

**PROPOSED RULES TO HART-SCOTT-RODINO ACT
FOR FORMATIONS OF UNINCORPORATED ENTITIES
AND ACQUISITIONS OF “NON-CORPORATE INTERESTS”**

APRIL 14, 2004

The Federal Trade Commission (the “FTC”) has proposed new rules that will substantially revise the treatment of partnerships, limited liability companies (“LLCs”) and other unincorporated entities under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the “HSR Act”). Under the HSR Act, premerger notification filings (“HSR filings”) are not required for most formations and acquisitions of interests in partnerships, LLCs and other unincorporated entities. The proposed rules attempt to reconcile the treatment of partnerships, LLCs and other unincorporated entities with the current treatment of similar transactions involving corporations. The new rules will require HSR filings for a variety of transactions involving unincorporated entities that have not previously been reportable. The proposed rule changes will also eliminate HSR filings for certain transactions. Additionally, the FTC has proposed certain technical changes to current rules and attempted to codify certain of its long-standing informal interpretations.

Current Treatment of Partnerships, LLCs and Other Unincorporated Entities under the HSR Act

The HSR Act applies to acquisitions of assets or voting securities. The FTC has taken the position that partnership interests and interests in other types of unincorporated entities are neither assets nor voting securities under the HSR Act. Thus, acquisitions of interests of existing partnerships, LLCs and other unincorporated entities are currently reportable only if the acquiring person will hold all of the interests of the entity as a result of the acquisition. The formation of a partnership is not reportable, and the formation of an LLC is generally not reportable unless the formation involves the combination of two or more independent “businesses” and at least one person controls the LLC.

Proposed Rules for Acquisitions of Interests in Existing Unincorporated Entities

The proposed rules will extend the application of the HSR Act to acquisitions of “non-corporate interests” defined as “an interest in any unincorporated entity which gives the holder the right to any profits of the entity or the right to any assets of the entity in the event of dissolution of that entity.” “Non-corporate interests” would include interests in partnerships, LLCs, cooperatives, business trusts, and other unincorporated entities.

The new rules will require an HSR filing where, as a result of a transaction, a person will acquire a “controlling” interest in an unincorporated entity and the requisite HSR size-of-

person and size-of-transaction thresholds are met. The proposed rules will amend the current definition of “control” for unincorporated entities to “having the right to 50% or more of the profits of the entity, or having the right in the event of dissolution to 50% or more of the assets of the entity.” Thus, the proposed rules will change the HSR reporting obligation from when 100% of the interests in an unincorporated entity are acquired to when “control” is acquired.

The new rules will also clarify that a contribution of assets or voting securities to an existing unincorporated entity is an acquisition by that entity and not treated as a formation of a new unincorporated entity, even if all or part of the consideration is interests in the entity. This would reverse the current position with regard to LLCs, which views the contribution of a business to an existing LLC in exchange for membership interests as a new formation of the LLC.

Where acquisitions of a controlling interest in an existing unincorporated entity are reportable, the acquiring person will be viewed under the new rules as acquiring whatever interests in the unincorporated entity's profits or assets it will hold as a result of the transaction. Therefore, the value of any non-corporate interests that are being acquired is (1) the acquisition price if determined or (2) if undetermined, the fair market value of those interests. The value of any non-corporate interests in the same unincorporated entity that are already held prior to the instant acquisition is the fair market value of those interests.

Proposed Rules for Formations of Unincorporated Entities

In order to conform the treatment of unincorporated entities to that of corporations, the proposed rules will make the formation of partnerships, LLCs and other unincorporated entities reportable under the HSR Act. Like any potentially reportable acquisition of an existing unincorporated entity, acquiring control will be the triggering event in the formation of an unincorporated entity. Each person that will control the newly-formed entity is considered an “acquiring person” under the new rules and will be viewed as acquiring its share of all of the assets which any person contributing to the formation of the entity has agreed to contribute at any time, including credit or loans to the entity that the forming persons have agreed to extend or guarantee at any time. The newly-formed entity is considered to be the “acquired person” under the new rules.

