Comment #: 9

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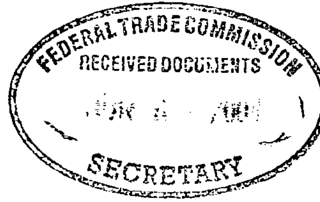

June 3, 2004

BY OVERNIGHT MAIL

Donald S. Clark, Esq.
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Office of the Secretary, Room H-159 (Annex E)
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Washington, DC 20580

Re: HSR Proposed Rulemaking, Project No. P989316

Dear Mr. Clark:

On behalf of the Section of Antitrust Law of the American Bar Association (the "Section"), I am pleased to submit the following comments on the proposed changes to the rules and regulations implemented pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act" or the "HSR rules") announced by the Federal Trade Commission (the "Commission") on March 30, 2004 (the "proposed rules"). These views are not being presented by the House of Delegates or the Board of Governors of the American Bar Association ("ABA") and should not be construed as representing the position of the ABA.

The proposed rules would go a long way to reconciling the disparate treatment of acquisitions of interests in incorporated and unincorporated entities. For the first time in the history of the HSR Act, acquisitions of control but less than 100 percent of a partnership would be reportable and limited liability companies would be treated similarly.

The Section supports the Commission's stated goal -- "to reconcile, as far as is possible, the current disparate [HSR] treatment of corporations, partnerships, limited liability companies and other non-corporate entities." Because the HSR Act is designed to facilitate enforcement of Section 7 of the Clayton Act, and because under Section 7 there is no meaningful distinction between or among the forms of joint venture entities or entities in general, there should not be a meaningful distinction under the HSR Act either, absent some overriding concern. The current disparate treatment is a function of numerous factors, including the evolving use and nature of non-corporate entities and previous Commission attempts to limit its review of such entities so as not to capture too many antitrust-neutral transactions.

The Section also supports most of the Commission's proposed rule changes. As the first attempt at improved harmonization of the treatment for all entities, the proposed rules are grounded in improved logic with due regard for administrability and the undeniable structural differences between and among entities. The proposed rules are therefore better able to serve the goals of Section 7 enforcement than the current rules and interpretations. Similarly, to the extent that the proposed rules reduce anomalies and logical inconsistencies, they can also be said to promote HSR Act compliance, for illogical rules can promote inadvertent violations.

The Section has considered whether such changes are necessary, always mindful of the law of unintended consequences when it comes to regulatory burdens. It believes, however, that change is desirable here. The current rules are in need of change, at least to the extent that they cannot be explained logically. The Commission itself has noted that unease: at least three times in the history of its HSR rulemaking -- in 1978, 1987, and 1999 -- the Commission noted some of the anomalies in the treatment of non-corporate entities and suggested it might revisit the issue in the future.

The strongest theoretical argument against changing the rules is that the new rules will increase significantly the reporting of antitrust-neutral transactions. To that extent we note the Commission has sought to address some of those concerns through certain expanded exemptions -- including expanded versions of the intraperson and underlying-exempt-assets exemptions (respectively, proposed § 802.30 and § 802.4). Perhaps the most significant new exemption is in proposed § 802.65, exempting effective "financing transactions" cast as formations of unincorporated entities. (*See* comments below). The Commission has made an effort to establish expanded exemptions that may offset the increased jurisdictional reach of the proposed rules. Still the Section is concerned that the proposed rules may result in a significant increase in the number of filings. Nonetheless, we endorse generally the proposed rules but suggest the Commission commit to review in two years whether the number of new filings generated by the proposed rules that do not raise substantive antitrust issues is greater than anticipated, or disproportionate from an enforcement perspective. If so, the Section recommends that the Commission revisit the rules to address this increased burden.

In the following discussion, the Section provides an overview of the proposed rules and generally sees much that is positive. However, the Section provides particular comment on three issues where the Section either disagrees with the Commission's analysis or believes there are ways to improve the current proposal: (1) calculation of the 50 percent profit/asset test; (2) the proposed financing exemption of § 802.65; and (3) the Commission's statistical estimate of increased filings anticipated from enactment of the proposed rules.

