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Legal Update

US FTC Revises Position on Treatment of Debt, But Is Something Else Behind the Curtain?

On August 26, 2021, the Bureau of Competition of the US Federal Trade Commission (FTC) released a blog post that simultaneously overturned previously released guidance concerning treatment of debt for HSR filing purposes and raised questions about whether the public can, or should, rely on thousands of informal interpretations relating to the HSR Act[1] provided by agency staff.[2]

Pursuant to the HSR Act, deals over certain dollar thresholds must be notified to both the FTC and the Antitrust Division of the US Department of Justice (DOJ) prior to consummation. Parties, therefore, need to determine the value of the assets, voting securities or non-corporate interests (i.e., LLC or LP units) that a buyer will hold as a result of the transaction.[3] Pursuant to the HSR Act rules and related explanatory notes, this amount includes all "consideration" being paid by the buyer as part of the deal, whether in the form of cash, interests, tangible or intangible assets, or assumption of liabilities.[4]

Based on a series of informal interpretations issued by the FTC's own Premerger Notification Office (PNO), parties understood that the FTC allowed the retirement of debt to be *excluded* from the value of the acquisition of voting securities but *included* when the deal was an asset acquisition.[5] It is no longer that simple; the blog post explains that this guidance induced some parties to take on debt just before signing a deal, only to retire that debt as part of the consideration in an end-run around an HSR obligation.[6] Instead of relying solely on the "Avoidance Device" rule,[7] beginning September 27, 2021, the Bureau of Competition will expand its HSR enforcement arsenal by recommending enforcement actions for companies that fail to file in certain situations when retirement of debt is part of the deal consideration.[8]

In addition to circumstances where pre-signing debt is retired as part of consideration, the FTC's new approach is that "full or partial retirement of debt should be included in calculating the Acquisition Price [anytime] selling shareholder(s) benefit from the retirement of that debt."[9] While the exact meaning is unclear, the "selling shareholder(s) benefit" test may refer to pay off of shareholder loans or debts owed to a target's parent. In theory, this test may mean that ordinary course debt or transaction expenses remain excluded from the transaction value, as these types of debt typically are owed, and thus repaid, to third parties.[10] Alternatively, one could argue that paying off a target's debt always "benefits" the selling shareholders, even if not strictly through repayment of a loan.[11]

In addition to revising the FTC's position on debt, the blog post also makes an apparent about-face regarding practitioner reliance on the large body of informal interpretations provided by the FTC's PNO staff in response to questions regarding specific transactions.[12] The blog post asserts that the interpretations are "not reviewed or authorized by the Commission," "may not reflect modern market

realities or the policy position of the Commission" and "do not carry the force of law."[13] Whereas previously parties comfortably may have relied on PNO informal interpretations involving the same or analogous facts as a basis for not filing, now these parties may be more inclined to file, absent a clear regulatory basis or deal-specific guidance from the PNO to the contrary.

With the looming threat of enforcement actions, the consequence of lack of clarity on the FTC's revised debt-treatment position and eroded public ability to rely on previously published guidance is that there likely will be more HSR Act filings. This would be on top of the "massive surge" of filings that the FTC already is experiencing.[14] In the FTC's fiscal year to date, nearly 3,300 filings have been submitted.[15] And there are no signs that the "tidal wave" of filings will slow down;[16] five of the past six months have seen more than 300 filings each.[17]

Going forward, for equity deals involving debt payoffs, companies should proceed with caution. Given the lack of any bright-line rules, the analysis of each transaction will require judgment calls. For example, parties will want to consider the type of debt andto whom it is being repaid before finalizing the filing analysis. Long-held, ordinary course debt being repaid to a third party may be more likely to be excluded from the transaction value than debt incurred in the shorter term being repaid to the target's parent. The blog post also does not preclude parties from continuing the practice of seeking guidance on specific deals by asking the PNO fact-specific questions, including about whether the debt in the deal at issue can be excluded. Seeking clarity may be helpful where the debt pay-offs are complicated or have a unique component. Whatever the path chosen, for those deals where debt is on the line, the answer of whether it should be included in the transaction value is not as clear as it once was.

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Endnotes

[1] Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, 15 U.S.C. § 18a.

[2] Holly Vedova, "Reforming the Pre-Filing Process for Companies Considering Consolidation and a Change of Treatment of Debt," Aug. 26, 2021, https://www.ftc.gov/news-events/blogs/competition-matters/2021/08/reforming-pre-filing-process-companies-considering (hereinafter "FTC Blog Post").

[3] 16 C.F.R. § 801.10 ("Value of voting securities, non-corporate interests and assets to be acquired.").

[4] *See* 16 C.F.R. § 801.10(c)(2); Statement of Basis and Purpose, 43 FR 33450, 33471 (Jul. 31, 1978). When administrative agencies, such as the FTC, promulgate rules or changes thereto, such rules must be accompanied by a "Statement of Basis and Purpose," which provides explanation and the reasoning behind the rules and any changes.

