

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

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As we explained in our previous memorandum dated April 14, 2004, The Federal Trade Commission (the “FTC”) issued proposed rules that would 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”). The purpose of the proposed rules was to reconcile the treatment of partnerships, LLCs and other unincorporated entities with the treatment of similar transactions involving corporations, which would ultimately require premerger notification filings (“HSR Filings”) for a variety of transactions involving unincorporated entities that have not previously been reportable. Last week, the FTC made final the previously published proposed rules with certain amendments in response to the public comments received.

Final Rules for Acquisitions of Interests in Existing Unincorporated Entities

The final rules 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 in the event of dissolution of that entity the right to any of its assets after payment of its debts.” “Non-corporate interests” include interests in partnerships, LLCs, cooperatives, business trusts, and other unincorporated entities.

The final rules 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. “Control” for unincorporated entities is defined as 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 (except for certain trusts for which control is defined as having the right to designate 50% or more of the trustees). Thus, the final rules change the HSR reporting obligation for unincorporated entities from 100% of the interests to an acquisition of only a “controlling” interest.

The final rules also clarify that a contribution of assets or voting securities to an existing unincorporated entity is an acquisition by that entity and is not treated as a formation of a new unincorporated entity, even if all or part of the consideration is interests in the entity. This reverses 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. However, when a person acquires control of an existing unincorporated entity as a result of a

contribution made to that unincorporated entity, the acquisition by the unincorporated entity from the contributing person is not separately reportable.

Where acquisitions of a controlling interest in an existing unincorporated entity are reportable, the acquiring person is viewed under the final 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 acquisition is the fair market value of those interests.

Final Rules for Formations of Unincorporated Entities

In order to conform the treatment of unincorporated entities to that of corporations, the final rules 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 is 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 final 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 final rules.

The standard HSR size-of-person and size-of-transaction thresholds are 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 \$53.1 million. For acquisitions valued in excess of \$53.1 million and up to \$212.3 million, either the acquiring person (i.e., the person controlling the new entity) or the acquired person (i.e., the newly-formed entity) must have annual net sales or total assets of \$106.2 million or more and the other must have annual net sales or total assets of \$10.7 million or more. If the acquiring person will hold a controlling interest in the newly-formed entity valued in excess of \$212.3 million, the size-of-person threshold is disregarded and the acquisition is reportable.

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).

Other Final HSR Rules

The FTC announced additional 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, has been expanded to include intra-person transactions involving unincorporated entities. Eliminating the requirement that control be through the holding of voting securities expands the intra-person exemption 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 issued a new rule that would exempt assets or voting securities contributed to the formation of a new entity with respect to the person contributing those assets or voting securities. 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 or voting securities and the non-controlling person contributes only cash. This exemption is 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 change expands the current exemption relating to acquisitions of voting securities of issuers that hold certain assets the direct acquisition of which would be exempt (most of which relate to real estate). The current exemption is only available if the acquired issuer or issuers do not in the aggregate hold non-exempt assets exceeding the \$53.1 million notification threshold.

The final rule broadened 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 pursuant to Section 801.21 of the HSR rules, including entities that hold only cash such as joint venture acquisition vehicles. 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 \$53.1 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 codified 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 exemption is 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, the same or less than the

percentage of 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 final rule will exempt certain acquisitions in financing transactions that confer control of a new or existing unincorporated entity. In some financing transactions, one party contributes only cash to a new or existing unincorporated entity. 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 new rule exempts such a transaction if three conditions are met: (1) the acquiring person is contributing only cash to the entity; (2) is doing so for the purpose of providing financing; and (3) the terms of the financing agreement are such that the acquiring person will no longer control the entity after it realizes its preferred return. While the investor's acquisition of control of the entity would be exempt, the investor would be deemed to control the new entity for all other purposes following the acquisition.

The proposed rule originally limited this exemption to formations of new unincorporated entities, but the final rule expands the exemption to cover financing transactions that involve acquisitions of interests in existing unincorporated entities as well. In response to public comments, the final rule also removed the requirement that the acquiring person not be a competitor of the acquired entity and reworded the exemption to require that the transaction be for the purpose of providing financing as opposed to requiring the transaction be in the ordinary course of the acquiring person's business.

Secondary Acquisitions

Another amendment clarifies 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 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 amended its current rules regarding consolidations to cover combinations of existing entities into a new parent. The amendment codifies 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. Even if the two entities are retaining their separate pre-consolidation identities by becoming subsidiaries of the new holding company, 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 expanded 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 rule codifies 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 corrected 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 new rule now requires 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 has been 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 modified Section 802.2(g) of the HSR rules. The modification excludes timberland or other real property that generates revenues from activities relating to forestry and logging or support activities from forestry and logging from the agricultural real property exemption.

Transitional Rule for Transactions Investigated by the Agencies

The final rules add a new transitional exemption for transactions that are or have been under active investigation by the FTC or the DOJ and would otherwise be subject to notification when the rules become final. The Commission has decided that subjecting the parties in such a

situation to additional filing and waiting period requirements, as well as filing fees, would serve no useful purpose.

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The final rules will become effective thirty days after they are published in the Federal Register, around April 1, 2005. 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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