



ORIGINAL



ASSOCIATION YEAR
2003-2004

CHAIR

Kevin E. Grady
One Atlantic Center
1201 W. Peachtree Street, NW
Atlanta, GA 30309-3424

CHAIR-ELECT

Richard J. Wallis
1 Microsoft Way
Redmond, WA 98052-6399

VICE-CHAIR

Donald C. Klawiter
1111 Pennsylvania Avenue, NW
Washington, DC 20004-2541

SECRETARY

William L. Greene
Minneapolis, MN

COMMITTEE OFFICER

Kathryn M. Fenton
Washington, DC

FINANCE OFFICER

Barbara O. Bruckmann
Washington, DC

INTERNATIONAL OFFICER

William Blumenthal
Washington, DC

PROGRAM OFFICER

Joseph Angland
New York, NY

PUBLICATIONS OFFICER

James A. Wilson
Columbus, OH

SECTION DELEGATES

Janet L. McDavid
Washington, DC

Allan Van Fleet
Houston, TX

IMMEDIATE PAST CHAIR

Robert T. Joseph
Chicago, IL

COUNCIL MEMBERS

Stephen W. Armstrong
Philadelphia, PA

Calvin S. Goldman
Toronto, ON

Ilene Knable Gotts
New York, NY

James E. Hartley
Denver, CO

Roxann E. Henry
Washington, DC

Robert M. Langer
Hartford, CT

Jeffrey A. LeVee
Los Angeles, CA

William C. MacLeod
Washington, DC

M. Howard Morse
Washington, DC

Kevin J. O'Connor
Madison, WI

Debra J. Pearlstein
New York, NY

Keith D. Shugarman
Washington, DC

Richard M. Steuer
New York, NY

Patricia M. Vaughan
Washington, DC

Theodore Voorhees
Washington, DC

JUDICIAL REPRESENTATIVE

Hon. Diane P. Wood
Chicago, IL

DEPARTMENT OF JUSTICE REPRESENTATIVE

Hon. R. Hewitt Pate
Washington, DC

NAAC REPRESENTATIVE

Patricia A. Conners
Tallahassee, FL

FTC REPRESENTATIVE

Hon. Timothy J. Muris
Washington, DC

BOARD OF GOVERNORS REPRESENTATIVE

Blake Tartt
Houston, TX

YOUNG LAWYERS DIVISION REPRESENTATIVE

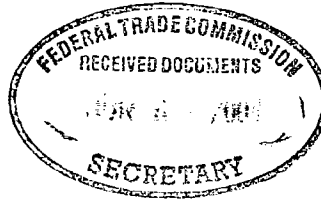
Matthew Bye
Washington, DC

SECTION DIRECTOR

Joanne Travis
Chicago, IL

(312) 988-5575
FAX: (312) 988-5637
travisj@staff.abanet.org

AMERICAN BAR ASSOCIATION



June 3, 2004

BY OVERNIGHT MAIL

Donald S. Clark, Esq.
Federal Trade Commission
Office of the Secretary, Room H-159 (Annex E)
600 Pennsylvania Avenue, N.W.
Washington, DC 20580

Re: HSR Proposed Rulemaking, Project No. P989316

Dear Mr. Clark:

On behalf of the Section of Antitrust Law of the American Bar Association (the "Section"), I am pleased to submit the following comments on the proposed changes to the rules and regulations implemented pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act" or the "HSR rules") announced by the Federal Trade Commission (the "Commission") on March 30, 2004 (the "proposed rules"). These views are not being presented by the House of Delegates or the Board of Governors of the American Bar Association ("ABA") and should not be construed as representing the position of the ABA.

The proposed rules would go a long way to reconciling the disparate treatment of acquisitions of interests in incorporated and unincorporated entities. For the first time in the history of the HSR Act, acquisitions of control but less than 100 percent of a partnership would be reportable and limited liability companies would be treated similarly.

The Section supports the Commission's stated goal -- "to reconcile, as far as is possible, the current disparate [HSR] treatment of corporations, partnerships, limited liability companies and other non-corporate entities." Because the HSR Act is designed to facilitate enforcement of Section 7 of the Clayton Act, and because under Section 7 there is no meaningful distinction between or among the forms of joint venture entities or entities in general, there should not be a meaningful distinction under the HSR Act either, absent some overriding concern. The current disparate treatment is a function of numerous factors, including the evolving use and nature of non-corporate entities and previous Commission attempts to limit its review of such entities so as not to capture too many antitrust-neutral transactions.

The Section also supports most of the Commission's proposed rule changes. As the first attempt at improved harmonization of the treatment for all entities, the proposed rules are grounded in improved logic with due regard for administrability and the undeniable structural differences between and among entities. The proposed rules are therefore better able to serve the goals of Section 7 enforcement than the current rules and interpretations. Similarly, to the extent that the proposed rules reduce anomalies and logical inconsistencies, they can also be said to promote HSR Act compliance, for illogical rules can promote inadvertent violations.