Reportability of Unincorporated Entity Transactions

Under the current HSR rules and interpretations, interests in unincorporated entities are not regarded as either "assets" or "voting securities." *See* 16 C.F.R. § 801.1(f)(1); Interpretation 73, ABA SECTION OF ANTITRUST LAW, PREMERGER NOTIFICATION PRACTICE MANUAL 93-94 (3d ed. 2003). Thus, acquisitions and other transfers of interests in unincorporated entities such as partnerships and limited liability companies ("LLCs") are reportable in only limited circumstances.

The core of the proposed rules is that acquisitions of controlling interests in unincorporated entities (including partnerships and LLCs) will be treated as acquisitions of the entities' assets. The proposed rules thus attempt to reconcile the analysis of non-corporate transactions which the FTC has established over its more than a quarter-century of experience in applying the HSR regulations, principally through the process of issuing informal guidance on transactions involving both partnerships and LLCs, but also in the form of Formal Interpretation 15 ("FI 15"), which currently governs reporting of LLCs. Most of the proposal consists of well-tried concepts. The acquisition of 100 percent of the interests in a partnership has long been treated as the acquisition of 100 percent of the entity's assets; the acquisition of control at the 50 percent threshold has been used as a trigger point for the reporting of LLC interests since the introduction of FI 15. The proposed rules combine these principles into a new and coherent form.

The proposed rules go far, not only to reconcile the treatment of partnerships and LLCs, but also to reconcile the treatment of all non-corporate transactions, with the treatment of corporate transactions. As we discuss at greater length below, the proposed rules would greatly lessen the number of transactions in which the outcome of the HSR filing analysis varies according to the legal form of the entities involved. Certain differences certainly remain: a fundamental conceptual distinction, for example, is that the acquisition of minority interests in a non-corporate entity is never reportable (*see* FI 15), whereas the acquisition of minority corporate interests in excess of $50 million is still subject to HSR reporting requirements, unless certain exemptions apply.[1]

[1] Because HSR treatment of corporations and unincorporated entities would differ in this and other significant respects under the proposed rules, it may be advisable for the FTC to further clarify what defines a corporate, as opposed to a non-corporate, entity. Foreign jurisdictions in particular offer many variations of legal entities that are not obviously corporate in nature. The FTC's current informal position is that an entity is a corporation if it has a board of directors in which at least one member is not an officer of the entity; the Section recommends that the Commission at least describe this test in the commentary to the proposed rules. The Commission should also clarify how the new rules will apply to foreign unincorporated entities. *Cf.* Interpretation 177, ABA SECTION OF ANTITRUST LAW, PREMERGER NOTIFICATION PRACTICE MANUAL 218-19 (3d ed. 2003) (Formal Interpretation ("FI") 15 does not apply to foreign LLCs).

But the better reconciliation of the treatment of unincorporated entities with that of incorporated entities is long overdue.

16 C.F.R. § 801.1(f)

The proposed rules would extend HSR reporting obligations to a broad array of acquisitions of "non-corporate interests." As defined, a "non-corporate interest" is "an interest in any unincorporated entity which gives the holder the right to any profits of the entity or the right to any assets of the entity in the event of dissolution of that entity."[2] *See* 16 C.F.R. § 801.1(f)(1)(ii) (proposed Mar. 30, 2004). An "unincorporated entity" is any legal entity which is not in corporate form, but which is capable of holding assets and generating profits; however, proposed rule 801.1(f)(1)(ii) only defines this term by giving a non-exclusive list: "partnership, LLC, cooperative, business trust or other unincorporated entity"[3] *Id*. Although it might have been better to provide a definitive list of entities that would now be covered by these proposed rules, the Section understands the Commission's need to be expansive in order that some other unforeseen innovation in non-corporate form does not fall between the cracks of HSR analysis as the LLC has done in the past.

