

New FTC Position on Debt and HSR Valuation

by Michael A. Lindsay, Anthony P. Badaracco, Stephen Weingold, and Alyssa Schaefer

On August 26, the Federal Trade Commission announced a new position on an important factor in determining whether a transaction must be reported under the Hart-Scott-Rodino Act: whether debt repayment at closing counts in determining the value of a transaction.¹

Background. The HSR Act requires parties to report certain M&A transactions to the FTC and the U.S. Department of Justice and then observe a mandatory waiting period (typically 30 days) before closing. This gives the agencies a chance to review the transaction to determine whether it presents any competition concerns.

Size of Transaction. Not all transactions are reportable. The first gate is the “size of transaction” – if the value of voting securities or assets that will be acquired falls below the statutory minimum, then the transaction is not reportable. This minimum is adjusted annually, and for transactions closing in 2021 (and early 2022, before the next annual adjustment), the minimum is \$92 million. Transactions whose value, as determined under the HSR Act, is at or below this number are not reportable. Moreover, transactions valued at or below \$184 million (also adjusted annually) are subject to a further test – the “size of persons.”

Value. Under the HSR Act and its regulations, the value of voting securities is the greater of the acquisition price (if determined) and the market price (or, for voting securities that are not publicly traded, the fair market value).

Previous Treatment of Debt and Debt Pay-off. But what happens if a company is carrying debt? Suppose, for example, that a company with an enterprise value of \$100 million is carrying \$45 million of debt. The value of the voting securities is presumably about \$55 million (give or take, depending on the terms of the debt). On the other hand, if the debt is eliminated (e.g., the shareholders contribute additional capital that is used to pay off third-party debt), then the value of those same voting securities would now be \$100 million. Historically, if a portion of the purchase price was to be used for debt pay-

Related People

- Michael A. Lindsay
- Anthony P. Badaracco
- Stephen Weingold
- Alyssa Schaefer

Related Capabilities

- Antitrust & Competition Law
- Mergers & Acquisitions

off at closing, the FTC permitted parties to exclude that portion from the value of the voting securities. This made sense, because at least theoretically the buyer could have bought the acquired issuer with the existing debt still in place, and then paid off the debt after closing. In that case, the value of the voting securities was clearly (in our example) below the reporting threshold.

The Perceived Problem. The FTC's blog post states that target companies "may be incentivized to take on debt just before an acquisition, so that the acquiring company can retire the debt as part of the deal. These deals then are not being reported to the FTC and the DOJ, which means that merging parties are effectively sidestepping the law and avoiding accountability."

New Treatment of Debt. The FTC acknowledges that "not all debt retired as a part of a proposed transaction is consideration," but "sometimes the retirement of debt is part of the consideration for a transaction in that it benefits the selling shareholder(s)." The FTC's new position is that "the full or partial retirement of debt should be included in calculating the Acquisition Price in any instance where selling shareholder(s) benefit from the retirement of that debt."²

Application. What does "benefitting the selling shareholders" mean? That is not clear, but one can envision at least one case where the FTC would not view debt pay-off as "benefitting the selling shareholders": pay-off of long-term debt to unrelated third parties that has not been guaranteed by a shareholder or parent/affiliates. Here are some kinds of debt that parties might want to assess for inclusion as "consideration" if any portion of the sales proceeds will be used for the debt's retirement:

- Debt owed to the individuals or legal entities that are themselves selling shares.
- Debt owed to affiliates or parent entities of either the target issuer or the entity that is selling the shares.
- Debt that was recently incurred, if any significant portion of the loan proceeds was distributed out to the selling shareholders or was used to pay off debts owed to the selling shareholders or parents/affiliates.

To be clear, the FTC's blogpost acknowledges that some kinds of debt pay-offs are not "consideration," but that determination will require a fact-specific assessment.

Consequences. The HSR Act provides for civil penalties for each day of noncompliance. The maximum daily civil penalty is currently \$43,792 (adjusted annually).³ In addition, the HSR Act also authorizes courts to award equitable relief (e.g., an injunction against future violations). In some circumstances, a reportable but unreported transaction may also attract closer scrutiny for potential substantive competition issues.

Effective Date. The FTC blog post states that "effective September 27, 2021, the [FTC] will begin to recommend enforcement action for companies that fail to file when retirement of debt is part of the consideration for the deal."⁴ We read this to mean that if a transaction closes no later than September 26, the FTC would not recommend an enforcement action (at least not based on the debt retirement issue).

¹ Holly Vedova, FTC Bureau of Competition *Reforming the Pre-Filing Process for Companies Considering Consolidation and a Change in the Treatment of Debt*, (Aug 26, 2021), <https://www.ftc.gov/news-events/blogs/competition-matters/2021/08/reforming-pre-filing-process-companies-considering>.

² FTC Bureau of Competition, *The Treatment of Debt as Consideration*, <https://www.ftc.gov/enforcement/premerger-notification-program/hsr-resources/treatment-debt-consideration>.

³ For example, on September 2, 2021, the U.S. Department of Justice announced the settlement of an enforcement action in which the acquiring person agreed to pay a civil penalty of \$637,950. *U.S. v. Fairbank*, Case 1:21-cv-02325, Dkt # 1-4 (D.D.C. Sept. 02, 2021).

⁴ The FTC makes a “recommendation,” because enforcement actions are brought by the U.S. Department of Justice.