

§ 7A(c)(10)
802.10



March 27, 1995

VIA TELECOPIER

John M. Sipple, Jr.
Chief, Premerger Notification Office
Bureau of Competition
Federal Trade Commission
6th Street and Pennsylvania Avenue N.W.
Washington, D.C. 20580

AID

Dear Mr. Sipple:

This is a written exposition of the matter that you and I discussed by telephone on March 24, 1995, with regard to the scope of the exemption set forth in Section 7A(c)(10) of the Clayton Act (the "Act") and 16 C.F.R. § 802.10.

Facts

Company X has four classes of voting securities that are currently entitled to vote in the election of directors: Class A Common, Class B Common, Series 1 Preferred and Series 2 Preferred. Collectively, the Class A Common and Class B Common represent 99.7234% of the total number of shares with voting rights and 99.378% of the voting power.¹

X is considering a special distribution of stock (the "Distribution"), to be made on a pro rata basis to the holders of its Class A Common and Class B Common. Holders of Class A Common would receive shares of Class AA Common and holders of Class B Common would receive shares of Class BB Common. The distribution ratio will be the same for holders of both classes of common. The exact ratio has not yet been fixed, but it will probably be in the range of one share of newly distributed stock for each three to four shares currently owned. No fractional shares will be distributed; in lieu thereof, the holders will receive cash.

¹ The reason these percentages are not precisely equivalent is that one class of X's common stock and one series of its preferred stock enjoy weighted voting power.

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Neither the holders of the Series 1 Preferred nor the holder of the Series 2 Preferred will participate in the Distribution at this time (although if the holder of the Series 2 Preferred later exercises his right of conversion into Class A Common, he will then also receive shares of Class AA Common commensurate with the conversion ratio). Because X's preferred stock will not participate in the Distribution, the voting power of X's common shareholders will be very slightly affected.

By virtue of a 1994 restructuring of X, several of X's principal shareholders and senior managers recently filed as acquiring persons under the Act with respect to their holdings of X's voting securities, and all of those individuals and entities crossed the respective HSR thresholds at which they had filed. Regardless of whether the 7A(c)(10) exemption is deemed to apply to the Distribution, none of those holders will be required to file again, as the Distribution would only marginally increase their percentage ownership of X's voting securities and certainly would not advance any of them to anywhere near the next reporting threshold.

ATD

There are two individuals who are officers or directors of X and who hold voting securities of X having a current market value in the neighborhood of \$15 million. Because each of these individuals holds common stock of X, each would participate in the Distribution, and each now faces a likelihood of having to file under the Act unless the 7A(c)(10) exemption is deemed to apply. One of these individuals presently holds .2021135% of X's voting securities. As a result of the Distribution, he will hold approximately .2023157% to .2023664% of X's voting securities. In other words, the increase in his holding of X's voting securities will be between about .0002022% and .0002529%. Expressed decimally rather than percentagewise, the change will be between about .000002022 and .000002529 of X's voting securities. The other individual now has .0606264% of X's voting securities and stands to have between about .06068762% and .0607029% after the Distribution. In his case, the increment would be between .00006122% and .0000765%. Expressed decimally, the projected increase would be between .0000006172 and .000000765 of X's voting securities.

All other large shareholders of X of whom X is aware have relied on the exemptions set forth in 16 C.F.R. § 802.64 and/or 16 C.F.R. § 802.9 when X has carried out a potentially reportable restructuring or rights offering in the past. Thus, such shareholders would in all likelihood not face a reporting obligation with respect to the Distribution, whether or not the 7A(c)(10) exemption is deemed to apply.

Discussion

You indicated that the staff of the Premerger Notification Office had previously addressed the question of fractional shares and had determined that the distribution of cash in lieu

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of fractional shares would not negate the applicability of the 7A(c)(10) exemption, notwithstanding the (minuscule) changes in relative voting power effected thereby.

Apparently, the Premerger Notification Office has not heretofore been asked to consider the applicability of the exemption when there is a pro rata distribution to holders of voting common stock but the holders of a *de minimis* quantity of voting preferred stock do not participate in the distribution. From anecdotal evidence and observation, I believe that a significant number of companies have capital structures analogous to X's. It is not unusual, I believe, for an acquiring company to finance an acquisition by issuing preferred stock of the acquirer to the sellers. In order to qualify the transaction for tax-free treatment under Section 368 of the Internal Revenue Code, such preferred stock must be vested with voting rights. Such voting rights are likely to be relatively insubstantial in relation to the overall voting power held by the acquirer's shareholders, as the purpose of the voting rights is primarily to meet the criteria for tax-free treatment and only secondarily to obtain voting rights with respect to the acquirer.

I suspect (but have no means of proving) that many companies have declared stock splits and stock dividends in reliance on the 7A(c)(10) and 802.10 exemptions without noting the potential significance under the Act of the collateral effect of the split or dividend upon the voting rights of preferred stock not participating therein.

The Premerger Notification Office is respectfully asked to conclude that X and its shareholders may regard the proposed Distribution as one that falls within the ambit of Section 7A(c)(10) and Section 802.10 and hence that the Distribution may be carried out without giving rise to any reporting obligation under the Act.

If you would like any further information, or any elaboration on the matters discussed, please let me know, and I will respond promptly. Thank you very much for your consideration.

Sincerely,
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[REDACTED] told requester that under the facts of this case, in which the preferred holders have .27% of the outstanding voting securities, the pro rata stock distribution to the holders of common stock is exempt under § 802.10 and § 7A(c)(10).