

6 801.40 [LLC formation]



October 2, 1996

Via Facsimile 202 326-2624

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PREMERGER NOTIFICATION OFFICE  
FEDERAL TRADE COMMISSION

Re: HSR Reportability of Limited Liability Company Formation

Dear Dick:

I am writing to confirm the understanding I gained from our telephone conversation of the morning of Friday, September 13. The conversation concerned the circumstances under which the formation of a limited liability company ("LLC") is reportable under the Hart-Scott-Rodino Antitrust Improvements Act (the "HSR Act" or "the Act") and encompassed a number of letters addressed to you on that subject. I also want to present to you my understanding of another HSR letter which we did not discuss.

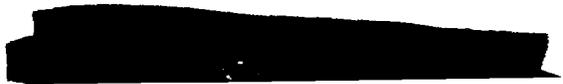
Our September 13 conversation included the following points:

1. When a contemplated transaction meets certain other threshold requirements<sup>1</sup>, the HSR Act requires persons intending to acquire "voting securities" to file notification of their intention with the Federal Trade Commission.<sup>2</sup> The Act defines voting securities as "any securities which at present or upon conversion entitle the owner or holder thereof to vote for the election of directors of the issuer or, with respect to unincorporated issuers, persons exercising similar functions."<sup>3</sup> Limited liability companies are

<sup>1</sup>These other requirements are the Commerce Test of 16 C.F.R. §801.40(d), the Size of Person Test of 16 C.F.R. §801.40(b)(1)-(2), and the Size of Transaction Test found at 15 U.S.C. §18a(a)(3).

<sup>2</sup>15 U.S.C. § 18a(a). See also 16 C.F.R. § 801.40(b).

<sup>3</sup>15 U.S.C. § 18a(b)(3)(A).



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unincorporated. Thus, whether the formation of an LLC is a reportable event depends on whether the LLC members receive interests entitling the members to vote for or otherwise select a decision-making body that is functionally equivalent to a board of directors.

2. When a proposed transaction involves an LLC and the LLC contains a decision-making body that is even arguably a board equivalent, your office uses a two-step analysis to determine reportability. The first step involves the identity of the persons who serve on that putative board equivalent. If all those persons will necessarily be:

- a. members of the LLC, or
- b. in the case of an LLC member that is an organization, directors, officers, or employees of the organization serving on the putative board equivalent as representatives of the organization.

then no board equivalent exists. In contrast, if the putative board equivalent includes any outsider -- i.e. someone who is neither a member nor a director, officer or employee of a member -- then your office proceeds to the second step of its analysis.

3. That second step considers whether the putative board equivalent performs functions normally associated with a corporate board. Board-equivalent functions include setting policies and goals, approving mergers and acquisitions, and superintending overall operations. Running an LLC's day-to-day operations does not involve board-equivalent functions.

4. Voting securities are involved only if the putative board equivalent includes "outsiders" and performs board equivalent functions. As a result, and because your office looks first at the "outsider" issue, your office reaches the second step of the analysis only when a putative board equivalent exists and "outsiders" are to be present on the board equivalent.

5. A letter addressed to you, dated November 20, 1995, involved an LLC with an "advisory board" possessing the authority to resolve deadlocks between the two corporate LLC members. The advisory board also had the power to remove the LLC's CEO. The handwritten comments on the letter indicate that the advisory board was not deemed to be a board equivalent at least in part because it lacked the *exclusive* power to remove the CEO, a power a corporate board usually does hold exclusively. I mentioned to you that, according to the letter, the advisory

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board had the power to resolve deadlocks between the two members and therefore in practice might hold ultimate management power. You explained that, be that as it may, the power to resolve deadlocks between shareholders is not ordinarily a function of a corporate board. Accordingly, the advisory board's power to resolve deadlocks between the members was no reason to characterize the advisory board as a board equivalent. You also said that this situation was a "close call" at the time your office considered the letter, but that you still believed that this LLC's formation was not a reportable event.

I also would like to confirm with you my understanding of another letter written to your office -- one that we did not discuss in our September 13 telephone conversation. That letter was addressed to you, dated January 2, 1996, and involved the formation of an LLC by a non-profit foundation and another organization. The LLC was to be governed by a board of governors, with some of the governors appointed by each member. While the foundation member could appoint to the board only officers, directors, or employees of the foundation, the other organization was able to appoint outsiders. The handwritten comments on this letter indicate that the transaction was not reportable because only one of the parties involved would be receiving voting securities. I infer that this conclusion rested on 16 C.F.R. § 802.30. I would like to confirm that my inference is correct. I would also like know if the Premerger Notification Office Staff still views as non-reportable the formation of an LLC in which only one member receives voting securities.

I very much appreciate the time you spent discussing this matter with me, and I hope that this letter states a correct understanding of our September 13 conversation and of the letter dated January 2, 1996. I will telephone you in a few days to make sure that I have properly understood this matter.

Since



*10/7/96 - Advised writer that I agreed with her conclusions and analysis except for the analysis in the penultimate paragraph of the letter. Here, 801.40 requires that two former persons of the LLC take back voting stock. If only one does so (and voting stock includes convertible), then there is no reportable event under 801.40. Sec. 802.303 is not applicable to 801.40 by its specific language.*

*RBS*