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Energy in the Crosshairs

Hart-Scott-Rodino Act Pre-Merger Notification Changes and
Antitrust Enforcement Trends

Presented to Association of Corporate Counsel -- Houston

www.mayerbrown.com

December 13, 2011

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Key Changes to Hart-Scott-Rodino Pre-Merger Notification Form

- New requirement that firms provide information regarding the minority holdings of “associates” that are neither parents nor subsidiaries of the filing party.
 - This change is designed specifically to capture more information about **master limited partnerships** and private equity groups.
- Changes to the documents that filing parties are required to produce under item 4 of the HSR form.
- Changes to required revenue reporting by North American Industry Classification System (NAICS).

Item 6(c): Introducing “Associates”

- The Federal Trade Commission and Department of Justice recognize that Master Limited Partnerships (MLPs) have become commonplace in the oil and natural gas sector and are attempting to capture more information regarding them in the pre-merger notification process.
- Old HSR Rules – MLP1 held natural gas pipeline assets, was managed by general partner (GP) that managed other MLPs holding competing assets – MLP1 could acquire additional competing assets without disclosing the other assets managed by GP.
- New Item 6(c)(ii) now requires MLP1 to report on its relationship with GP and GP’s management of competing assets.
- According to the Federal Trade Commission, this change was designed “to provide very useful information to the [government] in transactions involving the intricate structures that often characterize Master Limited Partnerships.”

Item 6(c): Introducing Associates

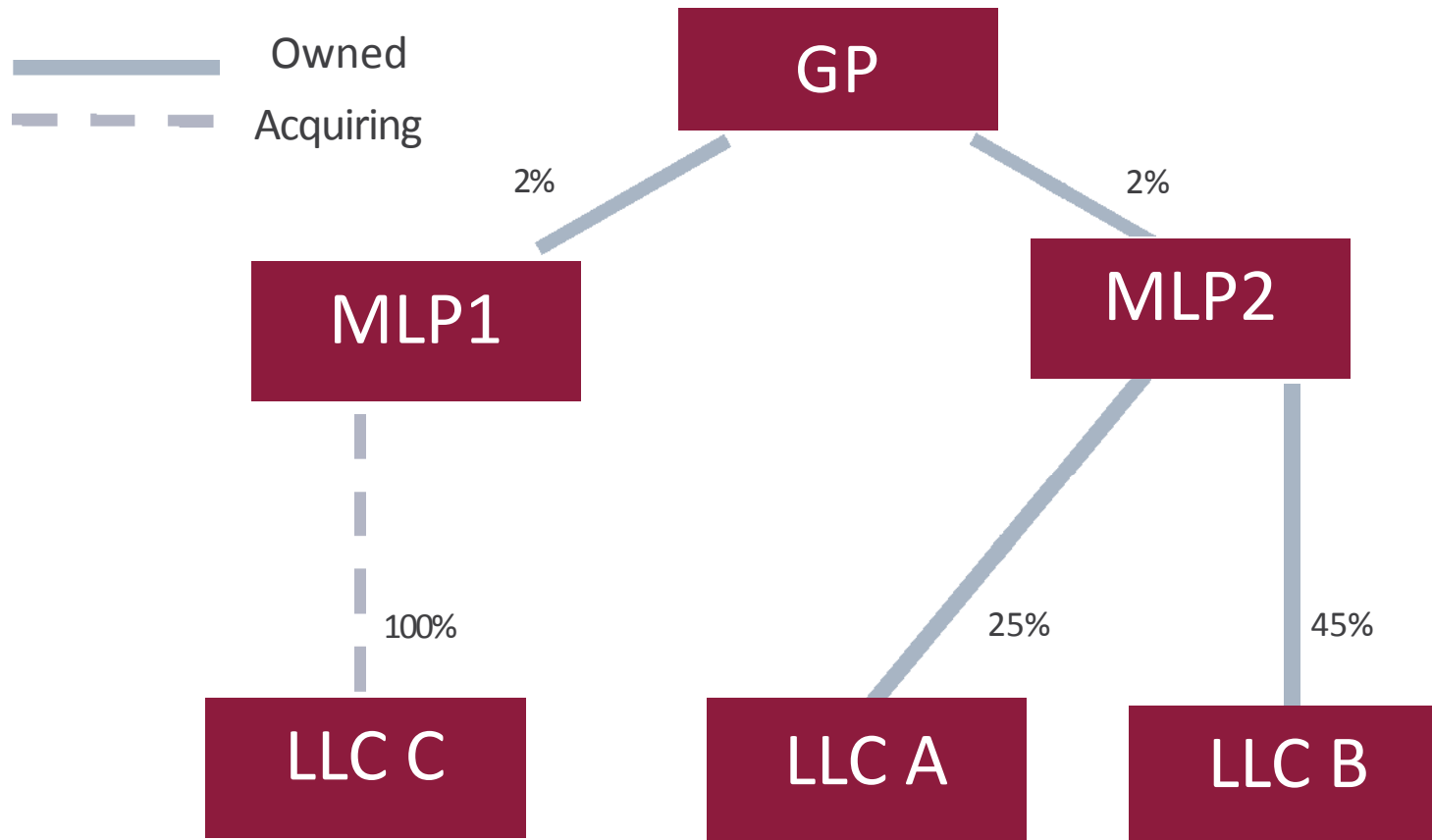
- Old HSR Form Item 6(c) required the acquiring person and acquired entity each to report all minority voting securities interests held in corporate issuers controlled by another person.
- Item 6(c) now is divided into two parts:
 - Item 6(c)(i) requires:
 - The acquiring person to list each entity in which it (a) holds a 5 percent or greater, but less than 50 percent, equity interest, either through voting securities or interests in non-corporate entities, and (b) that derives revenues in the same NAICS industry code as the acquired entity or acquired assets.
 - The acquired entity to provide similar information regarding its minority holdings that have a NAICS code overlap with the acquiring person.
 - Item 6(c)(ii), which applies only to the acquiring person, introduces the new concept of an “associate.”

