

October 26, 2010

Mr. R. Michael Verne  
Premerger Notification Office  
Federal Trade Commission  
601 Pennsylvania Avenue, N.W.  
Washington, D.C. 20580


RE: §§ 801.1(a)(2), 801.1(a)(3), 801.1(c)(1), 802.30– HSR Implications of Transfer of Voting Securities to a Reciprocal Insurance Exchange

This letter concerns certain issues relating to the treatment of a reciprocal insurance exchange (“Exchange”) under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the “HSR Act”) and rules and regulations thereunder, as well as to a potential transfer of voting securities from an attorney-in-fact (the “AIF”) to an Exchange. We seek to confirm the informal advice of the Federal Trade Commission Premerger Notification Office’s (“PNO”) regarding the issues below, including whether an Exchange is an “entity” within § 801.1(a)(2); if the Exchange is an entity, whether the AIF is its ultimate parent entity, as defined by § 801.1(a)(3); and if not, whether the AIF has beneficial ownership of certain voting securities “held” by the Exchange, such that a “transfer” from the AIF to the Exchange of certain voting securities is a reportable event under the HSR Act.

**I. Proposed Transfer of Shares from Attorney-in-Fact for Reciprocal Insurance Exchange to Reciprocal Insurance Exchange**

The AIF, which is an insurance indemnity company, holds 100% of the voting securities of Company X, and 22% of the voting securities of Company Y. The AIF intends to transfer to the Exchange, which is organized under the Pennsylvania Insurance Company Law of 1921, as a “reciprocal insurance exchange,” all of the voting securities of Company X, and its 22% interest in Company Y’s voting securities. The Exchange currently “holds” the remaining 78% of the voting securities of Company Y. Assume the size-of-person and size-of-transaction thresholds are met.

A reciprocal exchange is based on the mutual or cooperative principle of protecting its policyholders (called “subscribers”). A reciprocal exchange is not formally organized as a corporation, limited liability company, partnership, mutual fund company, or business trust. For that reason, the Exchange does not have any organizational document. The Exchange does not have a Board of Directors, officers, or employees. The Exchange is however classified by the



Internal Revenue Code and Treasury Regulations as a corporation for federal income tax purposes.

The subscribers of the Exchange use it to exchange contracts of insurance with one another. To avoid the need for all subscribers to be involved in every exchange, a manager, called the attorney-in-fact, is appointed. The AIF is appointed by each subscriber in writing, through a Subscriber's Agreement. Control and management of the day-to-day affairs of the Exchange is granted to the AIF by the limited power of attorney under the Subscriber's Agreement. The AIF has a fiduciary relationship with the subscribers and must act in their best interests, as well as in accordance with the Subscriber's Agreement. The AIF: (a) exchanges policies among subscribers of the Exchange; (b) takes any action required to exchange these policies; (c) issues, changes, nonrenews or cancels policies; (d) obtains reinsurance; (e) collects premiums; (f) invests and reinvests funds; (g) receives notices and proof of loss; (h) appears for, compromises, prosecutes, defends, adjusts and settles losses and claims under policies; (i) accepts service of process on behalf of the Exchange; and (j) manages and conducts the business and affairs of the Exchange, and its affiliates and subsidiaries. In exchange for these services, AIF retains up to 25% of the premiums as a management fee in return for conducting the Exchange's insurance business. The one page Subscriber Agreement that establishes AIF as attorney-in-fact is the only document that defines the Exchange's relationship with AIF.

The Exchange is a mere aggregation of subscribers, which cannot legally operate without the AIF. The Exchange writes insurance policies, and pays premiums at the direction of the AIF. The Exchange subscribers have no contact with one another, and all business is transacted by the AIF. The Exchange is not capable of performing, and does not perform, any activity except through the AIF. Thus, in this reciprocal exchange, the Exchange provides the subscribers, and the AIF provides all of the management and administration. Neither can operate without the other.

Both before and after the "transfer" of 100% of the voting securities of Company X, and of 22% of the voting securities of Company Y to the Exchange, the AIF votes and will continue to vote all the stock of both Company X and Company Y. The AIF can sell, and will be able to sell after the transfer, all of the stock and assets of Companies X and Y through its attorney-in-fact relationship with the Exchange. Before the transfer, the Exchange has the right to the dividends on the 78% ownership of Company Y.

**II. A Reciprocal Insurance Exchange is Not an “Entity” under § 801.1(a)(2)**

We believe that the Exchange does not meet the definition of an entity under § 801.1(a)(2) of the HSR rules. The individual subscribers in the Exchange are members of a group, each of whom have entered into a Subscription Agreement with the AIF relating to the Exchange. A group has not been recognized as an entity under the HSR rules. *See* FTC Staff Informal Interpretation No. 0711004 available at <http://www.ftc.gov/bc/hsr/informal/opinions/0711004.htm>; *see also* Premerger Notification Practice Manual, Interpretation No. 39 (unless a voting agreement provides the irrevocable power to appoint the board to just one of the shareholders, right of a group is not recognized).

**III. If a Reciprocal Insurance Exchange is an “Entity,” its Attorney-in-Fact is its Ultimate Parent Entity under § 801.1(a)(3)**

However, assuming that the Exchange meets the definition of an entity under the HSR Act, our view is that its ultimate parent entity is the AIF. The subscribers are not the ultimate parent entity of the Exchange. As stated above, the HSR rules do not recognize a group as an entity under § 801.1(a)(2). Further, the Subscriber’s Agreement grants the AIF the right to manage and control all of the Exchange’s operations. If the AIF is deemed to be the ultimate parent entity of the Exchange, any acquisition by or transfer by the AIF of its interests in Companies X and Y to the Exchange would be exempt under § 802.30(a).

**IV. The Subsidiaries of the Reciprocal Insurance Exchange are Held by the Attorney-in-Fact, under § 801.1(c)(1)**

Further, even if the AIF is not the ultimate parent entity of the Exchange, the AIF is the ultimate parent entity of Companies X and Y, because it has beneficial ownership of the interests in Companies X and Y based on its ability to vote the stock of Companies X and Y, as well as its ability to sell the stock of Companies X and Y. As a result of the transfer, the Exchange will have the right to the dividends of Companies X and Y. However, the retention of the right to dividends by the Exchange, standing alone, does not confer beneficial ownership on the Exchange within the meaning of § 801.1(c)(1). *See* PREMERGER NOTIFICATION PRACTICE MANUAL (4th Edition), at Interpretation 52 (where a holder had only one indicia of beneficial ownership and will not receive any other indicia of beneficial ownership in the securities, such as the right to vote or dispose of the acquired securities, that individual did not have beneficial ownership). For that reason, despite the fact that the AIF intends to “transfer” to the Exchange its holdings in Companies X and Y, the transfer is not a reportable event under the HSR Act, since beneficial ownership will rest with the AIF both before and after the “transfer.”

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Please let us know whether you agree with each of our conclusions. As always, we greatly appreciate your assistance with this matter.

Sincerely,

AGREE  
BV  
11/16/10

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