16 C.F.R. § 801.1(b)

Under the proposed rules, the formation of unincorporated entities and the acquisition of non-corporate interests could be reportable if, by reason of the formation or acquisition, the acquiring person would hold an aggregate total value of the unincorporated entity's interests in excess of $50 million and would obtain "control" of the unincorporated entity. "Control" of an unincorporated entity would be defined as the right to receive at least 50 percent of the unincorporated entity's profits or at least 50 percent of the unincorporated entity's assets upon dissolution. *See* 16 C.F.R. § 801.1(b) (proposed Mar. 30, 2004). The proposed rules would therefore eliminate the second or alternate test for "control" – that is, the right to designate 50 percent or more of an unincorporated entity's governing board – and eliminate the vexing problem of determining whether an unincorporated entity's governing board "exercise[es] similar functions" to a corporate board of directors. This 50 percent test generally is clear and provides business certainty, and for the most part will be easy to administer. The Section concurs with this modification, noting that the proposed rule teases out the

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2 It would be helpful if the Commission could clarify that the term "non-corporate interests" is not meant to include debt interests such as working capital loans, bonds, and other forms of debt instruments.

3 Notably, the term "unincorporated entities" already appears without definition in current HSR rule § 801.1(b)(2).

elements that apply best to corporations from those that apply best to unincorporated entities, resulting in a conceptually cleaner pair of two-pronged control tests.[4]

It is important to note, however, that the Statement of Basis and Purpose ("SBP") at page 17 (commentary to proposed § 801.50) modifies the control test for unincorporated entities by providing that if the profit distribution is undetermined at the time of formation, the residual assets test will be the sole determinant of control. This is a significant modification of the basic control test, and introduces some complexity into the analysis. In light of the role of the 50 percent test as an HSR reporting threshold, this is a critical part of the overall proposal and ought to be spelled out in the text of the rules, rather than simply mentioned in the SBP.

The Section notes that the Commission's proposed approach -- relying on the residual assets test when the profit distribution is undetermined -- may require more thought.[5] It is true that future profit distribution in an unincorporated entity is often subject to a formula based on variables that cannot be determined at the time of filing. It also happens that the rights to the entity's residual assets may be allocated under a formula based on undetermined variables. An ambiguity arises when both the profits and residual assets are undetermined at the time of formation. One possibility is that in such a situation, the entity would be deemed to be its own ultimate parent entity. The Section recommends that the Commission provide additional guidance and clarification on this point.

16 C.F.R. § 801.2(f)

Under proposed § 801.2(f)(1), an acquiring person who, as a result of the proposed transaction, would obtain control of that unincorporated entity, would be treated as acquiring 100 percent of the unincorporated entity's assets. This is the key

[4] The Section is aware that two Committees of the ABA Section of Business Law (the Committee on Partnerships and Unincorporated Business Organizations and the Venture Capital and Private Equity Committee) are concerned that this modification will cause the "control" test to be met in some transactions in which an investor holds or acquires a passive interest without other traditional indicia of control (e.g., limited partnership investments). These Committees believe that in some circumstances, the modified rules will impose a filing obligation on the holder of an interest in an unincorporated entity even though a substantively identical transaction in corporate form would not trigger a filing. For this reason, these Committees believe it would be appropriate for the Commission to consider creating additional exemptions or broadening the § 802.65 exemption to avoid unnecessary filings where an unincorporated entity is structured so as to separate "control" from economic rights.

[5] The Section believes it would also be helpful if the Commission could give more guidance with respect to the question of when a value is "undetermined." The concept of an undetermined value is already significant to HSR analysis under existing § 801.10, which requires a fair market valuation be made if there is an undetermined acquisition price; however, the Commission has never clarified what level of uncertainty in acquisition price will render it "undetermined."

conceptual provision of the FTC's proposed rules regarding unincorporated entities: non-corporate interests granting control are transformed by this rule into assets, and thus this rule resolves the quandary that because non-corporate interests are neither assets nor voting securities, they are outside the reach of the HSR Act.

