

801.1 (b)

Verne, B. Michael

From: [REDACTED]
Sent: Friday, April 15, 2011 9:37 AM
To: Verne, B. Michael
Subject: HSR Analysis Question

Mike:

I hope all is well. Please let me know whether my analysis of the transaction described below is correct.

Facts:

Two companies, E (our client) and MC, want to create a Newco LLC that will acquire and invest in two related businesses, H LLC and T LLC. The acquisition would be effected in three related contemporaneous transactions.

In Transaction 1, E and MC would create a Newco LLC ("Newco") and Opco LLC ("Opco"), a wholly owned subsidiary of Newco. E would contribute \$45 million in cash to Newco and MC would contribute \$26 million in cash to Newco. In exchange Newco will issue three classes of membership interests, both preferred and common. Class A units are preferred membership interests and are divided into A-1 and A-2 units. A-1 units are senior to A-2 units. Class B, and Class C units are common membership interests. E would receive 60% of the Class A units (in the form of A-1 units), and MC would receive 40% of the Class A units (in the form of A-1 and A-2 units) and 100% of the Class B units. The Class C units would be distributed to the management of Newco.

In Transaction 2, the owners of H LLC and T LLC, two affiliated LLC's, would contribute all of H LLC's and T LLC's outstanding membership interests to O, a newly created LLC in exchange for membership interests in O.

In transaction 3, Newco would acquire all of H LLC's and T LLC's membership interests from O for \$60 million in cash (less the amount of outstanding debt assumed) and a potential earn-out of up to \$30 million over five years.

Distributions from Newco would be made pursuant to a waterfall arrangement, whereby the A-1 and A-2 preferred membership interests are paid first, before holders of common class B and Class C interests receive anything. Specifically, the A-1 holders would be entitled to an 8% cumulative preferred return and repayment of their contributed capital, and then the A-2 holders would receive the same preferred rate of return and repayment of their contributed capital. Once the Class A holders received this initial rate of return, any proceeds would then be split among all three membership classes. First, 70% of any proceeds from Newco would be distributed to the Class A holders, 17.5% would be distributed to the Class B holders and 12.5% would be distributed to the Class C holders, until the Class A holders received an aggregate amount equal to 2 times their invested capital. Thereafter, 43.75% of any proceeds from Newco would be distributed to the Class A holders, 43.75% would be distributed to the Class B holders, and 12.5% would be distributed to the Class C holders, until the Class A holders received an aggregate amount equal to 5 times their invested capital. Thereafter, Class A holders would be entitled to 17.5% of any proceeds, Class B holders would receive 70% of any proceeds, and Class C holders would receive 12.5% of any proceeds.

Analysis:

Stage 1 – E has no HSR filing obligation because the formation of Newco is exempt under 802.4 because Newco does not hold non-exempt assets with an aggregate fair market value greater than \$66 million (the current HSR filing threshold).

Stage 2 – E has no involvement with the formation of O and has no filing obligation. The owners of H LLC and T LLC may have a filing obligation if the formation of O is not exempt.

Stage 3 – Newco’s acquisition of H LLC’s and T LLC’s membership interests from O for \$60 million in cash (less assumed debt) and up to a \$30 million earnout is likely reportable if the fair market value of the transaction is \$66 million or more. Assuming that both the size of transaction and the size of person tests were met, the question is who controls Newco. It is our understanding that the payment of preferred units is considered debt and is thus not considered when determining who controls Newco. Indeed, a non-corporate interest is defined as a right to profits or assets upon dissolution after payment of its debts. In this case, because Newco will not be making regular profit distributions, the appropriate test for control focuses on whether any one person or entity would have the right to 50% of the assets of Newco upon dissolution. The waterfall arrangement described above, indicates that after all of the Class A holders preferred rights are paid, the Class B holders would have the right to 70% of any remaining proceeds. Therefore, we believe that MC (not E) will control Newco, and E does not have an HSR filing obligation. MC will have a HSR filing obligation if the fair market value of the transaction is \$66 million or more and no exemptions apply.

Best,

*Agree -
Bar
4/18/11*

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