

801-11

Verne, B. Michael

From: [REDACTED]
Sent: Tuesday, June 10, 2008 5:15 PM
To: Verne, B. Michael
Cc: [REDACTED]
Subject: HSR Size of Person Question

Mike,

This email is a more detailed follow-up on a size of person question I initially raised with you on the telephone last week. Set forth below is an outline of the structure I am considering and my preliminary analysis. I would be grateful for your advice as to whether I am on the right track.

Structure and Background

- A. Natural Person M controls Corporation A by virtue of ownership of 100% of the voting shares of Corporation A.
- B. Corporation A has regularly prepared financial statements, indicating revenues and assets of approximately \$25 million at April 30, 2008.
- C. Corporation A will contribute substantially all of its assets to New LLC and initially obtain 100% of its membership interests.
- D. Private Equity Fund will then invest cash for debt of, and a minority equity stake in, New LLC. Corporation A will continue to control New LLC.
- E. New LLC will acquire substantially all of the assets of, or the equity of, Target LLC (exact price and structure to be determined but size of transaction test will be satisfied).
- F. Target LLC is not controlled by any other entity and is its own UPE.
- G. Target LLC has a regularly prepared income statement and balance sheet indicating annual net sales and total assets of between \$12.6 and \$126.2 million.
- H. Natural Person M and New LLC do not have regularly prepared financial statements.

Size of the Person Test

1. To satisfy the size of person test, generally, either the acquiring or acquired person must have annual net sales or total assets of \$126.2 million or more and the other must have annual net sales or total assets of \$12.6 million or more.
2. As its own UPE with regularly financial statements, the size of Target LLC would be determined by reference to those financial statements.
3. The size of the UPE, Natural Person M, would be determined by creating pro forma financial statements that would include, without duplication, (i) investment assets, voting securities and other income-producing property of Natural Person M immediately prior to the transaction, (ii) the assets indicated on Corporation A's last regularly prepared balance sheet at the values set forth in such balance sheet at April 30, 2008, and (iii) the assets of New LLC immediately prior to the transaction.

Issues/Questions

- a. In preparing a combined pro forma balance sheet for Natural Person M, Corporation A and New LLC under Section 801.11(b)(1), as of what date are their assets tested? Corporation A's assets would presumably be determined as of April 30, 2008 (or its last regularly prepared balance sheet date). Would we determine the assets of Natural Person M and New LLC as of a time immediately prior to the transaction, or should these be determined as of April 30, 2008, *i.e.*, the date of the regularly

prepared balance sheet with which the assets will be consolidated under Section 801.11(b)(1)?

b. Assuming the assets of Newco LLC are determined as of a time immediately prior to the transaction, is there a basis on which to exclude, in a manner similar to that which would apply under Section 801.11(e), the cash invested by Private Equity Fund immediately prior to the acquisition of Target LLC, substantially all of which will be used for acquisition expenses and purchase price?

Preliminary Analysis

i. If and to the extent applicable, Section 801.11(e) would permit deduction of the cash invested by Private Equity Fund to be used in the acquisition.

ii. However, Interpretation No. 139 in ~~ABA~~ SECTION OF ANTITRUST LAW, PREMERGER NOTIFICATION PRACTICE MANUAL (4th ed. 2007) suggests that the "pass-through" rule of Section 801.11(e) would not apply, as does Informal Staff Opinion No. 0605019 (<http://www.ftc.gov/bc/hsr/informal/opinions/0605019.htm>).

iii. The Editor's Note to Interpretation No. 134 of the Premerger Notification Practice Manual seems consistent with the view that there is a bright line rule that precludes application of the pass through rule of Section 801.11(e) if there is a regularly prepared balance sheet for any entity within the acquiring or acquired person. In other words, no entity within the UPE gets the benefit of the pass through rule if any entity within that person has a regularly prepared balance sheet.

iv. On the other hand, Interpretation No. 133 suggests in more general terms that in preparing a pro forma balance sheet, cash used in the acquisition may be deducted.

Tentative/Preliminary Conclusion

x. The assets of Natural Person M and New LLC would be tested immediately prior to the transaction. The assets of Natural Person M and New LLC so determined would be added to the assets of Corporation A as set forth on and as of the date of its regularly prepared balance sheet. In so doing, the pass-through rule of Section 801.11(e) would not apply. The cash invested by Private Equity Fund would therefore be counted under Section 801.11(b)(1) as part of the UPE's assets even if invested 1 hour before the transaction.

y. Possibly, some of the cash invested by Private Equity Fund might be excluded if Private Equity Fund requires that its funds be wired directly to Target LLC or its equity owner if one follows the reasoning in Informal Staff Opinion No. 9911008 (<http://www.ftc.gov/bc/hsr/informal/opinions/9911008.htm>). That letter describes an alternative scenario pursuant to which loan proceeds were to be paid directly to the seller and were not held at any time by the acquiring person, and in that case, the loan proceeds were not required to be included in the acquiring person's pro forma pre-acquisition balance sheet. Could the alternative scenario set forth in Informal Staff Opinion No. 9911008 apply here or does that alternative apply only in the case of a funding by a commercial bank lender? If such alternative scenario might apply, what conditions are there to its application?

- a. The assets of M and New LLC would be determined as of a time immediately prior to the transaction, not April 30, 2008.
 - b. There is no basis for excluding the cash to be used for the acquisition because you are under 801.11(b) not 801.11(e)
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- x. Correct
 - y. If the cash is transferred directly to seller not to Newco LLC, it would not be included in M's pro forma balance sheet. New LLC could not hold the funds prior to the acquisition. Another quirky application of the rule is that if the cash from the private equity fund was transferred to A rather than New LLC, and A paid seller, you would not include the cash on M's pro forma balance sheet, unless A produced a new regularly prepared balance sheet prior to the transaction that showed the cash from Private Equity Fund.

BM
6/11/08