The Section has considered whether such changes are necessary, always mindful of the law of unintended consequences when it comes to regulatory burdens. It believes, however, that change is desirable here. The current rules are in need of change, at least to the extent that they cannot be explained logically. The Commission itself has noted that unease: at least three times in the history of its HSR rulemaking -- in 1978, 1987, and 1999 -- the Commission noted some of the anomalies in the treatment of non-corporate entities and suggested it might revisit the issue in the future.

The strongest theoretical argument against changing the rules is that the new rules will increase significantly the reporting of antitrust-neutral transactions. To that extent we note the Commission has sought to address some of those concerns through certain expanded exemptions -- including expanded versions of the intraperson and underlying-exempt-assets exemptions (respectively, proposed § 802.30 and § 802.4). Perhaps the most significant new exemption is in proposed § 802.65, exempting effective "financing transactions" cast as formations of unincorporated entities. (See comments below). The Commission has made an effort to establish expanded exemptions that may offset the increased jurisdictional reach of the proposed rules. Still the Section is concerned that the proposed rules may result in a significant increase in the number of filings. Nonetheless, we endorse generally the proposed rules but suggest the Commission commit to review in two years whether the number of new filings generated by the proposed rules that do not raise substantive antitrust issues is greater than anticipated, or disproportionate from an enforcement perspective. If so, the Section recommends that the Commission revisit the rules to address this increased burden.

In the following discussion, the Section provides an overview of the proposed rules and generally sees much that is positive. However, the Section provides particular comment on three issues where the Section either disagrees with the Commission's analysis or believes there are ways to improve the current proposal: (1) calculation of the 50 percent profit/asset test; (2) the proposed financing exemption of § 802.65; and (3) the Commission's statistical estimate of increased filings anticipated from enactment of the proposed rules.

Reportability of Unincorporated Entity Transactions

Under the current HSR rules and interpretations, interests in unincorporated entities are not regarded as either “assets” or “voting securities.” *See* 16 C.F.R. § 801.1(f)(1); Interpretation 73, ABA SECTION OF ANTITRUST LAW, PREMERGER NOTIFICATION PRACTICE MANUAL 93-94 (3d ed. 2003). Thus, acquisitions and other transfers of interests in unincorporated entities such as partnerships and limited liability companies (“LLCs”) are reportable in only limited circumstances.

The core of the proposed rules is that acquisitions of controlling interests in unincorporated entities (including partnerships and LLCs) will be treated as acquisitions of the entities’ assets. The proposed rules thus attempt to reconcile the analysis of non-corporate transactions which the FTC has established over its more than a quarter-century of experience in applying the HSR regulations, principally through the process of issuing informal guidance on transactions involving both partnerships and LLCs, but also in the form of Formal Interpretation 15 (“FI 15”), which currently governs reporting of LLCs. Most of the proposal consists of well-tried concepts. The acquisition of 100 percent of the interests in a partnership has long been treated as the acquisition of 100 percent of the entity’s assets; the acquisition of control at the 50 percent threshold has been used as a trigger point for the reporting of LLC interests since the introduction of FI 15. The proposed rules combine these principles into a new and coherent form.

The proposed rules go far, not only to reconcile the treatment of partnerships and LLCs, but also to reconcile the treatment of all non-corporate transactions, with the treatment of corporate transactions. As we discuss at greater length below, the proposed rules would greatly lessen the number of transactions in which the outcome of the HSR filing analysis varies according to the legal form of the entities involved. Certain differences certainly remain: a fundamental conceptual distinction, for example, is that the acquisition of minority interests in a non-corporate entity is never reportable (*see* FI 15), whereas the acquisition of minority corporate interests in excess of \$50 million is still subject to HSR reporting requirements, unless certain exemptions apply.¹

¹ Because HSR treatment of corporations and unincorporated entities would differ in this and other significant respects under the proposed rules, it may be advisable for the FTC to further clarify what defines a corporate, as opposed to a non-corporate, entity. Foreign jurisdictions in particular offer many variations of legal entities that are not obviously corporate in nature. The FTC’s current informal position is that an entity is a corporation if it has a board of directors in which at least one member is not an officer of the entity; the Section recommends that the Commission at least describe this test in the commentary to the proposed rules. The Commission should also clarify how the new rules will apply to foreign unincorporated entities. *Cf.* Interpretation 177, ABA SECTION OF ANTITRUST LAW, PREMERGER NOTIFICATION PRACTICE MANUAL 218-19 (3d ed. 2003) (Formal Interpretation (“FI”) 15 does not apply to foreign LLCs).