This concept is not a new one. Indeed, the longstanding informal position of the FTC has been that the acquisition of 100 percent of the interests (not just control) in an unincorporated entity amounts to the acquisition of 100 percent of that entity's assets. However, having that transmutation occur only when 100 percent of the interests are held results in the current situation where the acquisition of 95 percent of a $3 billion partnership is a non-reportable transaction. The proposed rule would shift reportability from the time when the unincorporated entity's assets are deemed to have been acquired to the moment when control of the unincorporated entity shifts, which is clearly a more appropriate moment for review of the antitrust implications of the transfer.

<u>16 C.F.R. § 801.10(d)</u>

Proposed § 801.10(d) supplies the complementary aspect of the new analysis by providing that the value of the acquired non-corporate interests would be the acquisition price of those interests, or if the acquisition price is undetermined, the fair market value ("FMV") of those interests. Thus the HSR size-of-transaction would be the aggregate value of the non-corporate interests held by the acquiring person; it will not be the value of 100% of the unincorporated entity's assets, even though the transaction is conceptualized under proposed § 801.2(f)(1) as an asset acquisition. The proposed rule better aligns with business reality and expectations: it does away with the need for HSR practitioners to explain to their clients why the acquisition of the last 1% of a partnership may be treated for HSR purposes as being many times more valuable than the interests being acquired. (For example, under the current rules, if the last 1% interest in a partnership with $100 million in assets were being acquired for $10 million, that $10 million transaction, lacking any substantive antitrust effects and seemingly well under the HSR reporting threshold, would not only be reportable but would require a $125,000 HSR filing fee.) It makes intuitive sense to a businessperson that the value of a transaction is its purchase price; therefore, compliance with this rule will be much clearer.

<u>16 C.F.R. § 801.50</u>

The formation of an unincorporated entity would be governed by proposed § 801.50, which states that the acquisition of control of the newly-formed entity would be a potentially reportable event, so long as the $10 million/$100 million HSR size-of-person tests are met by the newly-formed entity and the acquiring person. This leaves

exempt the formation of a partnership or an LLC where no person acquires 50% or more of the interests, a category of transaction which the FTC has already determined is unlikely to raise antitrust concerns.[6]

Conforming Rules

The bulk of the proposed rule changes are logical extensions of the core concept, *i.e.*, that the acquisition of control of an unincorporated entity is treated as a reportable acquisition of the assets of the unincorporated entity, although valued at the value of the non-corporate interests being acquired. In particular, many of the new rules extend exemptions and limitations on reportability into the unincorporated entity context, so that as far as possible these interests are analyzed in a fashion parallel to the analysis of corporate acquisitions. The Section generally approves of the good sense intentions of these changes.[7]

As already discussed, proposed § 801.50 would create a scheme for reporting the formation of unincorporated entities, so long as the size of person tests were met, that closely parallels the workings of existing § 801.40, governing formation of corporations; with the important distinction that only controlling interests are reportable in a non-corporate formation. By way of logical extension of this concept, as well as a logical extension of an existing corporate exemption, proposed § 802.41 would exempt the newly-formed corporate or non-corporate entity in either a § 801.40 or § 801.50 transaction from filing as an acquired person.[8]

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[6] This determination is implicit in the FTC's assumption in FI 15 that only transactions conferring control of LLCs should be reportable.

[7] The Section also notes with approval a handful of the proposed rules that would institute purely technical fixes to the existing rules, and are essentially unrelated to the core concept of making the acquisition of non-corporate interests reportable. These include proposed § 802.2(g), which would correct an unintended effect of the shift from SIC to NAICS codes that had technically made the acquisition of timberland non-reportable. Proposed § 801.13(b), is designed to "correct a drafting oversight" in the original HSR rules: the new rule would aggregate assets from an earlier acquisition with the current acquisition, whether or not the earlier acquisition had closed. Also in this category is the revision of § 801.15, which the Statement of Basis and Purpose also describes as correcting a "drafting omission": this would require aggregation of foreign assets and foreign voting securities to determine whether a transaction had the requisite nexus with U.S. commerce.

