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By Hand

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Dear Melea and Dick:

In my recent discussions with the Premerger Notification Office concerning limited liability companies, it has become evident that the Office has not yet developed a comprehensive set of interpretations concerning the various Hart-Scott issues that these entities may present. I thought writing a letter would be useful in advancing our dialogue and resolving the various questions I have raised.

It is important to emphasize that I have asked about proper Hart-Scott treatment of a specific form of limited liability company, not limited liability companies in general. Under the Delaware Limited Liability Company Act, Title 6, Delaware Code § 18-101 et seq., limited liability companies may have a variety of different characteristics. Such companies are neither partnerships nor corporations, although they may closely resemble one or the other depending upon the terms of the particular company's limited liability company agreement. As stated in the Act, "It is the policy of this [Act] to give maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements." Id. at § 18-1101(b).

My questions thus relate to the following specific fact situation. A, B, and C intend to form X, a limited liability company, pursuant to the Delaware Limited Liability Company Act. Assume any applicable size tests are satisfied. The limited liability company agreement establishing X will provide for the following:

(a) X will have a manager or board of managers who will exercise functions similar to those exercised by a corporation's board of directors;

(b) X will issue voting interests to A, B, and C analogous to voting stock in a corporation, entitling the holders thereof to vote for the manager or members of the board of managers;

(c) X will issue nonvoting interests to D, analogous to nonvoting, nonconvertible preferred stock in a corporation. These interests will, thus, not entitle D to vote for the manager or board of managers.

(d) A, B, C, and D will each contribute assets to X at the time X is formed.

Pursuant to 16 C.F.R. § 803.30(a), I request an informal interpretation concerning the appropriate analysis under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 and the implementing regulations of the following issues:

1. **Is the above formation transaction, in which assets are contributed to X and X issues its voting interests, subject to a reporting obligation?**

Under the Commission's rules, the answer should be "no," because a Delaware limited liability company is not a corporation.

Under Hart-Scott, only the formation of corporations is made reportable, by virtue of § 801.40. The Statement of Basis and Purpose unequivocally states that the formation of entities other than corporations is not subject to reporting obligations:

> . . . [O]nly the formation of corporations the voting securities of which will be held by two or more persons is potentially subject to the act. And since the rule [§ 801.40] applies only to the formation of corporations, the formation of entities other

> than corporations is by virtue of this rule, not brought within the coverage of the act and need not be preceded by compliance with the act's requirements.

43 Fed. Reg. 33450, 33485 (July 31, 1978).

The Statement of Basis and Purpose, the HSR Act, and the regulations all recognize that entities other than corporations can, in fact, issue voting securities. Id. at 33487, Clayton Act § 7A(b)(3)(A), 16 C.F.R. § 801.1(f)(1). The Commission, however, expressly chose not to make formation of such entities subject to reporting requirements. It instead instructed the staff to report back after a year of operation of the Hart-Scott program as to whether additional regulations covering formation of noncorporate entities were required (and no such regulations have been adopted):

> There is evidence that Congress intended coverage of acquisitions by or of noncorporate entities. Section 7A(b)(3)(A) states:
>
> > The term "voting securities" means any securities which * * * entitle the owner or holder thereof to vote for the election of directors of the issuer or, with respect to unincorporated issuers, persons exercising similar functions. (Emphasis supplied [in original].)
>
> However, the Commission has instructed its staff to monitor the formation of joint business arrangements of all types and forms and to determine, after a year of operation, whether the rules provide appropriate coverage. The fact that persons contributing to the formation of a noncorporate joint venture are not required to report and wait prior to the transaction should not, of course, be construed as a Commission statement that such transactions are free from antitrust concerns.

43 Fed. Reg. at 33487 (emphasis added).

Based upon these clear statements of the Commission's official position, it appears that the transaction in which X is formed should not be reportable under Hart-Scott.

2. Are the interests to be held by A, B, C, and D "voting securities"?

It seems plain under the rules that the interests to be held by A, B, and C should constitute voting securities, but that D's interest should not.

Section 7A(b)(3)(A) of the Act and § 801.1(f)(1) of the regulations define "voting securities" identically, as follows:

> The term "voting securities" means any securities which at present or upon conversion entitle the owner or holder thereof to vote for the election of directors of the issuer, or of an entity included within the same person as the issuer, or, with respect to unincorporated entities, individuals exercising similar functions.

(Emphasis added.)

Applying this definition here is straightforward. X will be an unincorporated entity managed by a manager or board of managers who will exercise functions similar to those of a corporation's board of directors. The interests held by A, B, and C will be securities entitling the holder to vote for the election of the manager or managers of X. These interests therefore should qualify as "voting securities."

On the other hand, the interests to be held by D will not entitle D to vote for the election of any managers, and D's interests will not be convertible into any such voting interests. Therefore, D's interests should not qualify as "voting securities."

3. How is "control" of X, the limited liability company, to be determined?

It seems plain under the rules that control of X should be governed by §§ 801.12(b) and 801.1(b)(1)(i). Section 801.12(b)

sets forth the generally applicable rules for determining the percentage of an issuer's voting securities that a person holds. Section 801.1(b)(1)(i) provides that the term "control" means:

> Holding 50% or more of the outstanding voting securities of an issuer . . . .

As discussed above, the interests to be held by A, B, and C constitute voting securities. Since X is plainly the "issuer" of these securities, the § 801.1(b)(1)(i) test is clearly applicable.

The rules do not provide that an "issuer" must be a corporation. Indeed, given that an unincorporated entity may have voting securities, as recognized in § 7A(b)(3)(A) and § 801.1(f)(1), it seems axiomatic that an unincorporated entity may therefore be an "issuer." X would therefore be controlled by a person with 50% or more of X's voting securities. A person such as D, who would hold only nonvoting securities, could not control X.

The alternative control test in § 801.1(b)(1)(i), applicable to partnerships, is based upon right to profits and right to assets upon dissolution. This test, however, only applies "[i]n the case of an entity that has no outstanding voting securities." Because X will be an entity that has outstanding voting securities, this alternative test would be inapplicable.

4. Assuming arguendo that § 801.40 applies to the formation transaction, how should the transaction be analyzed?

If the Premerger Office determines that § 801.40 applies to the formation transaction of this noncorporate entity, despite the Commission's official position that formation of noncorporate entities is not reportable, it would seem that the normal § 801.40 rules applicable to corporations should be used. Thus, X would be deemed the acquired person, and A, B, and C would be acquiring persons required to report if applicable size tests were met and no exemption applied. D would have no reporting obligation because D would be acquiring only nonvoting securities.

[redacted]

I thank you in advance for your consideration of these issues and look forward to hearing your response as soon as possible. If you have any questions or need any additional information, please give me a call.

Very truly yours,

[redacted]

cc: John M. Sipple, Jr., Esquire