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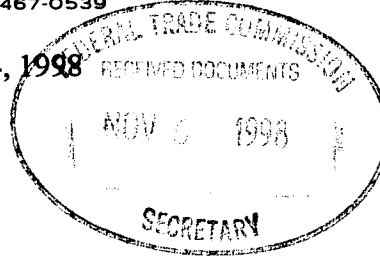
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FEDERAL TRADE
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Re: *Formal Interpretation Relating to Limited Liability Companies*

Dear Joe:

This letter constitutes my comments on the formal interpretation issued on October 13, 1998, relating to HSR Act treatment of certain transactions relating to limited liability companies (LLCs). I have some personal reservations about the complexity of the articulated analysis and the advisability of introducing a number of new concepts (e.g., bringing "businesses" under "common control," acquiring "interests" in non-corporate entities) with which parties to mergers and acquisitions will be generally unfamiliar. I also believe that the differences in treatment among corporations, partnerships and LLCs will make it more difficult for people to understand the overall reporting scheme, and therefore to comply with it.

On the other hand, if the Commission and the Antitrust Division wish to use the analytical methodology and resulting reporting requirements contained in the formal interpretation, I would respectfully urge (1) a substantially expanded explanation of the precise steps that need to be followed in order to determine whether an LLC transaction is reportable and (2) use of rulemaking as a vehicle for imposing these requirements.

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Rulemaking seems to me to have two advantages over reliance on a formal interpretation. First and most obvious, it could be more difficult to enforce a formal interpretation than a rule. Second, and perhaps more important, the exercise of actually drafting rules may help the Commission to state the requirements more precisely and to identify areas of ambiguity that require modification.

I have attempted to draft language for specific rules that would implement the formal interpretation as I understand it. Whether or not the Commission decides to employ rulemaking or to use any of this language, the Commission should consider clarifying any areas where these draft rules either conflict with, or fail fully to implement, the analysis and reporting obligations envisioned by the formal interpretation. These draft rules were reviewed by Tom Hancock and reflect a couple of suggestions made by him. I have not attempted to draft examples that might be embodied in the rules, or additional explanation that might be included in an accompanying statement of basis and purpose.

My proposed rules are as follows:

801.5 [new]. Acquisitions of certain interests in partnerships and limited liability companies.

(a) A person which, as a result of a transaction, will hold 100% of the partnership interests in a general or limited partnership is deemed to be acquiring all of the assets of the partnership in that transaction.¹

(b) A person which, as a result of a transaction, will hold 100% of the membership interests in a limited liability company ("LLC") is deemed to be acquiring all of the assets of the LLC in that transaction.

(c) A person which, as a result of a transaction, will acquire the right to 50% or more of the profits of an LLC or the right in the event of dissolution to 50% or more of the assets of the LLC is deemed to be acquiring all of the assets of the LLC in that transaction. The acquiring person shall be subject to the act if all or substantially all of the assets of two or more pre-existing operating units that were not controlled by the same person will, as a result of such transaction, be controlled by the same person.

¹ This provision is inserted to reflect the long-standing position of the Premerger Notification Office, implemented through informal interpretations issued by the FTC staff.

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801.41 [new]. Formation of Certain Limited Liability Companies.

(a) In the formation of an LLC as a result of which all or substantially all of the assets of two or more pre-existing operating units that were not controlled by the same person will be controlled by the same person, even though the persons contributing to the formation as members of such LLC and the LLC itself may, in the formation transaction, be both acquiring and acquired persons within the meaning of §801.2, the contributor members shall be deemed acquiring persons only, and the person within which the LLC is included shall be deemed the acquired person only.

(b) Unless exempted by the act or any of these rules, upon the formation of an LLC, in a transaction meeting the criteria of section 7A(a)(1) and (3) and paragraph (a) of this section, an acquiring person shall be subject to the act if:

- (1)(i) The acquiring person has annual net sales or total assets of \$100 million or more;
 - (ii) The LLC will have total assets or annual net sales of \$10 million or more; and
 - (iii) At least one other contributing member has annual net sales or total assets of \$10 million or more; or
-
- (2)(i) The acquiring person has annual net sales or total assets of \$10 million or more;
 - (ii) The LLC will have total assets or annual net sales of \$100 million or more; and
 - (iii) At least one other contributing member has annual net sales or total assets of \$10 million or more.

(c) An acquiring person subject to the act shall be deemed to be acquiring all of the assets of each operating unit that it did not control prior to the transaction but will control as a result of the transaction.