[8] Other examples of exemptions through logical extension of corporate treatment include proposed § 802.10(b) (codifying the exemption of pro-rata corporate reorganizations, and extending the exemption to unincorporated entities); and proposed § 802.40 (exempting the acquisition of both corporate and non-corporate not-for profit entities). The Section supports the proposed changes to § 802.10 as they will eliminate the fairly common class of HSR filings in which partners must file to report their acquisition of voting securities when their partnership is converted into a corporation.

Some proposed rules which would logically extend parallel treatment to unincorporated entities will expand the reach of the HSR regulations. One example is proposed § 801.13(c), which would require the aggregation of non-corporate interests acquired in the same entity in multiple acquisitions.[9] Another example is proposed § 801.4, which would extend the secondary acquisition rule to make reportable acquisitions of an outside issuer's voting securities acquired in the course of the acquisition of an unincorporated entity. Proposed § 801.2(d) would codify the principle that consolidations of unincorporated entities (the combination of two or more unincorporated entities into a single entity) are reportable in the same way that consolidations of corporations are reportable, a position that has been taken informally for some time by the FTC.

As drafted, proposed § 801.2(d) singles out dual-listed company ("DLC") arrangements as reportable, although it is not immediately clear why this should be so.[10] The rule defines a DLC as an arrangement "under which two entities effectively combine their assets and operations by agreement." Contractual joint ventures have traditionally been considered to be outside the scope of the HSR regulations, because they do not involve acquisitions of assets or voting securities; the Section assumes but would ask the Commission to confirm that it does not intend to render reportable such contractual joint ventures. The proposed rule would, however, essentially redefine one category of contractual arrangement as a consolidation of non-corporate interests. The Section believes this is a significant conceptual development in the application of the HSR rules, and recommends that the Commission provide a more extended consideration and analysis in the SBP.

Expanded Exemptions

The rules discussed above are essentially logical extensions of the basic scheme of the proposed rules; they carry out the parallel treatment of corporate and non-corporate interests in various details of the HSR regulatory framework. Some extend corporate exemptions into the non-corporate scheme; some extend additional corporate

9 Notably, proposed § 801.13(c) would not require the aggregation of minority holdings of non-corporate interests, another important distinction between treatment of corporate and non-corporate interests in the proposed system.

10 In a DLC, two companies agree to combine their operations and cash flows, but retain separate shareholder registries and identities. The companies pay equal dividends to their shareholders, and shareholders have equivalent votes in the decisions regarding the two companies. The companies in the DLC are usually traded in different markets and different currencies, and their shares cannot be exchanged for each other. Companies often choose a DLC structure to (1) avoid capital gains tax obligations that result from conventional mergers; (2) retain each company's national identity (essentially avoiding the appearance of having one company take over the other); and (3) obtain better access to capital markets by maintaining listings in each market.

reporting requirements in the same way. The overall tendency of these rules is essentially neutral; given the basic premise that non-corporate interests should be made reportable, these proposed rules logically follow. However, the proposed rules also contain several significant exemptions that are intended to limit the overall reporting burden associated with this rule change. Although the Section supports the Commission's efforts to limit the burden the proposed rules may impose, the extent to which these new exemptions would reduce the number of reportable transactions is open to question, as discussed below with respect to the FTC's statistical analysis.

16 C.F.R. § 802.4

One significant new exemption for transactions involving traditional voting securities acquisitions as well as acquisitions of non-corporate interests is contained in revised § 802.4. Under the current rules, § 802.4 exempts the acquisition of voting securities in an entity whose assets, if acquired directly, would be exempt because of specific listed real property and ordinary course of business exemptions. Proposed § 802.4 would expand this principle to exempt acquisitions of voting securities or non-corporate interests if the assets of the entity would be exempt for any reason in an assets acquisition. For instance, non-US assets meeting the requirements of current § 802.50(a) would no longer count toward the $50 million threshold of proposed § 802.4.

