

801-11(e)

Verne, B. Michael

From: [REDACTED]
Sent: Thursday, October 25, 2012 12:39 PM
To: Verne, B. Michael; Walsh, Kathryn
Subject: Question re: 801.11(e) / "Continuum Principle"

Mike and Kate,

I wanted to run a couple of scenarios by you concerning the application of 801.11(e) and the so-called "continuum principle."

New Fund, a new private equity fund, will form a Newco LLC ("Newco"), which will acquire LLC1 and LLC2 as a result of one transaction. LLC1 and LLC2 are affiliates and are under common control of the same two ultimate parent entities. The size-of-transaction is less than \$263.8 million. The transaction may be structured in any of the ways outlined below (for legitimate business purposes related to consummating the investment, and not to avoid HSR). New Fund is exploring possible co-investors, and under two possible scenarios, no one will control Newco, while under another scenario, a co-investor may have a controlling interest in Newco at closing (but immediately after closing, would have a non-controlling interest in Newco).

- (1) Newco, LLC may be its own ultimate parent entity at the time of the acquisitions because no one individual or entity will have the rights to 50% or more of the profits or 50% or more of the assets upon dissolution. Newco will not have a regularly prepared balance sheet. Per 801.11(e), Newco will not meet the size-of-person threshold because it will not have revenue, nor will it have at least \$13.6 million in net assets once you eliminate the cash on hand to make the acquisition. Although it is acquiring two entities from the same Acquired Person, both acquisitions will occur at the same closing in the proverbial blink-of-an-eye. In theory, Newco may meet the size-of-person threshold after the first acquisition is consummated, but prior informal interpretations suggest that this would all be looked at as one acquisition to which 801.11(e) would apply (and Newco will not meet size-of-person in the moment between the first acquisition closing and the second acquisition occurring). See <http://ftc.gov/bc/hsr/informal/opinions/8705005.htm> (applying 801.11(e) to multiple acquisitions from the same Acquired Person).
- (2) Alternatively, another private equity investor ("Co-Investor") may also invest in Newco and take a controlling interest in Newco immediately prior to Newco making its acquisition, *i.e.*, at the same closing as Newco's acquisition of LLC1 and LLC2. The following events will happen nearly simultaneously at the same closing: (a) Co-Investor will take a controlling interest in Newco; (b) Newco will acquire LLC1 and LLC2; (c) and the Acquired Persons will roll their equity in LLC1 and LLC2 into equity in Newco such that once the transaction(s) are consummated, Co-Investor will not have a controlling stake in Newco, and Newco will be its own ultimate parent entity. If you apply the "continuum principle" to look through all the intermediate steps, Newco will be its own ultimate parent entity with no regularly prepared balance sheet, no revenues, insufficient assets to meet the size-of-person threshold, and will hold the interests of LLC1 and LLC2 as a result of the transaction. In substance, it is similar to the scenario outlined in #1 above, although the form may be different, and thus the analysis should have the same outcome.
- (3) Alternatively, instead of Co-Investor taking its stake in Newco first, the Acquired Persons may take their interests in Newco, then Co-Investor takes its stake in Newco, then Newco acquires LLC1 and LLC2. In this scenario, before, during, and after the consummation of the transaction, Newco is its own ultimate parent entity with no regularly prepared balance sheet, no revenues, and insufficient assets to meet the size-of-person threshold. Under this scenario, the analysis would be no different than in the scenario outlined in #1 above.

Please advise if you agree with the analysis above, or if you need additional detail. As always, thank you in advance.

Best,
[REDACTED]

We are fine with 1 and 3, but we have problems with 2. We don't think we can ignore the fact that at the time of the acquisition of the two LLCs, Co-investor will control Newco. By definition it will be diluted to a non-controlling interest **after** it acquires the LLCs. Also, the continuum principle cannot be used when the ultimate step is not reportable.

Bm
10/26/12

K. WALSH. CONCURS