



Questions and Answers for Emerging Companies About the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 u.s.c. § 18a

The following is intended to provide general information about the Hart-Scott-Rodino Antitrust Improvements (HSR) Act and its applicability to emerging companies during funding rounds or when issuing new shares as compensation. In general, these kinds of transactions do not have any impact on competition and are unlikely to trigger an investigation by the Federal agencies that jointly enforce the antitrust laws (the Federal Trade Commission (FTC) and the U.S. Department of Justice (DOJ)), however they are still subject to the HSR Act. While this questions and answers are intended to provide general information regarding when transactions may trigger an HSR filing obligation, this information is not a substitute for a fact-specific analysis of a particular proposed transaction and does not fully address the requirements or exceptions in the HSR Act.

What is the HSR Act?

The HSR Act established the Federal government's process for reviewing transactions that involve the acquisition of voting securities, assets or non-corporate interests by requiring the advance notification of transactions of a certain size and character and implements a waiting period prior to consummating the transactions. Under the HSR Act, the FTC and the DOJ are provided with information about certain transactions prior to their consummation. The objective of the HSR Act is to permit the Federal antitrust enforcement agencies an opportunity to review the transactions, in advance of closing, and to determine whether such transactions may be anticompetitive. Parties must submit notifications for transactions even if there will be no impact on competition unless an exemption applies.

When are companies or individuals required to file under the Act?

In general, a transaction is subject to the HSR Act premerger notification requirements if it involves any acquisition of voting securities, assets or non-corporate interests and the transaction meets/satisfies three statutory tests (the "commerce" test, the "size-of-transaction" test, and the "size-of-person" test) and no exemptions apply. All of these tests are governed by specific regulations and interpretations issued by the FTC, which Foley Hoag can help apply to individual transactions. The threshold levels for the size of transaction and size of person tests are revised annually based on changes in gross national product.¹

Transactions are subject to the HSR Act based on the outcome regardless of structure of the transaction. For example, when evaluating whether or not a transaction is subject to the HSR Act, it does not matter if voting securities are being acquired as the result of the exercise of options, the issuance of new shares during a funding round, a purchase on an open market or as part of the acquisition of an entire company. If, as a result of a transaction, the ownership of voting securities will change or new voting securities will be acquired, then the transaction is potentially subject to the HSR Act.



NOTE: Acquisitions of convertible voting securities that do not presently provide any voting rights, including options and warrants, and other types of non-voting securities, are exempt from the HSR Act; however, the exercise of convertible voting securities may be reportable. The HSR Act is only triggered by the acquisition of securities that provide voting rights.

Commerce Test

A transaction satisfies the commerce test if either of the parties to a transaction is engaged in commerce or in any activity affecting commerce. As used in the HSR Act, the term “commerce” means trade or commerce among the states, with foreign nations, or between the District of Columbia or any territory of the United States and any state, territory, or foreign nation. It would be extraordinary for an otherwise-reportable transaction not to satisfy this test.

Size-of-Transaction Test

The size-of-transaction test, as its name suggests, is concerned with the value of what is being acquired. As of February 23, 2022, the size-of-transaction test is satisfied if, as a result of the transaction, the acquiring person would hold voting securities, assets or non-corporate interests (such as LLC or partnership interests), or a combination of them, of the acquired person with an aggregate value of **\$101 million** or more.

NOTE: The transaction value for HSR purposes can vary significantly from the agreement price. For example, previous acquisitions of voting securities need to be aggregated with the current transaction value and any assumed liabilities may count toward the transaction value. Foley Hoag can help determine the transaction value of individual transactions.

How to Aggregate Previous Acquisitions of Voting Securities

The transaction value for the acquisition of voting securities is the sum of the value of the voting securities to be presently acquired, as determined in accordance with HSR rules, and the value of all voting securities from the same issuer (or any other issuer controlled by the same ultimate parent entity (UPE))² held by the acquiring person prior to the acquisition.

For HSR purposes, the value of voting securities of an issuer held prior to an acquisition shall be determined as follows:

- a. If the security is traded on a national securities exchange, the value shall be the market price, which is the lowest closing quotation within the 45 calendar days prior to the consummation of the acquisition; or
- b. If the security is not traded on a national securities exchange, the value shall be the fair market value as determined in good faith by the UPE of the acquiring person. Such determination must be made as of any day within 60 calendar days prior to the filing of the notification required by the act, or, if such notification has not been filed, within 60 calendar days prior to the consummation of the acquisition.

Size-of-Person Test

As of February 23, 2022, if the value of the transaction exceeds **\$403.9 million**, then the size-of-person test does not apply and the transaction is subject to the HSR Act unless it qualifies for an exemption.

