June 17, 1993

VIA NETWORK COURIER

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FEDERAL TRADE COMMISSION
PREMERGER NOTIFICATION OFFICE

Richard Smith
Premerger Notification Office
Bureau of Competition, Room 303
Federal Trade Commission
6th Street and Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Dear Mr. Smith:

This letter is to confirm the advice you gave the undersigned during a telephone conversation on Wednesday, June 16, regarding the Federal Trade Commission's (the "FTC's") position under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "Act") and the regulations promulgated by the FTC thereunder (the "Regulations"), with respect to the formation of a corporation by two parties where one of the parties is agreeing to be at risk for part of the performance of the corporation under a contract it may enter into with the federal government.

Our client, Corporation A, and a second corporation, Corporation B, propose to form a new corporation ("Newco"). Corporation A will contribute $9 million in cash in return for 60% of Newco's voting securities and Corporation B will contribute $6 million in cash for 40% of Newco's voting securities. In addition, Corporation A will sell certain assets to Newco for $1 million in cash which is the deemed fair market value of the assets being sold. Corporation A and Corporation B each have annual net sales or total assets of over $100 million.

Newco is being formed to bid on a federal government contract to provide health care services. If the contract is awarded, Newco will make available a health care plan where in return for payments under the contract, Newco will cover the health care expenses of the individuals participating in the plan. In connection with the proposed bid, Corporation A and Corporation B will agree to make available a loan in the aggregate amount of $5 million in the event that there is a breach by Newco of the government contract and Newco is required to pay liquidated damages. In addition, to enable Newco to perform under the government contract, Newco will subcontract with

Corporation A for Corporation A to make available to Newco its network of health care providers. As part of this subcontract Corporation A will agree to be at risk for up to $125 million of health care costs incurred by Newco in connection with services provided to participants under the government contract in the event of nonpayment of these costs by Newco.

Over the telephone, you advised the undersigned that it would appear that in determining the total assets of Newco under §801.40(c) that the potential $5 million loan and the $125 million "at risk" obligation could be excluded since both of these obligations are not certain at this time.

Section 801.40(c)(2) states that the assets of a corporation being formed shall include "[a]ny amount of credit or any obligations of the joint venture or other corporation which any person contributing to the formation has agreed to extend or guarantee, at any time." Although Corporation A and Corporation B have agreed to extend a $5 million loan in the future, this loan is contingent upon Newco incurring a claim for liquidated damages which the parties do not presently anticipate. Likewise, the agreement by Corporation A to pay up to $125 million in health care claims is also contingent and uncertain. This situation is to be distinguished from that where a newly formed company incurs or assumes a liability in connection with its formation and that liability is guaranteed by one of the persons contributing to its formation. Although the guarantor may never be required to pay the obligation it has guaranteed, the underlying obligation that it is guaranteeing is set and determined at the time of formation of the new corporation. In this situation, the underlying obligations of Newco (i.e., liquidated damages and health care claims) have not been incurred at the time of formation of Newco. Moreover, the obligation of Corporation A will be to ensure part of Newco's future performance under the government contract. This obligation is not fixed and certain at this time. Accordingly, you confirmed that in your view the contingent amounts would not be included in determining the total assets of Newco under §801.40(c), and therefore, the total assets of Newco would be $15 million which is the value of the cash contributions to be made by Corporation A and Corporation B upon formation.

Because Newco will not have total assets of $25 million or more, the acquisition by Corporation A of the voting securities of Newco in connection with Newco's formation will not be subject to the notification requirement of the Act pursuant to the exemption under §802.20.

We understand that the advice of the Justice Department's Antitrust Division need not be sought regarding the matters described above since it follows the FTC's advice on such matters.

Please know that, in reliance on your advice, the parties to the proposed transaction described above do not intend to file a Notification and Report Form with the FTC or the Justice Department in connection with the proposed transaction.

The parties would like to consummate the proposed formation of Newco in the near future. Accordingly, if you are unable to concur with any part of the foregoing summary and analysis, or if you have any questions or further comments, we would appreciate it if you would contact the undersigned not later than June 25, 1993.

Please also file-stamp the enclosed copy of this letter, and return it to me in the enclosed stamped, self-addressed envelope, to serve as a record of your receipt of this letter. Thank you for your assistance.

Very truly yours,

By

7/9/93 called writer and advised that the conditional contributions and/or guarantees ~~made~~ to be made to the joint venture if it is successful in its intended activities need not be counted into the assets of the joint venture under 801.40(c). This conclusion is based, in part, on the analysis used and the conclusions reached in ABA letter # 202, copy attached.

RBSmith

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Applicable subsections of the rules. §§ 801.40, 801.10(a), 801.90.

Brief statement of the question or problem. Whether the commitment of joint venturers to contribute equal amounts of additional capital in the future must be considered in determining the value of the voting securities acquired in the formation of the joint venture corporation.

Interpretation and discussion. Such a commitment does not affect the value of voting securities acquired in the formation of the joint venture if the commitment is conditional. For example, A, B and C form a joint venture, Newco. Each contributes $10 million initially and agrees, upon the satisfaction of certain conditions, to contribute an additional $5 million in the future. In exchange A, B and C each receive 33⅓ percent of Newco voting securities. Since the additional contributions to capital are not certain, the fair market value of the Newco stock acquired by each of A, B and C is less than $15 million and no reporting is required for formation of the joint venture. Furthermore, no filing is required subsequently if the conditions are met and A, B and C make the anticipated capital contributions. Such contributions would not be acquisitions of voting securities subject to the Act's requirements, or, if voting securities were then issued, the percentage interests of the shareholders would not be increased, and those acquisitions would be exempt under § 7A(c)(10).

Documents pertaining to this issue. Letter to Dana Abrahamsen, Esq., (date unknown).

Commentary. A different result obtains when the commitment to contribute additional capital is not conditional. In that case the fair market value of each joint venturer's shares should reflect the value of the full amount of the commitments. The acquisition price of the shares, which should determine their value (§ 801.10(a)(2)(i)), is the value of all consideration being given for the shares, which would include the contractual obligation to make any future contributions. 43 Fed. Reg. 33,471 (1978). *But see* Int. #200.

If, instead of agreeing to contribute additional amounts in the future, the shareholders agree to purchase additional shares in equal amounts at a point in the future, the value of the shares acquired at the formation of the joint venture would then reflect only the capital initially contributed. The shareholders' percentage interests would not increase as a result and those acquisitions would be exempt under § 7A(c)(10). However, if there is no legitimate business purpose for delaying the purchase of the additional shares, and one person's aggregate purchases exceed $15 million, this structure might be regarded as a device for avoidance under § 801.90.

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Applicable subsections of the rules. §§ 801.40(c), 801.10(a)(2), 802.20(b).

Brief statement of the question or problem. How to determine