt with the knowledge and intention of converting it into equity.[4]

- Financial institutions such as private equity groups, hedge funds, banks and even nonfinancial companies such as manufacturers with financial arms that lend money or buy debt in their ordinary course of business can take advantage of the debt exemption.[5]

- Voting securities issued as part of a rights offering or acquired as compensation for a backstop commitment are also exempt.[6]

- Pre-announcement debt that qualifies for the debt exemption remains HSR-exempt regardless of whether the debtor also acquires debt that does not qualify. Once the debt is converted into voting securities, the "exempt debt" is not aggregated with the "nonexempt debt" for purposes of determining whether the aggregate holding exceeds $94 million, the current size of transaction threshold.[7]

It is important to note that the above informal interpretations are merely nonbinding guidance, and the FTC can and does change its guidance.

Special Considerations Regarding Acquisitions of Assets of Voting Securities in Bankruptcy

There are a number of helpful rules for acquisitions out of Section 363(b) bankruptcy:

- The HSR waiting period is reduced to 15 days (from 30).

- The parties can file on the court order setting forth the procedures for the sale or a letter of intent.

- Multiple buyers can file for HSR approval at the same time prior to the completion of a bankruptcy auction.

But, it is important to note that an acquisition out of bankruptcy is not immune from antitrust enforcement. There are plenty of examples of both the FTC and the DOJ pressing hard to prevent buyers from acquiring close rivals' bankrupt assets.

Moreover, the so-called failing firm defense elements, which permit such acquisitions only where (1) the debtor shopped the assets; (2) the debtor found no other buyer; and (3) the assets would, but for the deal, exit the marketplace, are rarely met.

Special COVID-19 Law and Lore

Outside of straight M&A transactions, the FTC and the DOJ suggested they might be flexible in evaluating other types of collaborations focused on COVID-19-related solutions.[8] In a joint statement, the agencies announced that they will "account for exigent circumstances in evaluating efforts to address the spread of COVID-19 and its aftermath."

As examples, the agencies described the potential need for health care facilities to collaborate in order to provide resources to communities in need and for businesses to temporarily combine "production, distribution, or service networks to facilitate production and distribution of COVID-19-related supplies they may not have traditionally manufactured or distributed."[9]

The FTC and the DOJ limited this flexibility to "joint efforts that are limited in duration," thereby excluding M&A transactions. Yet the substance of their joint statement suggests they might be more flexible in their HSR Act reviews when the parties can show that their transactions will increase capacity and/or keep companies afloat, particularly for those directly or indirectly helping COVID-19 efforts.

Substantive Antitrust Considerations

Historically, the FTC and the DOJ Have Not Let Up on the Enforcement Gas in Economic Downturns

The U.S. antitrust authorities remain active in antitrust enforcement during times of economic turmoil. In fact, although the total number of second-request investigations during financial turmoil declines, historically the percentage of second requests issued as a percentage of HSR filings increases twofold.

For instance, whereas during years of peak economic strength about 2-3% of all HSR filings trigger a second request, during recession years (1991, 2002, 2009), the percentage increased to more than 4.5%. Moreover, the U.S. antitrust authorities granted early termination somewhat less frequently in 2009 than in years before or after.[10]

Considerations for Acquiring Minority Ownership Interests in Competitors

Finally, there are a number of antitrust considerations to keep in mind when acquiring minority equity interests in competitors.

- *Substantive Antitrust Issues.* Owning sufficient minority positions in concentrated industries may raise concerns that it will enable an investor to control both companies, change the incentives of the firms to vigorously compete, and enable coordination between the companies.[11]

- *Right to Appoint Directors to Competing Corporations.* Section 8, which has received renewed attention from the antitrust agencies, has been interpreted to prohibit companies and organizations such as private equity groups from appointing directors to competing corporations — and possibly noncorporate entities — that are not under common control.[12]

- *Improper Information Exchanges.* Funding parties must ensure that they do not become conduits for unlawful information exchanges between competitors in which they hold minority interests.

Correction: An earlier version of this article misstated in footnote 10 the percentages of early termination grants in 2017 and 2018 HSR filings. The errors have been corrected.

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[1] 16 C.F.R. § 802.21.

[2] It's worth noting that none of the above indicia is binding law, but merely guidance that the FTC published when it released the final HSR rules in 1978. See 43 Fed. Reg. 33,450, 33,465 (1978).

[3]16 C.F.R. § 802.63.

[4] See FTC Informal Interpretation No. 0909004 (Sept. 18, 2009).

[5] See FTC Informal Interpretation No. 0812006 (Dec. 18, 2008).

[6] See FTC Informal Interpretation No. 1011007 (Nov. 28, 2010).

[7] See FTC Informal Opinion 1505003 (Mar. 22, 2015). On June 14, 2017, the FTC updated its guidance with other aspects of this Informal Opinion, clarifying that creditors cannot reorganize any prepetition debt such that the debt (or the equity or assets exchanged for the debt) will be held within a separate ultimate parent entity and rely on the debt exemption.

[8] See Joint Antitrust Statement Regarding COVID-19, FTC and DOJ (Mar. 24 2020).

[9] Id.

[10] Early termination was granted for 78.6% and 78% of HSR filings where requested in 2017 and 2018, respectively. Comparatively, early termination was granted for 69% of HSR filings in 2009.

[11] See, e.g.,What's the interest in partial interests? Mike Moiseyev, Bureau of Competition, FTC (May 9, 2016).

[12] See Interlocking Mindfulness, Michael E. Blaisdell, Bureau of Competition, FTC (June 26, 2019) ("It prohibits not only a person from acting as officer or director of two competitors, but also any one firm from appointing two different people to sit as its agents as officers or directors of competing companies, subject to a few limited de minimis exemptions."); see also Assistant Attorney General Makan Delrahim Delivers Remarks at Fordham University School of Law(May 1, 2019) ("[W]hether one LL competes against another, or ... competes against a corporation, the competition analysis is the same.... We are thinking about how to bring this thinking to Section 8 as well.").