Associates: Required Information and Effect on Oil and Natural Gas Transactions

- An “associate” is an entity that is not a parent or subsidiary the acquiring person but that:
 - Manages the acquiring person’s operations or investment decisions (“managing entity”); or
 - Controls , is controlled by, or has the same parent as the managing entity; or
 - Manages, is managed by, or is under common operational or investment management with the managing entity; or
 - Whose operations or investment decisions are managed by the acquiring person.
- Item 6(c)(ii) requires an acquiring person to identify for each of its associates any holding of 5 percent or greater but less than 50 percent of the voting securities or non-corporate interests held in the acquired entity, or in any entity that derived revenues in the most recent year from the same 6-digit NAICS code as the acquired entity or acquired assets.
- Item 7(b)(ii) requires the acquiring person to list each associate that, directly or through an investment, derives revenues in the same NAICS code as the acquired entity or assets and, if different from the associate (e.g., an entity in which the associate holds a minority interest), the entity actually deriving those revenues.

Associates: An Example

EXAMPLE FOR ITEMS 6(c)(ii) AND 7(b)(ii)



GP manages and holds 2% interests in MLP 1 and MLP 2. MLP 2 holds minority interests in LLC A (25%) and LLC B (45%). MLP 1, which is its own UPE, is acquiring 100% of LLC C and must report the acquisition under the HSR Act. LLC A, B and C all own pipelines and report revenue under the same 6-digit NAICS code.

Result: Item 6(c)(ii) – MLP 1 must identify GP and MLP 2 as Associates, report MLP 2’s percentage holdings in LLC A and B, and identify the overlapping NAICS code or industry. Item 7(b)(ii) -- MLP 1 must list GP and MLP 2 as Associates, and LLCs A and B as entities that actually derived revenues in the overlapping NAICS codes.

Changes to Documents that Must Be Produced with HSR Form

- Item 4(c):
 - Requires filing parties to produce documents produced by or for officers or directors analyzing the acquisition with respect to market shares, competition, competitors, markets, and potential for sales growth into product or geographic markets.
- New Item 4(d)
 - The new HSR form now contains Items 4(d)(i), 4(d)(ii), and 4(d)(iii)
 - 4(d)(i) – requires a filing party to provide all Confidential Information Memoranda (CIM) prepared by or for officers or directors of the Ultimate Parent Entity of the Acquiring or Acquired firm; if there is no CIM, must provide documents given to buyer serving a “similar function.”
 - 4(d)(ii) – requires a filing party to provide all studies, surveys, and reports prepared by investment bankers, consultants, or other third-party advisors for officers or directors which analyze the same subject matter as covered in item 4(c) – includes documents created both by engaged advisors and advisors seeking engagements, even if not hired (“pitch books”).
 - 4(d)(iii) – requires a filing party to provide all studies, surveys, analyses and reports analyzing synergies and/or efficiencies of the deal prepared by or for any officer or director.

Item 5: Changes in Revenue Reporting

- Welcome Changes

- New Item 5(a) – limits reporting to revenues for the filing person's most recent fiscal year.
- The new HSR form no longer requires revenue reporting using a 2002 base year. Therefore, companies no longer need to collect and aggregate historical sales data, as previously required by Item 5.

- New Requirements

- The new Item 5(a) requires filing companies to report revenue by NAICS code for products manufactured outside the United States that are sold directly to U.S. customers.
- May impact energy industry companies that manufacture products outside the U.S. and sell them into the U.S.