[5] *See generally*, Premerger Notification Practice Manual § 49 ("The PNO's general position with regard to voting securities is that the dollar value of the liabilities of the acquired entity is not included in the purchase price in calculating the size of the transaction. . . . These principles apply to the acquisition of controlling interests in a non-corporate entity such as a partnership or limited liability company.") While the blog post and related HSR resource publication, "The Treatment of Debt as Consideration," appear to address only retirement of debt in an equity transaction, the approach in an asset deal always has been to include any assumed liabilities in such acquisition price "since preexisting liabilities otherwise would remain the responsibility of the seller of the assets after the sale." *Id.* Additionally, the PNO makes a distinction between debt that is assumed and debt that is retired. In equity deals, debt is excluded only where it is retired, not assumed; in asset deals, debt is added where it is either assumed or retired. *See, e.g.*, Informal Interpretation

No. 2003002, Mar. 3, 2020, https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/2003002 ; Informal Interpretation No. 1904001, Apr. 3, 2019, https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/1904001 .

[6] *See* FTC Blog Post.

[7] HSR Act Rule 16 C.F.R. § 801.90, the "Avoidance Device" rule, says that parties cannot structure transactions solely to avoid an HSR obligation; if they do so, the transaction structure may be disregarded by the FTC, and the transaction may treated as reportable. *See* Meytal McCoy, "US Antitrust Agencies Reject Parties' Corporate Deal Structure to Determine Alleged HSR Act Violations," June 17, 2019, https://www.mayerbrown.com/en/perspectives-events/publications/2019/06/us-antitrust-agencies-reject-parties-corporate-deal-structure-to-determine-alleged-hsr-act-violations .

[8] *See* FTC Blog Post.

[9] "Treatment of Debt as Consideration," https://www.ftc.gov/enforcement/premerger-notification-program/hsr-resources/treatment-debt-consideration .

[10] Note that while the guidance document that the FTC published with the blog refers to "shareholders," which implies transactions involving voting securities, the FTC, if asked, likely would acknowledge that this guidance also applies equally to non-corporate entities (i.e., LLPs, LLCs, etc.) and their equity holders.

[11] Interestingly, these questions likely would have been resolved if the FTC addressed the questions relating to treatment of debt posed in its Advanced Notice of Proposed Rulemaking ("ANPRM"), which it first announced 11 months ago. *See* 85 Fed. Reg. 77042, Fed. Trade Comm'n, Premerger Notification; Reporting and Waiting Period Requirements (announced on Sept. 21, 2020).

[12] Informal interpretations are FTC Premerger Notification Office Staff responses to inquiries made by the public concerning the applicability of HSR Act rules to specific factual circumstances. *See* Fed. Trade Comm'n, Informal Interpretations, https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations (last visited Aug. 27, 2021). While the PNO always has advised that informal interpretations do not replace legal analysis, it has been long-standing practice for HSR practitioners and the public to rely on this guidance when analyzing the HSR Act rules.

[13] FTC Blog Post. Interpretations may not be reviewed or authorized by the Commission, but they are authored and published by PNO staff, which is tasked specifically with administering the premerger notification program and responding to public requests for HSR Act assistance. As such, informal interpretations are relied on by counsel even if they may not reflect "modern market realities" or the "policy position of the Commission." To be sure, informal interpretations are from time to time overturned when such opinions "no longer, in part or full, represent the positions of the PNO." *See* "Superseded Informal Interpretations," https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations/superseded-informal . And there have been times that the PNO has provided a more significant "reset" of its views on a particular rule. *See, e.g.*, "Resetting our views on HSR Items 4(c) and 4(d)," FTC Blog Post, Nov. 28, 2016, https://www.ftc.gov/news-events/blogs/competition-matters/2016/11/resetting-our-views-hsr-items-4c-4d . But that does not mean that all informal interpretations have "missed the mark." FTC Blog Post.

[14] *See* Ltr to The Honorable Jim Jordan from Chairwoman Lina M. Khan, Sept. 2, 2021, https://res.cloudinary.com/gcr-usa/image/upload/v1631049151/2021-09-02_Letter_from_Chair_Khan_to_Ranking_Member_Jordan_pf7ylq.pdf .

[15] *See* "HSR Transactions by Month," Premerger Notification Program, https://www.ftc.gov/enforcement/premerger-notification-program The number of HSR Act filings submitted in this fiscal year is more than 900 more than the next highest year since FY 2001, which is when the HSR Act last underwent significant revision.

[16] Holly Vedova, "Adjusting merger review to deal with the surge in merger filings," FTC Blog Post, Aug. 3, 2021, https://www.ftc.gov/news-events/blogs/competition-matters/2021/08/adjusting-merger-review-deal-surge-merger-filings .

[17] The average number of filings per month in FY 2021 is nearly 300, which is more than double the monthly average from across the last twenty years.