If the transaction value is less than **\$403.9 million**, then the size-of-person test first requires the parties to determine their UPEs. Once the UPEs have been determined, the size-of-person test is satisfied if at least one of the UPEs involved in the transaction has **\$202 million** or more in annual net sales or total assets, and the other ultimate parent entity has **\$20.2 million** or more in annual net sales or total assets.

Calculating annual net sales and total assets

The size-of-person includes the annual net sales and total assets of all entities, both domestic and foreign, included within the ultimate parent entity.

Generally, an entity's sales and assets are as stated on its last regularly prepared annual statement of income and last regularly prepared balance sheet. These financial statements must be as of a date not more than 15 months old, and have been prepared in accordance with procedures normally used.

The total assets of a natural person include their investment assets (cash, deposits in financial institutions, other money market instruments, and instruments evidencing government obligations), voting securities (including any current holdings in the acquired party), and other income-producing property, together with the total assets of any entity they control and the assets of any spouse and minor children. The value of residences, cars, and personal property not held for producing income are omitted from the calculation.

The annual net sales of a natural person are the sum of the net sales of the entities they control, including proprietorships, as well as income derived from investments.

Examples

- The CEO of NewCo receives 100,000 new shares in NewCo valued at \$60 million as part of hiring bonus. These 100,000 shares are the only shares of NewCo the CEO holds.
 - *No HSR filing obligation.*
- ALTERNATIVE: The CEO of NewCo receives 200,000 new shares in NewCo valued at \$120 million as part of hiring bonus. These 200,000 shares are the only shares of NewCo the CEO holds.
 - *Possible HSR filing obligation. Contact Foley Hoag before the shares are granted to determine if the size-of-person test is satisfied and if an HSR filing is required.*
- The CEO of NewCo receives an additional 100,000 options for NewCo as part of annual compensation.
 - *No HSR filing obligation, as long as the options do not convey any voting rights.*
- The CEO of NewCo exercises the options and immediately sells the shares, resulting in the sale of 100,000 new shares with a value of \$60 million. As a result of the sale, the CEO will continue to hold only 100,000 shares.
 - *No HSR filing obligation.*
- ALTERNATIVE: The CEO of NewCo exercises the options and keeps the shares, resulting in the CEO holding 100,000 new shares with a value of \$60 million. Combined with the previous 100,000 shares the CEO held, total holdings in NewCo are now valued at \$120 million.
 - *Likely HSR filing obligation. Contact Foley Hoag before the options are exercised.*
- As part of NewCo's Series B fundraising round, the CEO is entitled to a pro rata share of 5% and decides to participate at (but not above) the pro rata.
 - *No HSR filing obligation.*
- ALTERNATIVE: As part of NewCo's Series B fundraising round, the CEO is again entitled to a pro rata share of 5%, but decides to participate at 5.1% (i.e. above the pro rata).
 - *Likely HSR filing obligation. Contact Foley Hoag before the funding round closes.*



Exemptions

Certain exemptions do exist to the filing requirements, including those for transactions involving unproductive real property, financial institutions, passive investments, acquisitions of foreign securities or assets and other areas. In addition, transactions that involve existing shareholders investing at or below their pro rata share in a new funding round are likely exempt from the HSR Act. Foley Hoag can provide information about the applicability of such exemptions for individual transactions.

What does the HSR Act require?

If the transaction is subject to the HSR Act, both the acquiring and the acquired parties must submit a prescribed form and any responsive documentary attachments to both the FTC and the DOJ. The information included in the form provides the Federal antitrust enforcement agencies with an overview of each entity, including its revenues broken down by specific categories, shareholders, investments, previous acquisitions, public filings, financial records, role in the current transaction and other relevant information.

As part of the filing, the parties must pay a single filing fee that can be paid by either party or may be split between the parties. Currently, the filing fee is determined as follows:

- \$45,000 for transactions valued at \$101 million or more, but less than \$202 million;
- \$125,000 for transactions valued at \$202 million or more, but less than \$1.0098 billion; and
- \$280,000 for transactions valued at \$1.0098 billion or more.

In most cases, the HSR Act filing is deemed complete, and the waiting period begins, only after both parties' filings and the filing fee are in the possession of both Federal agencies.

How long does it take to receive government approval?

The waiting period will expire automatically 30 days from the completion of the HSR Act filing (or in the case of a cash tender offer, 15 days), unless the Federal agencies (1) issue a Request for Additional Information and Documentary Materials (known as a "Second Request" and basically a very broad subpoena) or (2) grant early termination of the waiting period.

How do I get early termination?

The Federal agencies currently have suspended all grants of early termination of the waiting period. There has been no guidance regarding when the agencies may resume granting early termination.