This is a welcome and sensible expansion, because it relies on precisely the same reasoning as the current rule -- that is, if the FTC has determined that the acquisition of certain types of assets does not ordinarily require antitrust scrutiny, the same can presumably be said for any acquisition of interests in an entity whose value is comprised almost entirely of such assets. Indeed, the Section recommends that the Commission add additional examples to this rule given its significant implications.

16 C.F.R. § 802.30

Proposed § 802.30 would extend the intraperson exemption to acquisitions of non-corporate interests; but like proposed § 802.4, this revision has a more ambitious agenda than simply to ensure parallel treatment for corporations and unincorporated entities, in that it would fundamentally expand the application of the existing exemption to corporations. Existing § 802.30 defines "intraperson" to mean transactions in which the acquiring and the acquired person are the same "by reason of holdings of voting securities." This language has always proven something of an analytical difficulty, and through its narrow application has excluded several classes of transaction even where the acquired and acquiring persons are the same, so that there are not likely to be any serious antitrust concerns raised by the transfer. For instance, in a transaction between a corporation and a person holding the right to appoint more than 50% of the corporation's board of directors, the latter would be both an acquiring and an acquired

person, but since this identity is not "by reason of holdings of voting securities," the existing intraperson exemption would not apply. The proposed rule would extend the intraperson exemption for corporations into that situation. The Section believes that this application of the expanded intraperson exemption to both corporate and unincorporated entities would enhance the consistency of the application of the rules.[11]

There is, however, an apparent incongruity in one part of this proposed rule as drafted. Under proposed § 802.30(c), if A and B form a partnership and A contributes $51 million in assets to the new partnership in exchange for 51% of the new partnership interests, and B contributes only cash in exchange for 49% of the new partnership interests, no HSR filing would be required. However, there is an opposite outcome under nearly the same facts, if, rather than assets, A contributes over 50% of the voting securities of corporation C worth in excess of $50 million to the new partnership. Technically, this could be reportable because proposed § 802.30(c) only exempts assets contributed to new partnerships. The Section believes this incongruity could be resolved by extending proposed rule § 802.30(c) to voting securities of an issuer contributed by an acquiring person to a new entity, so long as the acquiring person controls the issuer before and after the contribution, and encourages the Commission to consider such an extension.

16 C.F.R. § 802.65

One significant new exemption is aimed specifically at acquisitions of non-corporate interests: proposed § 802.65 would reduce the number of "financing transactions" that are potentially reportable under the proposed rules. In discussions with the private bar during the drafting of these rules, and based on its experience administering different interpretations of LLC reportability, the FTC has identified financing transactions as a class of acquisition that does not ordinarily have any significant competitive effects. A financing transaction might be broadly defined as a transaction where the party acquiring control of a newly-created unincorporated entity is contributing only cash.[12] Existing FI 15 exempts certain such transactions via its requirement that a newly-created LLC "bring two or more pre-existing separately controlled businesses under common control," thus exempting the two-party financing

[11] The Section assumes but would ask the Commission to confirm that this revised intraperson exemption applies in a situation where a person currently controls an unincorporated entity even though it obtained control of such entity at a time when such an acquisition did not require an HSR filing.

[12] The SBP to FI 15 describes the sort of financing transaction the FTC had concluded was unlikely to raise competitive concerns: "In these transactions, a financial institution (or other party providing financing) in the ordinary course of its business contributes only cash or other financial assets and one other party contributes one or more operating units to a new LLC that the financial institution may control for HSR purposes, at least for a period of time." See FI 15 and Explanatory Material, (amended March 2001).

transaction where one party acquires control of a newly-created LLC in exchange for cash, and any businesses contributed to the LLC are controlled by the other LLC partner pre-acquisition.

However, the Section believes the proposed financing transaction exemption of § 802.65 is drafted too narrowly. The proposed exemption contains four conditions: (a) the acquiring person is contributing only cash; (b) the transaction is in the ordinary course of business for the acquiring person; (c) the acquiring person will "no longer control the entity after it realizes its preferred return"; and (d) the acquiring person and the new entity will not be competitors. The exemption is narrower than the existing LLC analysis permits, both in being limited to transactions that are made by a financial institution or institutional investor (or other entity for whom a financing transaction is in the "ordinary course of business"), and in being limited to arrangements that have what might be called an "evaporating control" provision.

