WILMER CUTLER PICKERING
HALE AND DORR LLP

ANTITRUST AND COMPETITION LAW UPDATE

March 14, 2005

New HSR Reporting Rules for LLCs and Partnerships; FTC Announces Extensive Changes to HSR Regulations

The US Federal Trade Commission (FTC) has announced sweeping changes to Hart-Scott-Rodino (HSR) Act premerger reporting rules, including those governing transactions involving partnerships and LLCs, that will come into effect on April 6, 2005. *See* 70 Fed. Reg. 11526 (March 8, 2005).

In addition to reconciling the HSR analysis of LLCs, partnerships and other unincorporated entities with that of corporations, the new rules will make a number of technical adjustments and codify some informal FTC interpretations. The changes will make some transactions reportable that have historically be exempt; this effect will be offset to some extent by new exemptions from filing, most notably a significant expansion of the exemption for acquisitions of voting securities of entities whose assets would be exempt if acquired directly. We discuss all of these changes in more detail below.

LLCs, Partnerships and Other Unincorporated Entities

Under the new rules, any interest in an entity that is not a corporation that conveys either (i) the right to profits of the entity, or (ii) the right to any assets of the entity on its dissolution, is potentially subject to preacquisition reporting requirements. The concept of a noncorporate or "unincorporated" entity applies not only to all manner of partnerships and LLCs, but also to business trusts, cooperatives and any other entity whose ownership interests convey such rights. Because the HSR Act expressly applies only to acquisitions of assets or corporate voting securities, the acquisition of noncorporate interests can only be HSR-reportable if those interests are understood to convey control of assets. Therefore only an acquisition of "control" of a noncorporate entity (which presumably conveys control of the entity's assets) is reportable under the new rules.

Thus, the new rules provide that the following transactions are potentially subject to HSR:

- The formation of a new partnership, LLC or other unincorporated entity when at least one person will "control" the new entity. ("Control" of an unincorporated entity means having the right to at least (i) 50% of the entity's assets, or (ii) 50% of the entity's profits on dissolution.[1])
- The acquisition of interests in an existing unincorporated entity when the acquiring person will gain "control" of the entity as a result of the acquisition.

1. If either the right to profits or the right to assets on dissolution is variable, the right that is fixed will determine control; if both rights are variable, control will be determined as of the time of acquisition.

wilmerhale.com

Baltimore
Beijing
Berlin
Boston
Brussels
London
Munich
New York
Northern Virginia
Oxford
Waltham
Washington

- The consolidation of existing entities into a single unincorporated entity, when at least one person will end up with "control" of the resulting entity.

Such transactions will be subject to the same size-of-person and size-of-transaction thresholds that apply to acquisitions of assets or corporate interests. The value of an acquisition of noncorporate interests will be (i) the purchase price, if determined, or (ii) if the purchase price is undetermined, the fair market value of the interests being acquired.

The major distinction in the future between corporate acquisitions on the one hand, and LLC or partnership acquisitions on the other, is that in the latter case acquisitions of less than 50% will never be reportable regardless of their absolute value. Thus, for example, mergers of unincorporated entities such as law firms, accounting partnerships, or similar unincorporated service firms, will generally not be reportable under the new rules, because no one person will be acquiring "control" of the merged entity.

Reconciling Corporate And Noncorporate Reporting Obligations

Many of the other features of the new HSR rules are aimed at ensuring that treatment of acquisitions of entities that are not corporations conforms as closely as possible to treatment of corporations. For instance, the analysis and procedures governing newly-formed entities (as set forth in new Rule §801.50) is nearly identical to the existing rule governing newly-formed corporations. The following technical rules have each been expanded to apply to noncorporate as well as corporate acquisitions:

- The "secondary acquisition" rule, which requires a secondary HSR filing with regard to third-party voting securities held as assets of an acquired entity, if the notification thresholds are separately met.
- The "intra-person" exemption, which eliminates the need to file HSR for an acquisition when the acquiring person already controls the person from whom it is acquiring assets or additional voting securities.
- The "pro-rata reorganization" exemption, which states that transactions that do not change the pro-rate percentage of interests that any person holds in the acquired entity need not be reported.
- The "not for profit" exemption, which eliminates filing requirements when the acquired entity is not for profit with the meaning of certain provisions of the Internal Revenue Code.

Two New Exemptions: New Rules §802.4 and §802.65

New Rule §802.4 exempts from HSR reporting requirements acquisitions of interests in corporate or noncorporate entities when a direct acquisition of the the assets that the acquired entity holds would be exempt from notification under any provision of the rules or the HSR Act. This rule is an expansion of an existing exemption, which applied only to limited types of exempt assets; in its new form, the rule will potentially be a very significant factor in determining HSR reportability for almost every acquisition of corporate or noncorporate interests.

Under this new rule, *if an acquired entity holds any exempt assets, and the fair market value of the non-exempt assets held by the acquired entity is less than the $50 million (as adjusted[2]) HSR reporting threshold, the transaction is exempt.* Important categories of exempt assets include cash, certain holdings in real estate, and foreign assets or voting securities with a sufficiently limited nexus to the United States.

2. On March 2, 2005, all of the HSR thresholds were adjusted upward for inflation by 6.2 percent, so the size-of-transaction threshold is now $53.1 million.

The second new exemption, which addresses financing transactions that involve noncorporate interests, generated a great deal of excitement among HSR practioners during the notice-and-comment period, but may prove to have quite limited application in its final form. New Rule §802.65 exempts acquisitions of interests in unincorporated entities when (i) the acquiring person is contributing only cash in exchange for these interests, (ii) the purpose of the transaction is financing, and (iii) "the terms of the financing agreement are such that the acquiring person will no longer control the entity after it realizes its preferred return." In other words, the exemption applies to specialized financing arrangements when the acquiring person will be getting only a temporary right to 50% or more of the entity's profits or assets on dissolution, and will ultimately hold less than a controlling interest once it has recouped its initial investment.

Other Technical Changes

The FTC has taken the opportunity afforded by reworking the HSR rules to make many minor technical changes and corrections, several of which are of no great moment. These changes include the following:

- The real estate exemption has been amended to clarify that it does not apply to timberlands or other real property generating revenues from forestry or logging operations.
- The requirement that foreign voting securities and assets be aggregated when applying the foreign exemption rules (which the 2000 HSR rule amendments inadvertently eliminated) has been restored.
- The aggregation rules have been clarified to require that when aggregating previously acquired assets from the same seller, one must include pending transactions as well as those that have already closed.
- The profits/assets on dissolution test is no longer a factor for determining control of corporations.

Please contact any of us if you have any questions about these developments.

Berlin:

Ulrich Quack
ulrich.quack@wilmerhale.com

Boston:

James C. Burling
james.burling@wilmerhale.com

Brussels:

Claus-Dieter Ehlermann
claus-dieter.ehlermann@wilmerhale.com

John Ratliff
john.ratliff@wilmerhale.com

London:

Suyong Kim
suyong.kim@wilmerhale.com

Washington:

Douglas Melamed
doug.melamed@wilmerhale.com

William J. Kolasky
william.kolasky@wilmerhale.com

Janet Durholz Ridge
janet.ridge@wilmerhale.com