Managing Increased HSR Reporting Requirements

- Associate Relationships – companies planning to engage in acquisitions that may require reporting these relationships -- consider compiling a list of these ahead of any particular acquisition or HSR filing so the information is readily available when you need it.
- Item 4(c)/4(d) documents:
 - Instruct employees to create only those documents required to analyze, decide whether to do deal.
 - Create CIM so there is certainty re what to submit under 4(d)(i).
 - Instruct third party advisors only to create documents upon request
 - Have all 4(c)/4(d) documents reviewed by counsel in draft to avoid creating documents that include anticompetitive language that can result in closer government scrutiny (e.g., “if we do this deal we’ll dominate market,” “after this deal we can raise prices,” “high entry barriers mean no new competition”).

Energy Industry Scrutiny by Antitrust Agencies

- Energy Industry is Closely Watched
 - Consolidated Appropriations Act of 2008 directs FTC to submit a report to the Committees on Appropriations summarizing its activities dealing with the oil and natural gas industries.
 - Mergers & acquisitions and other transactions
 - Pricing behavior
 - Other potential anticompetitive actions

Energy Industry Scrutiny by Antitrust Agencies

- “The Commission’s significant activities involving petroleum and natural gas during the first half of calendar 2011 demonstrate clearly that the FTC considers the protection of American consumers from potentially anticompetitive practices in the energy sector to be one of its major responsibilities.”
 - 48 premerger reviews involving oil and natural gas sector under Hart-Scott-Rodino in 2010 (up from 24 in 2008)
 - Mergers III division of FTC primarily devoted to oil and natural gas industries
 - FTC has an Associate General Counsel for Energy
 - Gasoline and Diesel Price Monitoring Project

Energy Industry Scrutiny by Antitrust Agencies

- Recent FTC Challenges to Proposed Acquisitions in the Energy Sector
 - Irving Oil Ltd./ExxonMobil Corp.
 - Proposed acquisition of ExxonMobil's terminal and pipeline assets in South Portland and Bangor/Prescott Bay areas of Maine
 - On May 26, 2011, parties entered into consent decree that required Irving to divest 50% of South Portland terminal and give up acquisition of Bangor terminal and intrastate pipeline
 - McGraw-Hill Cos., Inc./Oil Price Information Serv., LLC
 - Proposed acquisition of Oil Price Information Service by McGraw-Hill
 - On February 16, 2011, the parties abandoned the deal and the FTC closed its investigation

FTC Merger Litigation Strategy

- The FTC has begun using a combination of an argument for lowering the standard to obtain preliminary injunction in federal court and threat of prolonged administrative proceedings to pressure parties to abandon transactions the agency decides to challenge
- Unlike DOJ, where entire merger challenge (PI and trial) is litigated in federal court – the FTC can choose trial on the merits before an FTC administrative law judge (ALJ)
- *FTC v. CCC Holdings, Inc.* – FTC argued to court in preliminary injunction proceeding that under Section 13(b) of the FTC Act it only needs to show a probability the transaction is anticompetitive, and that it raises such serious issues that further investigation and deliberation by FTC is appropriate
 - Idea court should defer to FTC administrative process with respect to merits of merger challenge
 - US District Court for the District of Columbia agreed – parties abandoned transaction
 - Same argument was ultimately accepted by the D.C. Circuit in *Whole Foods*

FTC Adjudication Procedures

- April 2009 – FTC adopted changes to its Rules that would expedite adjudicative proceedings
- Past: Generally, adjudicative proceedings brought by FTC only after preliminary injunction issued by federal court
- Changes include, *inter alia*,
 - Parallel preliminary injunction and adjudicatory proceedings
 - Tighter timetables (including less time to answer a complaint: 210 hours for a hearing, unless Commission allows otherwise)
 - Commissioners acting as ALJs
 - Commission authority over dispositive pretrial motions

Concerns Raised by FTC Procedures

- 2009 revisions attempted to address concerns that FTC administrative process takes too long for parties to continue with deal if they prevail
- However, the changed raise new concerns:
 - Bias of Commissioner serving as ALJ
 - Commission presiding over outcome-determinative proceedings (discovery and dispositive motions) is unfair
 - Expediting procedures gives FTC staff time advantages over merging parties
 - Burden of two parallel proceedings (motion for preliminary injunction in federal court and trial on the merits before ALJ) puts additional pressure on merging parties to abandon transaction (*see, e.g.*, Inova/Price William Health System, Inc.; Old Castle Architectural, Inc.; CCC Holdings)

FTC Merger Litigation Strategy

- How can merging parties respond?
- Proactive approach to agency regarding addressing potential issues
 - FTC litigation strategy gives agency staff more leverage by reducing likelihood agency will have to win on merits in court
 - Increases importance of persuading staff up front not to challenge deal and/or to minimize staff concerns
 - Transaction raising serious issues – prepare to meet with agency staff early in process with fully developed arguments and analysis
- Careful analysis early in deal process to identify potential issues, assess risks
 - Retain and involve antitrust counsel early in process
 - Consider retaining antitrust economist early in process to assist with analysis
 - Compare issues in deal to those in prior transactions