But the better reconciliation of the treatment of unincorporated entities with that of incorporated entities is long overdue.

16 C.F.R. § 801.1(f)

The proposed rules would extend HSR reporting obligations to a broad array of acquisitions of “non-corporate interests.” As defined, a “non-corporate interest” is “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.”² See 16 C.F.R. § 801.1(f)(1)(ii) (proposed Mar. 30, 2004). An “unincorporated entity” is any legal entity which is not in corporate form, but which is capable of holding assets and generating profits; however, proposed rule 801.1(f)(1)(ii) only defines this term by giving a non-exclusive list: “partnership, LLC, cooperative, business trust or other unincorporated entity”³ *Id.* Although it might have been better to provide a definitive list of entities that would now be covered by these proposed rules, the Section understands the Commission’s need to be expansive in order that some other unforeseen innovation in non-corporate form does not fall between the cracks of HSR analysis as the LLC has done in the past.

16 C.F.R. § 801.1(b)

Under the proposed rules, the formation of unincorporated entities and the acquisition of non-corporate interests could be reportable if, by reason of the formation or acquisition, the acquiring person would hold an aggregate total value of the unincorporated entity’s interests in excess of \$50 million and would obtain “control” of the unincorporated entity. “Control” of an unincorporated entity would be defined as the right to receive at least 50 percent of the unincorporated entity’s profits or at least 50 percent of the unincorporated entity’s assets upon dissolution. See 16 C.F.R. § 801.1(b) (proposed Mar. 30, 2004). The proposed rules would therefore eliminate the second or alternate test for “control” – that is, the right to designate 50 percent or more of an unincorporated entity’s governing board – and eliminate the vexing problem of determining whether an unincorporated entity’s governing board “exercise[es] similar functions” to a corporate board of directors. This 50 percent test generally is clear and provides business certainty, and for the most part will be easy to administer. The Section concurs with this modification, noting that the proposed rule teases out the

² It would be helpful if the Commission could clarify that the term “non-corporate interests” is not meant to include debt interests such as working capital loans, bonds, and other forms of debt instruments.

³ Notably, the term “unincorporated entities” already appears without definition in current HSR rule § 801.1(b)(2).

elements that apply best to corporations from those that apply best to unincorporated entities, resulting in a conceptually cleaner pair of two-pronged control tests.⁴

It is important to note, however, that the Statement of Basis and Purpose (“SBP”) at page 17 (commentary to proposed § 801.50) modifies the control test for unincorporated entities by providing that if the profit distribution is undetermined at the time of formation, the residual assets test will be the sole determinant of control. This is a significant modification of the basic control test, and introduces some complexity into the analysis. In light of the role of the 50 percent test as an HSR reporting threshold, this is a critical part of the overall proposal and ought to be spelled out in the text of the rules, rather than simply mentioned in the SBP.

The Section notes that the Commission’s proposed approach -- relying on the residual assets test when the profit distribution is undetermined -- may require more thought.⁵ It is true that future profit distribution in an unincorporated entity is often subject to a formula based on variables that cannot be determined at the time of filing. It also happens that the rights to the entity’s residual assets may be allocated under a formula based on undetermined variables. An ambiguity arises when both the profits and residual assets are undetermined at the time of formation. One possibility is that in such a situation, the entity would be deemed to be its own ultimate parent entity. The Section recommends that the Commission provide additional guidance and clarification on this point.

16 C.F.R. § 801.2(f)

Under proposed § 801.2(f)(1), an acquiring person who, as a result of the proposed transaction, would obtain control of that unincorporated entity, would be treated as acquiring 100 percent of the unincorporated entity’s assets. This is the key

⁴ The Section is aware that two Committees of the ABA Section of Business Law (the Committee on Partnerships and Unincorporated Business Organizations and the Venture Capital and Private Equity Committee) are concerned that this modification will cause the “control” test to be met in some transactions in which an investor holds or acquires a passive interest without other traditional indicia of control (e.g., limited partnership investments). These Committees believe that in some circumstances, the modified rules will impose a filing obligation on the holder of an interest in an unincorporated entity even though a substantively identical transaction in corporate form would not trigger a filing. For this reason, these Committees believe it would be appropriate for the Commission to consider creating additional exemptions or broadening the § 802.65 exemption to avoid unnecessary filings where an unincorporated entity is structured so as to separate “control” from economic rights.

⁵ The Section believes it would also be helpful if the Commission could give more guidance with respect to the question of when a value is “undetermined.” The concept of an undetermined value is already significant to HSR analysis under existing § 801.10, which requires a fair market valuation be made if there is an undetermined acquisition price; however, the Commission has never clarified what level of uncertainty in acquisition price will render it “undetermined.”

conceptual provision of the FTC's proposed rules regarding unincorporated entities: non-corporate interests granting control are transformed by this rule into assets, and thus this rule resolves the quandary that because non-corporate interests are neither assets nor voting securities, they are outside the reach of the HSR Act.