The standard HSR size-of-person and size-of-transaction thresholds will be applied to formations of unincorporated entities. Accordingly, an acquisition by an acquiring person that will confer control of an unincorporated entity is reportable only if such acquisition is valued at more than \$50 million. For acquisitions valued in excess of \$50 million and up to \$200 million, either the acquiring person (i.e., the person controlling the new entity) must have annual net sales or total assets of \$100 million or more and the acquired person (i.e., the newly-formed entity) must have annual net sales or total assets of \$10 million or more, or the acquiring person must have annual net sales or total assets of \$10 million or more and the acquired person must have annual net sales or total assets of \$100 million or more. For acquisitions valued at more than \$200 million, the size-of-person threshold is disregarded and the acquisition is reportable so long as at least one person will control the newly-formed entity.

If the requisite size-of-person and size-of-transaction thresholds are met, then each acquiring person that will control the newly-formed entity must make an HSR filing. Similar to the current rules applicable to formations of new corporations, no HSR filing is required by the acquired person (i.e., the newly-formed unincorporated entity) and a single HSR waiting period begins once all acquiring persons required to file have done so.

Other Proposed HSR Rules

The FTC has also proposed additional rules changes to adapt the application of current rules to unincorporated entities, codify certain long-standing informal interpretations of the FTC, and make certain technical corrections unrelated to unincorporated entities.

Intra-person Exemption

The “intra-person exemption” which now exempts transactions where the acquiring and acquired persons are the same person through the holding of voting securities, will be expanded to encompass intra-person transactions involving unincorporated entities. For example, if a parent controlled two corporations and transferred assets from one to the other, no filing is required under the current rule; however, if the parent controlled two partnerships and made the same transfer between them, the current exemption would be inapplicable and a filing would be required. Eliminating the requirement that control be through the holding of voting securities expands the intra-person exemption consistently to all types of entities. In addition, the FTC restated the existing exemption for formations of wholly owned subsidiaries to exempt the formation of any type of wholly owned entity and proposed a new rule that would exempt assets contributed to the formation of a new entity with respect to the person contributing those assets. This is intended to eliminate a filing requirement where the assets contributed to the formation by other persons would not on their own be subject to the HSR Act, such as when the controlling person contributes assets and the non-controlling person contributes only cash. This proposed exemption would be applicable to the formations of both corporations and unincorporated entities.

Exemption for Acquisitions of Voting Securities of Issuers or Non-Corporate Interests of Unincorporated Entities Holding Certain Assets the Direct Acquisition of Which is Exempt

Another proposed change would expand the current exemption relating to acquisitions of voting securities of issuers that hold certain assets exempted under the real property and ordinary course of business exemptions. The current exemption is only available if the acquired issuer or issuers do not in the aggregate hold non-exempt assets exceeding the \$50 million notification threshold. For example, the current rule does not exempt the acquisition of voting securities of a U.S. issuer whose only assets are foreign with no nexus to the U.S., while the direct acquisition of those foreign assets would be exempt under the HSR rules foreign exemption. Another example would be the acquisition of an issuer whose only assets consisted of cash and cash equivalents, such as the acquisition of voting securities of a newly-formed

acquisition corporation. While the direct acquisition of the assets (i.e., the cash) would not be reportable under Section 801.21 of the HSR rules, the acquisition of the voting securities of a corporation that held such assets is not exempted by the current version of the rule.

The proposed rule would broaden the exemption to encompass acquisitions of voting securities of issuers or non-corporate interests which confer control of an unincorporated entity whose assets are exempt under any exemption in the HSR Act or rules (not just those related to exempt real estate or goods acquired in the ordinary course of business) or pursuant to Section 801.21 of the HSR rules. Again, the exemption is available only if the acquired issuer or unincorporated entity and all entities it controls do not in the aggregate hold non-exempt assets exceeding \$50 million. Therefore, the acquisition of an interest in any entity (corporate or non-corporate) whose only assets are ones the direct acquisition of which would otherwise be exempt will not be reportable.

Exemption for Reorganizations

The FTC also proposes to codify a long-standing informal position that exempts the pro-rata reorganization of corporations (for example, the reincorporation or formation of an upstream holding company by an existing corporation) and expands this exemption to include unincorporated entities. The proposed exemption would be available as long as two conditions are met: (1) no new assets will be contributed as a result of the conversion, and (2) the interests that will be held by an acquiring person in the new entity will be pro-rata to or less than the holdings in the original entity or the acquiring person was a controlling shareholder or interest holder prior to the conversion. The reorganization will be exempt for a person that controlled the original entity regardless of its holdings in the new entity as long as the first condition is met.