Energy Industry Scrutiny by the Antitrust Agencies

- Antitrust Division, Department of Justice
 - Transportation, Energy, and Agriculture Section
 - Investigates and enforces antitrust laws in the transportation, energy, and agriculture sectors
 - Recent enforcement:
 - Baker Hughes, Inc./BJ Servs. Co.
 - Merger between two of the four providers of vessel stimulation services to oil and natural gas companies in the Gulf of Mexico.
 - Divestiture of two vessels and associated facilities (*e.g.*, a dock and mooring facilities)
 - Schlumberger Ltd./Smith Int'l, Inc.
 - Merger between two leading players in oil field products and services sector.
 - DoJ made a second request inquiry into merger on April 5, 2010.
 - On July 27, 2010, DOJ cleared the merger without any conditions

Energy Industry Scrutiny by Antitrust Agencies

- Despite vigorous enforcement – higher gasoline prices have led to claims that lax merger enforcement resulted in too much concentration, collusion
- Such claims have resulted in FTC conducting various studies and instituting a program to monitor gasoline prices, *e.g.*,
 - In April 2011 the FTC launched an investigation into whether oil producers, refiners, transporters, marketers, and traders engaged in anticompetitive or manipulative practices related to the wholesale price of crude oil or petroleum products.
 - FTC Chairman Jon Leibowitz reported on investigation to Senate in June 20, 2011 letter.
- These investigations have not resulted in any findings of anticompetitive behavior

Market Manipulation Rule

- FTC tasked with examining and identifying market manipulation in the petroleum sector and taking action where necessary
 - Pursuant to Section 811 of the Energy Independence and Security Act of 2007
 - Targets “any manipulative or deceptive device or contrivance” “in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale”
 - Final rule became effective on November 4, 2009

FTC Final Rule Regarding Market Manipulation in the Petroleum Industry

- Final rule prohibits market manipulation in the petroleum industry
- Specifically, the final rule prohibits any person, directly or indirectly, in connection with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale, from
 - A) knowingly engaging in any act, practice, or course of business – including making any untrue statement of material fact – that operates or would operate as fraud or deceit upon any person; or
 - B) intentionally failing to state a material fact that under the circumstances renders a statement made by such person misleading, provided that such omission distorts or is likely to distort condition for any such product
- Penalties
 - Anyone violating the rule faces civil penalties of up to \$1 million per violation per day, in addition to any relief available to the Commission under the FTC Act

FTC Final Rule Regarding Manipulation in the Petroleum Industry

- Additional Developments
 - In April 2011 the FTC and Commodity Futures Trading Commission signed a memorandum of understanding to facilitate sharing non-public information regarding on-going investigations
 - FTC Chairman Jon Leibowitz: “With gasoline prices on the rise, we are committed to doing all we can to ensure the petroleum markets are competitive. . . . [T]his MOU improves the ability of the FTC and CFTC to take action if and when we find market manipulation.”
 - Also in April 2011, Attorney General Holder announced the creation of an Oil and Gas Price Fraud Working Group
 - Includes representatives from the Department of Justice, National Association of Attorneys General, CFTC, FTC, Dept. of Treasury, Federal Reserve, SEC, Dept. of Agriculture, and Dept. of Energy

Energy Industry Scrutiny by Antitrust Agencies

- Gasoline and Diesel Price Monitoring Project
 - Project underway since 2002 to monitor the wholesale and retail prices of gasoline in order to help detect potential anticompetitive conduct and determine if investigation is warranted
 - Tracks retail gasoline and diesel prices in approximately 360 cities and wholesale prices in 20 major urban areas
 - FTC Bureau of Economics takes relevant information and determines whether prices each week are anomalous in context of historical data
 - May trigger an investigation

Managing Agency Scrutiny of Prices

- Document reasons for pricing changes that may attract government scrutiny
- Confer with counsel before engaging in transactions or making changes that could be viewed as manipulation or evidence of collusion
- Institute and enforce an antitrust/manipulation compliance policy to reduce risk of investigation or liability
 - Under policy – require relevant employees to review FTC Guide to Complying with Petroleum Market Manipulation Regulations, www.ftc.gov/os/2009/11/091113mmrguide.pdf.

Energy Industry Scrutiny - Summary

- The oil and natural gas industry has been closely scrutinized by the FTC; DOJ is bringing enforcement actions as well
- The Obama Administration has established a track record of scrutinizing industry transactions and behavior closely
- Areas of interest include merger review, potential gasoline price manipulation and possible collusion
- Important to manage these risks to avoid unwanted and unwarranted government intrusion into your business