Condition (b), requiring that the acquiring person make this transaction in its "ordinary course of business," appears to limit the availability of this exemption to purely financial investors, as opposed to business operators (although the possibility that the investor could be a direct competitor is also ruled out by condition (d)). The SBP does not discuss why this provision is necessary or desirable. As currently drafted, the proposed rules would appear to prevent a purely financial investor from taking advantage of this exemption if that investor had no previous history of business investment. The Section recommends that the Commission clarify its position by indicating what is meant by an investor acting in its "ordinary course of business."

It would seem that a transaction meeting conditions (a), (b), and (d) would already be very unlikely to raise serious antitrust concerns.[13] However; condition (c) limits the exemption still further to what might be called the "evaporating control" transaction, a relatively sophisticated form of financing transaction in which the financial investor will realize a preferred share of the profits until the initial investment is recovered, at which point the investor's profit share will sink back below 50%. This transaction is a subcategory of what might be called the "shifting control" transaction, wherein the allocation of the future profit stream is designed by contract to change over time.

The concept of "control" itself becomes somewhat confusing in this context. In the SBP to proposed § 802.65, the Commission explains why "evaporating control" is of less material concern than ordinary control by noting that "[a]lthough this right to

[13] In enacting FI 15, the FTC did not see fit to require that the financial investor's control disappear over time, although it observed at the time that some financing transactions are so structured. See footnote 12, *supra*.

profits constitutes control of the entity under Section 801.1(b), the investor has *no operational control* of the entity." [emphasis added] This commentary sounds as if the "evaporating control" required by the proposed rule is actually intended as a proxy for the absence of "operational control," with the thought being that a purely financial investor who will ultimately have only a minority interest in the entity is unlikely to have *de facto* control over the entity's business operations. However, under the proposed rule, it would theoretically be possible for a financial investor to have operational control of the unincorporated entity (e.g., by virtue of the right to appoint the board of directors; or alternatively, e.g., by a contractual right to directly participate in management decisions) and still take advantage of this exemption. Thus, the rule as drafted does not quite capture the sense of the discussion in the SBP. The SBP's invocation of "operational control" might be taken as a signal that the exemption would be applied more narrowly than the precise language of the proposed rule suggests. The Section urges the Commission to clarify this point. If the "evaporating control" requirement of condition (c) is meant as a proxy for the lack of "operational control," that concept needs a more extensive discussion and definition.[14]

As with the "ordinary course" requirement, the "evaporating control" requirement imposes restrictions on the availability of the financing transactions exemption more stringent than currently apply to the formation of LLCs under Formal Interpretation 15. Under the current interpretation, if an LLC is formed by the contribution of a business by one party, and the contribution of cash by the other party, that LLC formation is exempt regardless of the business in which the financial contributor normally operates, and regardless of whether the financial contributor will have a controlling interest in the new LLC. The Commission does not state in the SBP to the proposed rules that the existing arrangement has been unsatisfactory, or that it has allowed competitively problematic transactions to go unreviewed. In the absence of such a conclusion by the Commission, it appears to the Section that condition (c) is probably unnecessarily stringent, and possibly unnecessary, in that the remaining conditions of proposed § 802.65 would be adequate to prevent the exemption from being used in undesirable situations.

One remaining criticism of condition (c) is that it does not readily align with business expectations. In this sense, it reintroduces some of the arbitrary formalism that the proposed HSR rules were supposed to reduce. The Section believes the Commission should reconsider the way this exemption has been drafted in light of these

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[14] It is illustrative to compare EU merger law, which defines "control" as "the possibility of exercising decisive influence on an undertaking." Council Regulation (EEC) 4064/89, art. 3, 1997 O.J. (L 180). Without a precise shareholding or other measurable test, the concept of "control" becomes quite subtle and can only be decided on a case-by-case basis; this is not an approach that would be desirable to introduce into HSR analysis.

comments and urges the Commission to provide a clear and less formalistic approach to exempt these financing transactions from the reach of the proposed rules.

