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**Verne, B. Michael**

**From:** [redacted]
**Sent:** Thursday, December 09, 2004 12:50 PM
**To:** Verne, B. Michael
**Subject:** LLC Formation / Exempt Asset Rules

Mike - this is to follow up on our call this morning regarding an LLC formation under the current rules and under the proposed rules relating to LLCs. Please let me know if you disagree or have questions on any of the analysis set forth below. Also, there is a small third participant that I did not mention this morning, and the dollar amounts / percentage ownership is a little different than we discussed, but I do not see how that would change the analysis.

FACTS.

* A, B and C intend to form a new LLC.
* A will contribute assets with a fair market value of $60 million (net asset value is $37 million, as there is $23 million in debt that will come with the assets). A will take an appx. 54% interest in the LLC.
* B will contribute assets with a fair market value of $37 million (net asset value is $23 million, as there is $14 million in debt that will come with the assets). B will take an appx. 36% interest in the LLC.
* C will contribute $8 million in cash, for an appx. 10% interest in the LLC.

CURRENT RULES

The only party with a potential reporting obligation is A, because it is the only party acquiring a 50% or more interest in the LLC. A is treated as acquiring B's assets. Since B's assets are valued at $37 million, the HSR size-of-transaction test is not satisfied, and no filing is required. Alternatively, if the parties used a partnership rather than an LLC, that also would not be reportable as partnership formation is not reportable. A does not have any reporting obligation for its "acquisition" of $8 million in cash from C.

PROPOSED RULES

Under the proposed new rules that you plan to send to the Commission shortly, the transaction also would not be reportable, but for different reasons. The bullets below paraphrase the text from the proposed rules from last March, but I understand based on our discussion this morning that the concepts are similar or identical in the rules that you propose to send to the Commission shortly.

* First, new rule 802.4 says that -- in an acquisition of non-corporate interests in an entity whose assets (including the assets of all entities it controls) will include assets the acquisition of which is exempt under part 802 of the rules -- an acquisition is exempt from the reporting requirements if the acquired unincorporated entity (and entities it controls) will not hold non-exempt assets with an aggregate fair market value of more than $50 million.

* Second, new rule 802.30(c) would say that assets contributed to a new entity upon its formation are not subject to the requirements of the Act with respect to the person contributing the assets to the formation.

* Third, new rule 801.50 relating to the formation of unincorporated entities, a person contributing to the formation of an unincorporated LLC can only have a filing obligation if it acquires control (50% plus interest) in the LLC or partnership.

Applying these three rules to the facts above if the formation were to occur after the new rules come into effect, we concluded that no filing would be required.

B's acquisition and C's acquisition. B does not have any reporting obligation because it is not acquiring 50% or more of the LLC. The same is true for C. The same would be true if the parties used a partnership rather than an LLC.

A's acquisition. Under proposed 802.30(c), the assets that A is contributing to the formation of the LLC are treated as "exempt assets" for A under the rules. Because the $60 million in assets contributed by A are "exempt assets" with respect to A, they are treated as exempt assets with respect to A's acquisition of an interest in the LLC. Thus, from A's perspective, the LLC would only hold $37 million of non-exempt assets (consisting of the assets contributed by B; the cash contributed by C is not treated as an asset acquired by A under 801.21). Since the LLC does not have in excess of $50 million in non-exempt assets from A's perspective, A's acquisition of an interest in the LLC would be exempt under proposed rule 802.4. The same analysis would apply if the parties used a partnership rather than an LLC.

Conclusion

Under both the current rules and the proposed rules, in an LLC (or partnership) formation described above, as long as the minority holder (B) is not contributing assets worth in excess of $50 million, the transaction is not reportable. The parties intend to proceed with the transaction described above, and are doing so with the understanding that they will not be required to file the transaction under either the current rules relating to LLCs or the proposed rules relating to LLCs. Alternatively, if the parties employed a partnership structure instead, the transaction would not be reportable under the current or proposed rules. Please let me know if you have any questions or concerns about the analysis set forth above. As always, thanks for your help!

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AGREE -

B [redacted]

12/9/04

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