Early termination can be requested by checking a box on the HSR Act form. The benefit is that the filing may get expedited consideration by a weekly review committee. Thus, the parties may be free to close in two to three weeks instead of 30 days. The decision to grant early termination rests solely with the Federal antitrust enforcement agencies. We have previously had success in obtaining early terminations, but it is important to remember that early termination decisions are completely within the control of the agencies.

In addition, the grant of early termination and the names of the filing parties becomes public information. Early termination is received in a telephone call from the FTC, which is followed by a confirmatory letter soon thereafter and posting a notice on the FTC's website and in the Federal Register.



Can a deal close before the waiting period ends or early termination is granted?

No. The government can impose penalties of **\$46,517 per day on both parties** and seek broad equitable relief if parties seek to close a transaction or improperly coordinate the business of the parties before receiving HSR Act clearance (also known as gun-jumping). Foley Hoag can provide guidance on the level of activity that may be seen as violating the HSR Act, and parties should approach such issues carefully.

Are the contents of the HSR Act filing and its attachments public information?

Generally, no. Unless early termination is granted, or one of the Federal antitrust enforcement agencies moves to block the transaction, none of the information included in the HSR form or any of the documentary attachments is publicly disclosed by the Federal agencies. Except in very limited circumstances related to potentially illegal conduct, the HSR form and documentary attachments also are not shared with any government agency beyond the DOJ or the FTC.

If early termination is granted, then only the date of the early termination and the parties involved become public information published in the Federal Register and on the FTC website. If one of the Federal agencies moves to block the transaction, information and documents that were previously confidential could become public as part of the litigation or administrative proceeding. No other information from the HSR form or any of the documentary attachments is ever publicly disclosed by the Federal agencies.

How long is the HSR notification valid, once clearance is obtained?

Based on the transaction value, the parties must designate in the HSR filing the highest notification threshold that is being crossed as result of the transaction. Currently, there are five notification thresholds as follows:

1. Transaction value of \$101 million or more;
2. Transaction value of \$202 million or more;
3. Transaction value of \$1.0098 billion or more;
4. Transaction will result in holding at least 25% of the outstanding voting securities with an aggregate value greater than \$2.0196 billion; or
5. Transaction will result in holding at least 50% of the outstanding voting securities.

Once a transaction receives early termination or the waiting period expires, the acquiring party has exactly one year from that date to complete the transaction and cross the designated notification threshold. The one-year period ends on the same date, one year later, regardless of whether it falls on a weekday, weekend or holiday. If the transaction is not completed with a year, the HSR filing expires and the parties must submit a new one before the transaction can be completed. If the transaction is completed, but as a result of the transaction, the designated notification threshold is not crossed, the parties must submit a new HSR filing before any subsequent acquisitions can be made.

However, if the transaction is completed within one year and the designated notification is crossed, the acquiring party may make additional acquisitions from the same acquired party up to the next applicable notification threshold for five years from the date early termination was granted or the waiting period expired without making another HSR filing.

EXAMPLE

An individual agrees to acquire \$120 million worth of shares from NewCo, makes an HSR filing, waits for the waiting period to expire, and then immediately acquires the shares. The individual may acquire additional shares of NewCo up to an aggregate value of \$202 million over the course of the next five years without making another HSR filing.

After the five-year period ends, any additional acquisitions will require a new HSR filing. In addition, if any of the additional acquisitions during the five-year period would result in the acquiring party holding, in the aggregate, voting securities, assets or non-corporate interests valued in excess of the next notification threshold, including as a result of an increase in the value of the previous acquisitions, the parties would need to make a new HSR filing. Given the potential for a significant increase in value of previous holdings, each subsequent transaction should be carefully evaluated for potential HSR filing obligations regardless of whether or not an HSR filing was made previously. In addition, the thresholds are changed annually and, although they typically go up, last year the thresholds went down.

**Who can I contact about an HSR Act issue or filing?**

Please contact **Austin A.B. Ownbey** at (202) 261-7364 or aownbey@FoleyHoag.com for more information or if you need any assistance with the HSR process.

¹ The HSR Act thresholds were last updated January 24, 2022, effective February 23, 2022. See <https://foleyhoag.com/publications/alerts-and-updates/2022/january/ftc-announces-increased-2022-hsr-thresholds>.

² "Ultimate parent entity" means an entity that is not controlled by any other entity. "Control" means the following: (1) holding at least 50 percent of the outstanding voting securities of an issuer; or (2) in the case of an unincorporated entity, having the right to 50 percent or more of the profits of the entity, or having the right in the event of dissolution to 50 percent or more of the assets of the entity; or (3) having the contractual power presently to designate 50 percent or more of the directors of a for-profit or not-for-profit corporation. Note, while a natural person is considered their own ultimate parent entity, the holdings of spouses and minor children are all aggregated.