

Verne, B. Michael

801.1 (b)

From: [REDACTED]
Sent: Monday, April 22, 2013 12:36 PM
To: Verne, B. Michael
Subject: LLC "Control"

Mike,

I have a question about determining who the UPE of an LLC is.

A1, a financial investor, and A2, the managing member, formed OpCo LLC last year ago to build, and then operate, a power generation facility. When construction was completed, an additional investor, B, invested in the OpCo LLC. Neither the formation nor the subsequent investment were reportable. As is typical with these types of LLCs, the parties have established highly complex rules about both (i) how available cash is periodically distributed, and how tax attributes (income, loss, deduction and credit) are allocated, among the members and (ii) and how LLC assets are distributed among the members upon dissolution. Pursuant to a purchase option that was established in the original transaction, A2 now would like to purchase a portion of A1's membership interests. The value of the interests held as a result of the transaction is likely greater than \$70.9 million.

We are interested in evaluating whether control would be transferred as part of this transaction. Based on what follows, it is rather difficult to tell whether the acquisition of the interests would confer control. It's conceivable that under some scenarios, it could.

Regarding who is entitled to profits, at the end of any given month, immediately before the transaction A1 is entitled to 51% of available cash (after LLC operating costs and expenses) and A2 is entitled to 49%. After the transaction, A1 would be entitled to 25% of the available cash and A2 would be entitled to 75%. B would be allocated to 99% of the LLC's tax attributes both before and immediately after the transaction, some of which are quite valuable (e.g. renewable energy credits, depreciation). These distribution and allocation rules are stipulated in the LLC agreement to change or "flip" several times in the future after the transaction is completed.

Upon dissolution, which of the members receives 50 percent or more of the assets depends on the value of the LLC's assets. B is entitled to an amount sufficient to achieve an agreed rate of return on its investment. A1 and A2 get the rest, pro rata based on the percentages above (before the transaction 51%/49%, and after the transaction 25%/75%). If the value of the LLC's assets have appreciated significantly since December, or if the aggregate initial investment amounts significantly undervalued the LLC's assets, it is theoretically possible that A2 would be entitled to more than 50% of the assets upon dissolution after the transaction is completed. Under what appear to be more likely asset valuation scenarios, A2 would not be entitled to more than 50% of the assets upon dissolution after the transaction is completed.

Do you believe that A2 is acquiring control by virtue of its acquisition of A1's interests? And, how do you figure out who "controls" when, at any given moment, any of the three parties could "control" under the assets-upon-dissolution test?

Also, I note some remarks made suggesting that once an LLC reaches a "flipping point," the "flip" may be reportable. I'm also not sure how one would report the "flip." Once the flip has occurred, any further transfer of interests would have to be evaluated with the member as the new UPE with no immediately accruing duty to notify, or would the flip itself, which could happen at any particular moment without any real notice (e.g., upon the receipt of a large check from a customer), be the event that needs to be anticipated and notified?

Thanks for your help,

A2 is acquiring a controlling interest in the LLC. Rights to profits are variable, but rights to assets upon dissolution are fixed (A1 – 51% and A2 – 49% pre-acquisition) and (A1 – 25% and A2 – 75% post-acquisition). Paying out B's return on investment prior to making the distributions to A1 and A2 do not constitute B receiving assets upon dissolution as a result of holding non-corporate interests, but payment of the LLC's debt. See below:

Discussion in column 3 at page

11504: <http://www.ftc.gov/os/fedreg/2005/march/050308premergerruleandreg.pdf>

Also, see language of §801.1(f)(1)(ii) – definition of non-corporate interest:

(ii) *Non-corporate interest.* The term “non-corporate interest” means an interest in any unincorporated entity which gives the holder the right to any profits of the entity or in the event of dissolution of that entity the right to any of its assets **after payment of its debts.**

BN

4/24/13

KW concurs