Finally, the Commission has not sought to define the term "competitor" as used in condition (d), which is already in current use in HSR analysis (e.g., in the Statement of Basis and Purpose for existing § 802.9). The Section believes that the Commission ought to clarify whether or not it intends that a financial institution should be permitted to use the exemption of proposed § 802.65 when it finances multiple LLCs that are participants in a single industry. In other words, it should be stated whether the intended result is that a financial investor with a temporary controlling interest in LLC1 should be able to claim the financing transaction exemption when it enters into a similar financial arrangement with LLC2, even though LLC1 and LLC2 are direct competitors.

Proposed Modifications to the HSR Notification and Report Form

The Commission has recognized that the HSR Notification and Report Form and its instructions will need to be conformed to the proposed rules, and has posted some revisions which will need to be implemented if the proposed rule changes occur. However, other instances of necessary revisions may arise in practice. We encourage the FTC to post any additional changes to the HSR form and the instructions in draft on its website on a continuing basis to provide practitioners with an ongoing opportunity to proffer comments and input before the amended notification and its instructions become effective.

The Effect of the Proposed Rules on Filing Obligations

In the Notice of Proposed Rulemaking, the Commission estimates that the proposed rule changes would result in a less than one percent increase (or an additional nine filings) in the number of transactions reported in 2003. *See* Premerger Notification; Reporting and Waiting Period Requirements, 69 Fed. Reg. 18,686 (proposed Mar. 30, 2004) (to be codified at 16 C.F.R. §§ 801-803). The Commission arrived at this estimate using public data and several assumptions it characterizes as "extremely conservative."

The Section notes that estimating the number of filings likely generated by the proposed rules is a thorny and intricate – if not impossible – task. There are no precise data available, and the Commission has done a good job of marshalling the facts and its experience to generate a reasonably sensible prediction. However, the Section believes that the Commission's estimate of a one percent increase could ultimately prove to be too low, as it is necessarily based on analytical assumptions that are difficult to verify.

Although, the Section – as noted above – endorses generally the Commission's efforts and the resulting proposed rules, the Section urges the Commission to commit to revisit the proposed rules after they have been in force for two years, to determine (i) the actual effect the revised rules have had on the number of reportable transactions; (ii) the competitive significance of transactions that have been made reportable by the revisions; and (iii) the degree of additional burden that the revisions have created for businesses subject to HSR regulations. The Section also urges, in the spirit of transparency, that the Commission make this analysis available publicly so the business community and practitioners can see what impact these changes have on filing obligations.

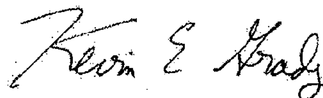
Conclusion

The Commission's proposal addresses a problem of long standing: the inconsistent treatment of corporations, partnerships, and LLCs. Overall, it is a sound proposal. As we have noted, some aspects of the proposed rules do call for further analysis and development, particularly the control test for unincorporated entities (proposed § 801.1(b), as modified by the SBP), and the limitations to the financing transactions exemption (proposed § 802.65). Whether the practical effect of the proposal will be to increase or decrease filings is unclear, and thus the Section recommends that the Commission commit to revisit the question of the impact of these proposed rules two years after their implementation.

The Section also appreciates the extensive effort by the Premerger Notification Office, and their colleagues at the Antitrust Division, in preparing the proposed rules. The agencies grappled long and hard with difficult issues, sought informal input from the private sector, and conducted considerable outreach with Section members, in a healthy pursuit of promulgating balanced, workable rules. .

We hope that the Commission will find these comments helpful in evaluating the proposed rules.

Sincerely,



Kevin E. Grady
Chair, Section of Antitrust Law
2003-04

cc: Marian Bruno, Assistant Director, FTC Premerger Notification Office