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FTC Revises HSR Act Thresholds and Amends Rules With Respect to Partnerships and LLCs

The Federal Trade Commission (the "FTC") has recently published two sets of amendments to the Premerger Notification Rules (the "Rules") under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act"). In the first rulemaking, effective March 2, 2005,[i] the FTC has adjusted the HSR Act's jurisdictional and filing fee thresholds. The second set of changes affects reporting requirements for acquisitions of non-corporate interests and formation of non-corporate entities. It also expands certain exemptions, including the intra-person exemption, to cover non-corporate entities as well as corporations. These amendments will take effect April 7, 2005.[ii]

Threshold Adjustments.

This is the first of the annual adjustments (based on changes in the gross national product) that are required by the 2000 amendments to the HSR Act. Rather than attempt to revise the Rules annually, the FTC has added in the Rules a parenthetical "(as adjusted)" after each dollar amount that is subject to adjustment and a cross-reference to a table of adjusted values published in the Federal Register.[iii] A summary of the adjusted dollar thresholds of the HSR Act and Rules is attached as Appendix A to this memorandum. For example, the basic size-of-transaction threshold will increase from $50 million to $53.1 million.

Current Treatment of Non-Corporate Interests.

The HSR Act applies to acquisitions of voting securities or assets.[iv] The FTC, by informal interpretation, has long taken the position that partnership interests, and, by extension, interests in other types of unincorporated entities, are neither assets nor voting securities. Thus, any acquisition of such interests has not been deemed a reportable event unless 100% of the interests are acquired, in which case the acquisition is deemed to be an acquisition of all of the underlying assets of the entity. With the exception of certain LLC formations,[v] formations of non-corporate entities are not currently reportable.

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Under existing HSR Rules, any transfer of assets from a corporation to a controlling shareholder, or a transfer of assets of one corporate subsidiary of a parent to another corporate subsidiary of the same parent, is exempt.[vi] However, because partnerships and other unincorporated entities are not controlled through holdings of voting securities, similar transfers involving non-corporate entities are reportable. For example, when assets are transferred from a partnership to a partner that holds a 90% interest in that partnership, the transfer is potentially reportable under the HSR Act. Similarly, under current Rules, if a person controls two different partnerships and transfers assets from one to the other, that person may have a filing obligation.

New Treatment of Non-Corporate Interests.

Definition of Control. Under the new Rules, control of an LLC or a partnership is solely 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. The prior alternate test of control of unincorporated entities, which provides for control through having the contractual power presently to designate individuals exercising functions similar to those of directors of a corporation, is eliminated except for certain types of trusts that can still be controlled through having the right to designate 50% or more of the trustees of such trusts.

Acquisitions of Non-Corporate Interests. The new Rules provide that a potentially reportable acquisition occurs at the time non-corporate interests that confer *control* of an unincorporated entity are acquired. For example, if A holds 30% of the interests in Partnership B and proposes to acquire an additional 30%, the acquisition is potentially reportable because it would confer "control" of Partnership B.

Valuation. Under the new Rules, the value of an acquisition of non-corporate interests will be the sum of the value of the interests already held plus the value of the interests being acquired. The value of any non-corporate interests being acquired will be the acquisition price, or if no acquisition price is specified, the fair market value of those interests. The value of any non-corporate interests in the same entity that are already held prior to the acquisition will be the fair market value of those interests. Thus, in the above example, if the purchase price for the additional 30% interest is $30 million, A will be deemed to be making an acquisition valued at $30 million plus the fair market value of the 30% interest already held.

Formations of Non-Corporate Entities. The new Rule will conform with the existing Rule covering formations of new corporations with one notable exception -- a requirement that at least one person acquire a *controlling interest* in the newly-formed entity. This is consistent with the threshold for any potentially reportable acquisition of non-corporate interests in an existing entity. Thus, the formation of a non-corporate entity will be reportable if: (a) at least one person will "control" the new entity; (b) the controlling interest in the new entity will have a value of more than $53.1 million; and (c)

for transactions valued at more than $53.1 million and up to $212.3 million, the size-of-parties test of the HSR Act is satisfied. The size-of-parties test will be satisfied if (i) the acquiring person has sales or total assets of $106.2 million or more and the newly formed entity has total assets of $10.7 million or more or (ii) the acquiring person has sales or assets of $10.7 million or more and the newly formed entity has total assets of $106.2 million or more.[vii]

Intra-person Transactions. The new Rules expand this exemption to cover intra-person transactions involving non-corporate entities. Thus, the transfer of assets from a partnership to a partner holding a controlling interest in the partnership will now be exempt. The acquisition of additional partnership interests by a person already holding a controlling interest in the same partnership will also be exempt.

Secondary Acquisitions. The new Rules clarify that an 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 requirements of the HSR Act. This is true whether the primary acquisition confers control of a corporation or an unincorporated entity.

Other Amendments.

The new Rules also make a number of conforming and technical amendments to the Rules, including the following:

- Not-for-profit corporations. The new Rules codify a long-standing FTC position 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.