Exemption of Certain Financing Transactions

A new proposed rule would exempt certain acquisitions in financing transactions involving the formation of unincorporated entities. In some financing transactions, a new unincorporated entity is formed into which one party contributes assets and another contributes only cash. In such an arrangement, the cash investor will take a preferred return on the profits of the entity until it recoups its investment. During this period, the investor is deemed to control the entity under the HSR rules since it has a right to more than 50% of the profits, yet it has no operational control of the entity. The proposed rule would exempt such a transaction if four conditions are met: (1) the acquiring person is contributing only cash to the formation of the entity; (2) the formation transaction is in the ordinary course of the acquiring person's business; (3) the terms of the formation agreement are such that the acquiring person will no longer control the entity after it realizes its preferred return; and (4) the acquiring person will not be a competitor of the new entity. While the investor's acquisition of control of the new entity at its formation would be exempt, the investor would be deemed to control the new entity for all other purposes following the formation.

Secondary Acquisitions

Another proposed amendment would clarify that any indirect acquisition of voting securities of an issuer that is not controlled by the acquired entity in the primary acquisition is deemed a secondary acquisition and is separately subject to the reporting requirements of the HSR Act. Under the proposed amendment, this will be true whether the primary acquisition confers control of a corporation or an unincorporated entity. A separately reportable acquisition of an unincorporated entity may also occur through an indirect acquisition of minority non-corporate interests if the acquiring person already holds non-corporate interests in that entity that in aggregate would result in control.

Consolidations

The FTC also proposes to amend its current rules regarding consolidations to cover all combinations of existing entities into a new parent. The amendment would codify the existing FTC position that the combination of any two entities into a new holding company is the functional equivalent of a consolidation and should be treated in the same manner regardless of whether the entities are corporations or unincorporated entities. It would also formalize that even if the two entities are retaining their separate pre-consolidation identities, either by becoming subsidiaries of the new holding company or through arrangements such as dual-listing agreements, the transactions would be treated the same.

Not-for-profit Corporations

Since the vast majority of not-for-profit corporations do not issue voting securities, the FTC proposes to expand its current rule that exempts an acquisition of voting securities in the formation of a not-for-profit corporation to cover the formation of unincorporated not-for-profit entities. Another proposed rule would codify an existing informal interpretation that acquiring the right to designate 50% or more of the board of directors of a not-for-profit corporation is an acquisition of all of the underlying assets of such an entity. This is generally accomplished by becoming a member with the right to designate 50% or more of the board of directors.

Aggregation Rules

The FTC has also proposed changes to correct prior drafting oversights. Section 801.13(b)(2) of the HSR rules currently requires aggregation of a current acquisition of assets with an earlier acquisition of assets from the same acquired person if the earlier transaction has been consummated. The proposed rule would now require aggregation of the assets under an earlier agreement with assets in a new agreement, whether the earlier transaction has closed or is still pending. No aggregation is required if the earlier contemplated or consummated acquisition was subject to the reporting requirements of the HSR Act.

Section 801.15 of the HSR rules currently does not require aggregation of sales attributable to foreign assets with sales attributable to foreign issuers being acquired in the same transaction from the same acquired person to determine whether the nexus with U.S.

commerce threshold of the foreign exemptions is met. The rule will be modified to require sales in or into the U.S. attributable to foreign assets being acquired to be aggregated with those sales attributable to foreign issuers whose voting securities would be acquired in the same transaction.

Exemption of Agricultural Real Property

In an attempt to correct an unintentional expansion of the exemption of agricultural real property, the FTC proposes to modify Section 802.2(g) of the HSR rules. The proposed modification would exclude timberland or other real property that generate revenues from activities relating to forestry and logging from the agricultural real property exemption.

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The proposed rules are currently open for public comment. Comments are due by June 4, 2004. The proposed rules will not become effective until thirty days after they are published as final rules. We will provide you with any changes made to the proposed rules as a result of public comments and inform you when the rules will become final. If you have any questions, please call Joseph Tringali (212-455-3840; jtringali@stblaw.com), Jack D'Angelo (212-455-2722; jdangelo@stblaw.com), or Ken Ehrhard (212-455-2403; kehrhard@stblaw.com).

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