This concept is not a new one. Indeed, the longstanding informal position of the FTC has been that the acquisition of 100 percent of the interests (not just control) in an unincorporated entity amounts to the acquisition of 100 percent of that entity's assets. However, having that transmutation occur only when 100 percent of the interests are held results in the current situation where the acquisition of 95 percent of a \$3 billion partnership is a non-reportable transaction. The proposed rule would shift reportability from the time when the unincorporated entity's assets are deemed to have been acquired to the moment when control of the unincorporated entity shifts, which is clearly a more appropriate moment for review of the antitrust implications of the transfer.

16 C.F.R. § 801.10(d)

Proposed § 801.10(d) supplies the complementary aspect of the new analysis by providing that the value of the acquired non-corporate interests would be the acquisition price of those interests, or if the acquisition price is undetermined, the fair market value ("FMV") of those interests. Thus the HSR size-of-transaction would be the aggregate value of the non-corporate interests held by the acquiring person; it will not be the value of 100% of the unincorporated entity's assets, even though the transaction is conceptualized under proposed § 801.2(f)(1) as an asset acquisition. The proposed rule better aligns with business reality and expectations: it does away with the need for HSR practitioners to explain to their clients why the acquisition of the last 1% of a partnership may be treated for HSR purposes as being many times more valuable than the interests being acquired. (For example, under the current rules, if the last 1% interest in a partnership with \$100 million in assets were being acquired for \$10 million, that \$10 million transaction, lacking any substantive antitrust effects and seemingly well under the HSR reporting threshold, would not only be reportable but would require a \$125,000 HSR filing fee.) It makes intuitive sense to a businessperson that the value of a transaction is its purchase price; therefore, compliance with this rule will be much clearer.

16 C.F.R. § 801.50

The formation of an unincorporated entity would be governed by proposed § 801.50, which states that the acquisition of control of the newly-formed entity would be a potentially reportable event, so long as the \$10 million/\$100 million HSR size-of-person tests are met by the newly-formed entity and the acquiring person. This leaves

exempt the formation of a partnership or an LLC where no person acquires 50% or more of the interests, a category of transaction which the FTC has already determined is unlikely to raise antitrust concerns.⁶

Conforming Rules

The bulk of the proposed rule changes are logical extensions of the core concept, *i.e.*, that the acquisition of control of an unincorporated entity is treated as a reportable acquisition of the assets of the unincorporated entity, although valued at the value of the non-corporate interests being acquired. In particular, many of the new rules extend exemptions and limitations on reportability into the unincorporated entity context, so that as far as possible these interests are analyzed in a fashion parallel to the analysis of corporate acquisitions. The Section generally approves of the good sense intentions of these changes.⁷

As already discussed, proposed § 801.50 would create a scheme for reporting the formation of unincorporated entities, so long as the size of person tests were met, that closely parallels the workings of existing § 801.40, governing formation of corporations; with the important distinction that only controlling interests are reportable in a non-corporate formation. By way of logical extension of this concept, as well as a logical extension of an existing corporate exemption, proposed § 802.41 would exempt the newly-formed corporate or non-corporate entity in either a § 801.40 or § 801.50 transaction from filing as an acquired person.⁸

⁶ This determination is implicit in the FTC's assumption in FI 15 that only transactions conferring control of LLCs should be reportable.

⁷ The Section also notes with approval a handful of the proposed rules that would institute purely technical fixes to the existing rules, and are essentially unrelated to the core concept of making the acquisition of non-corporate interests reportable. These include proposed § 802.2(g), which would correct an unintended effect of the shift from SIC to NAICS codes that had technically made the acquisition of timberland non-reportable. Proposed § 801.13(b), is designed to "correct a drafting oversight" in the original HSR rules: the new rule would aggregate assets from an earlier acquisition with the current acquisition, whether or not the earlier acquisition had closed. Also in this category is the revision of § 801.15, which the Statement of Basis and Purpose also describes as correcting a "drafting omission": this would require aggregation of foreign assets and foreign voting securities to determine whether a transaction had the requisite nexus with U.S. commerce.

⁸ Other examples of exemptions through logical extension of corporate treatment include proposed § 802.10(b) (codifying the exemption of pro-rata corporate reorganizations, and extending the exemption to unincorporated entities); and proposed § 802.40 (exempting the acquisition of both corporate and non-corporate not-for profit entities). The Section supports the proposed changes to § 802.10 as they will eliminate the fairly common class of HSR filings in which partners must file to report their acquisition of voting securities when their partnership is converted into a corporation.