- Aggregation of multiple assets acquisitions. The new Rules require aggregation of multiple acquisitions of assets between the same parties if, within 180 days preceding the execution of a letter of intent or agreement, either (1) a still valid letter of intent or agreement for a transaction that has not been consummated was entered into with the same acquired person; or (2) assets were acquired from the same acquired person and are still held by the acquiring person. No aggregation is required if the earlier contemplated or consummated acquisition was reportable under the HSR Act.

- Reorganizations and reincorporations. The new Rules exempt the reincorporation, change in form of entity or formation of an upstream holding company by any existing entity, as long as two conditions are met: (1) no new assets will be introduced in connection with the reorganization; and (2) the percentage of interests that will be held by

an acquiring person in the new entity will be the same or less than the percentage of holdings in the original entity or the acquiring person already controlled the original entity prior to the reorganization.

- Acquisitions of interests in entities holding certain assets the acquisition of which is exempt. Current Rule 802.4 exempts an acquisition of voting securities if the acquired issuer holds non-exempt assets with a value not exceeding $53.1 million. New Rule 802.4 expands this exemption to apply not only to acquisitions of voting securities but also to acquisitions of controlling interests in unincorporated entities. Rule 802.4 is also broadened by expanding the categories of exempt assets to include any assets the direct acquisition of which would be exempt under §7A(c) of the HSR Act, Part 802 of the Rules or Rule 801.21. For example, A and B form a new corporation as an acquisition vehicle to acquire all of the voting securities of C. Each contributes $250 million in cash. Because all the cash is considered to be exempt under Rule 801.21, the new corporation does not have non-exempt assets valued in excess of $53.1 million and the acquisition of its voting securities by A and B is exempt under Rule 802.4. The acquisition of C by the new corporation may be separately reportable.

- Exempt acquisitions of certain non-corporate interests in certain financing transactions. New Rule 802.65 exempts acquisitions of non-corporate interests that confer control of a new or existing unincorporated entity if (a) the acquiring person is contributing only cash to the unincorporated entity; (b) for the purpose of providing financing; and (c) the terms of the financing agreement are such that the acquiring person will no longer control the entity after it realizes its preferred return.

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This memorandum constitutes only a general description of the recent HSR Act and Rules amendments. It is not intended to provide legal advice and no legal or business decision should be based on its contents. Any questions concerning the foregoing should be addressed to any of the following members of our Antitrust Group:

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APPENDIX A

Summary of Revised Jurisdictional Thresholds of the HSR Act and Rules

Relevant Section of HSR Act or Rules	Old Threshold	New Threshold
§7A(a)(2)(A) size of transaction test	$200 million	$212.3 million
§7A(a)(2)(B)(i) size of transaction test	$50 million	$53.1 million
§7A(a)(2)(B)(ii) size of parties test	$10 million	$10.7 million
§7A(a)(2)(B)(ii) size of parties test	$100 million	$106.2 million
§7A note -- filing fee thresholds*	$50 million $100 million $500 million	$53.1 million $106.2 million $530.7 million
Thresholds and limitation values in the Rules (16 C.F.R. Parts 801-803)**	$10 million $50 million $100 million $110 million $200 million $500 million $1 billion	$10.7 million $53.1 million $106.2 million $116.8 million $212.3 million $530.7 million $1,061.3 million

* The filing fee amounts, which are currently $45,000, $125,000 and $280,000, remain unchanged.

** The $200 million and $500 million limitations set forth in Rule 802.3 for acquisitions of certain carbon-based mineral reserves remain unchanged.

[i] 70 Fed. Reg. 4,987 (Jan. 31, 2005).

[ii] 70 Fed. Reg. 11,502 (Mar. 8, 2005).

[iii] 70 Fed. Reg. 5,020 (Jan. 31, 2005).

[iv] The HSR Act requires the parties to certain mergers and acquisitions to file notification of the proposed transaction with the FTC and the Department of Justice (the "DOJ") and wait a specified period of time (usually 30 days) after filing before consummating the transaction. Generally, filings are required, unless an exemption applies, when one person with total assets or sales of $10.7 million or more contemplates engaging in a transaction with another person with total assets or sales of $106.2 million or more and the transaction will result in the buyer's holding more than $53.1 million and up to $212.3 million of the voting securities or assets of the seller or when, regardless of the sales and assets of the parties, one person contemplates engaging in a transaction with another person and the transaction will result in the buyer's holding more than $212.3 million of the voting securities or assets of the seller.

[v] Formal interpretation No. 15 treats as potentially reportable the formation of an LLC if (1) two or more pre-existing, separately controlled businesses will be contributed, and (2) at least one of the members will control the LLC. The formation of all other LLCs is treated similar to the formation of a partnership which is not reportable. This interpretation will be repealed on the effective date of the new Rules.

[vi] Current Rule 802.30 provides that "an acquisition … in which, by reason of holdings of voting securities, the acquiring and acquired persons are … the same person, shall be exempt from the requirements of the act."

[vii] The value of the assets of the new entity includes all assets which any person contributing to the formation of the new entity has agreed to transfer to the new entity and any amount of credit or any obligations of the new entity which any person contributing to the formation has agreed to extend or guarantee.