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Federal Trade Commission
Office of the Secretary

RE: HSR Proposed Rulemaking, Project No. P989316

Ladies and Gentlemen:

This letter is submitted in response to the request for comments from the Federal Trade Commission (the "Commission"), on its proposed amendments to the Antitrust Improvement Act Rules (the "HSR rules") concerning Section 7A of the Clayton Act, as added by the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "Act").

We appreciate the opportunity to comment on the proposed amendment to the HSR rules, and look forward to working with the Commission and other relevant agencies, as the comments are reviewed. While we support the general approach taken by the Commission with respect to modifying existing rules and regulations concerning the application of the Act and the HSR rules to unincorporated entities, we respectfully request that the Commission fully consider the application of its proposed amendments so as not to unintentionally encumber the activities of those unincorporated entities which are truly free from antitrust concerns.

Background Information

In its published notice seeking comment,[1] the Commission properly noted the increase in the formation and use of unincorporated entities. Similar to the statistics reported by Delaware, California also noted comparable increases in the formation of unincorporated entities in 2002. According to the California Secretary of State, 35,274 limited liability companies and 4,902 limited partnerships were formed in 2002. While many of these unincorporated entities have undoubtedly been used to conduct business in lieu of the more traditional corporate structure, we have observed that the vast majority of such entities have instead been selected due to their suitability as passive investment vehicles. In particular, the venture capital community has

[1] As published in the Federal Register, 69 FR 18686, dated Thursday, April 8, 2004.

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traditionally employed limited partnerships and limited liability companies as part of its investment structure. As such, we are concerned that an overbroad application of the HSR rules to all unincorporated entities, regardless of an entity's actual purpose, would subject entities to meaningless antitrust review, and needlessly tie up the Commission's assets is responding to such reviews.

Proposed Exemption

As currently drafted, the proposed amendments would adjust the 'control test' so as to apply to any individual who has the right to acquire 50% of the assets of an unincorporated entity. In addition, such reporting could be required in connection with the formation of such an entity. We do not believe that the formation and operation of a bona fide passive investment vehicle causes any concern for review, particularly when the other transactions (such as the investment vehicle's acquisition of an operating entity's securities or an investment vehicle's distribution of such securities to its underlying investors) would presumably remain subject to premerger reporting. The current exemptions for persons involved in pure investment transactions[2] do not fully cover the formation of a venture capital organization, particularly since such exemptions are available only if a person holds less than 10% of the voting securities of an issuer. Often, an early investor in a venture capital organization may hold more than 50% of a partnership's interests until additional investors are subsequently admitted.[3] As such, the proposed amendments would inadvertently expose a class of persons engaged in bona fide venture capital investing to unnecessary federal regulation and non-meaningful antitrust review.

At first glance, proposed § 802.65 would appear to address the concerns regarding the capitalization of investment vehicles. However, as currently drafted, this provision would not adequately provide relief to the majority of private equity funds. First, not all investors are admitted to an unincorporated investment entity upon the entity's formation. Often, the sponsor of an unincorporated investment fund may have the flexibility to admit new investors up to twelve or eighteen months following formation. Second, investments are not always made "in the ordinary course" of an investor's business. Provided such an acquisition is made for bona fide passive investment purposes, there should be no concern as to an investor's underlying business objectives. Third, not all investment vehicles incorporate the concept of a preferred return. This is a highly negotiated term, and many private equity funds provide for a invariable allocation of profits and losses. Fourth, an acquiring person, may, in fact, be seen as competing with such an investment vehicle. Certain institutions may not only invest in private equity funds, but may also invest directly in portfolio companies. Such competition for investments should not invalidate an otherwise valid exemption from HSR notification requirements.

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[2] See, for example, 15 U.S.C. § 18(a)(c)(9) and 16 C.F.R. § 802.9.

[3] In addition, such passive investment exemptions are inapplicable since the Commission currently holds that partnerships cannot have "voting securities" as defined in the Act. Furthermore, the exemption provided by § 802.4 may not apply if an existing venture capital organization has already acquired portfolio company securities prior to the admission of the acquiring person in question. Due to the relationship between a venture capital organization and its portfolio companies, the venture capital organization may be required to count its portfolio companies as "entities it controls" for purposes of the § 802.4 calculation, and could likely exceed the $50 million if forced to aggregate the assets of such entities. Likewise, the application of § 802.30 would provide no applicable relief.

Provided an exemption for bona fide venture capital investors is sufficiently narrow in scope, there should exist no concern that such vehicles could be used to circumvent the premerger notification requirements of the Act. We believe that a transaction by a passive investor in an unincorporated entity should be exempt from the Act, and propose that an additional section to the HSR rules be provided as follows:

§ 802.XX Exempt acquisition in a bona fide investment vehicle:

In a transaction to which § 801.50 applies, an acquisition of non-corporate interests that confers control of an unincorporated entity is exempt from the notification requirements of the Act if:

(a) Such unincorporated entity relies on the exception provided by either section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 so as not to be deemed an 'investment company' thereunder;[4]

(b) The acquiring person in question contributed only cash in return for its investment in such unincorporated entity; and

(c) The acquiring person to which the Act and HSR rules would otherwise apply is not, and is not affiliated with, a person involved with the day to day operations of such unincorporated entity (which for a partnership shall include the general partner, and for a limited liability company shall include a manager).

Thank you very much for the opportunity to comment on this important matter. If you have any questions concerning these comments, or if we can be of assistance in connection with this matter, please do not hesitate to contact me at the number indicated above.

Very truly yours,

Sean Caplice

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[4] In lieu of (or in addition to) this subsection (a), a more narrow provision may be adopted such that the proposed exemption applies only to bona fide venture capital organizations: "Such unincorporated entity is, at all times, a 'venture capital operating company,' as such term is defined in subsection (d) of 29 CFR 2510.3-101 (the Department of Labor's definition of "plan assets" – plan investments)."