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(d) For purposes of paragraph (b) of this section and determining whether any exemptions provided by the act and these rules apply to its formation, the assets of the LLC shall include:

(1) All assets which any person contributing to the formation of the LLC as a member has agreed to transfer or for which agreements have been secured for the LLC to obtain from a contributor member at any time, whether or not such person is subject to the requirements of the act; and

(2) Any amount of credit or any obligations of the LLC which any person contributing to the formation as a member has agreed to extend or guarantee, at any time.

(e) The commerce criterion of section 7A(a)(1) is satisfied if either the activities of any acquiring person are in or affect commerce, or the person filing notification should reasonably believe that the activities of the LLC will be in or will affect commerce.

(f) (1) For purposes of this section, the term "operating unit" shall have the meaning defined in section 802.1(a) of these rules.

(2) Contribution of an interest in intellectual property which is exclusive against all parties including the grantor is the contribution of an operating unit, whether or not the intellectual property has generated any revenues.

802.30. Intraperson transactions.

[designate existing rule as subparagraph (a) and add the following:]

(b) An acquisition described in §801.5(b) of these rules shall be exempt from the requirements of the act if the acquiring person has previously filed notification pursuant to §801.5(c) for a transaction relating to the same LLC and such transaction has previously been consummated.

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802.41. [Insert the following underlined language in the caption to the rule:] Joint venture or other corporations and limited liability companies at time of formation.

[designate existing rule as subparagraph (a) and add the following:]

(b) Whenever any person(s) contributing to the formation of an LLC are subject to the requirements of the act by reason of §801.41, the LLC need not file the notification required by the act and §803.1.

Add the following underlined language to §803.10(a):

(2) In the case of the formation of a joint venture or other corporation covered by §801.40 or the formation of an LLC covered by §801.41, all persons contributing to the formation of the joint venture or other corporation or to the formation of the LLC that are required by the act and these rules to file notification. . . .

There was one issue raised by these draft rules (and by the formal interpretation) that I was unable to resolve. Draft rule 801.5(c) applies only to a person that acquires control of an LLC as a result of a "transaction." This is meant to distinguish a situation in which the profits of an LLC are distributed in tranches that, for example, confer a right to receive more than 50% of the LLC's profits on different members, depending upon the level of profits earned. If control of the LLC shifts by reason of an increase in its profits, the draft rule would not be triggered, because the person obtaining control would not have acquired control as a result of a "transaction." Use of the term "transaction" is meant to imply a deliberate transfer of membership interests as a result of agreement among some or all of the LLC members. The same issue could, of course, arise under a partnership structure.

I have one additional suggestion. It seems to me that the analytical methodology underlying the reporting requirements for formation of an LLC (and my draft rule 801.41) is sufficiently complicated to warrant a step-by-step explanation, that might look something like this:

1. Identify the forming members (presumably that's any person that, as a result of contributing something to the LLC, will have any right to any profits of the LLC or to any of its assets in the event of dissolution).
2. Determine the annual net sales and total assets of each contributing member.

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14. Determine the fair market value² of the assets of the operating unit which the acquiring person will control as a result of the formation (but did not control prior to the formation).

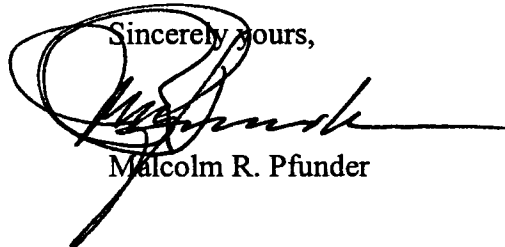
15. Determine whether any exemptions (e.g., the minimum dollar value exemption in rule 802.20(a)) apply.

16. Repeat steps 12 through 15 for each additional situation in which an acquisition of control of a pre-existing operating unit satisfies the reporting criteria.

17. The waiting period starts when all contributing members that are required to file notification as acquiring persons in connection with formation of the LLC do so; there are no "acquired person" filings.

Obviously, if you disagree with any aspect of my explanation, you might consider clarifying the formal interpretation to eliminate any confusion. I would be happy to discuss any of these comments with you or Tom or anyone else that may be interested.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'Malcolm R. Pfunder', written over the typed name below it.

Malcolm R. Pfunder

MRP/mrp

WA983080.055/1+

² I understand the staff takes the position that in this situation there is no "acquisition price" within the meaning of rule 801.10(b).