February 4, 1994

VIA TELECOPY AND REGULAR MAIL

Mr. Dick Smith
Premerger Notification Office
Bureau of Competition, Room 303
Federal Trade Commission
Washington, D.C. 20580

Re: Acquisition of [redacted]

Dear Mr. Smith:

This letter will confirm our telephone conversations on Wednesday, February 2, 1994 regarding the referenced matter.

Facts

Company A is negotiating to acquire the [redacted] comprising the [redacted] For business reasons, the [redacted] have conducted their business through two entities: Partnership B, which owns the "hard assets" used in the business (principally, land, buildings and equipment); and Company C, a corporation which employs the [redacted] and otherwise manages the [redacted] The [redacted] employed by Company C, or trusts related to the [redacted] own 100% of its voting securities, and the [redacted] or related trusts also own 100% of the partnership interests in Partnership B, although the ownership of the two entities is not identical. No single [redacted] or other entity owns 50% or more of either Partnership B or Company C. Neither Partnership B nor Company C is engaged in manufacturing.

Company A has total assets and annual net sales in excess of $100 million. Partnership B has total assets in excess of $10 million. The acquisition price to be paid by Company A to Partnership B in exchange for its assets is in excess of $15 million. Based on these facts, Company A and Partnership B will file a Notification and Report Form with respect to the acquisition by Company A from Partnership B.

Company C uses the cash-basis method of accounting to manage its business. Unaudited financial statements are prepared monthly on the cash-basis method of

accounting, and these financial statements are used by management of Company C in managing the [redacted] Pursuant to standards underlying the cash-basis method of accounting, accounts payable and accounts receivable are not reflected on the balance sheets regularly prepared by Company C. The cash-basis method of accounting has been used by Company C for at least the last several years.

Pursuant to a financing transaction consummated in December 1990, for each of the calendar years 1990, 1991 and 1992, Company C also prepared a set of financial statements as of and for the years then ended that had been reviewed by an independent certified public accountant. Typically, these reviewed financials were available in mid-March. As required by the related loan agreement, the reviewed financial statements were prepared in accordance with generally accepted accounting principles. As a result, accounts payable and accounts receivable are reflected on the reviewed financial statements prepared to satisfy the covenant in the loan agreement. The sole purpose for these financial statements is to satisfy the loan covenant, and these financial statements are not used by management of Company C in managing the Practice. In 1993, Company A, which is the lender under the loan agreement, waived the requirement in the loan agreement that reviewed financial statements be prepared for calendar year 1993. The reason for this was to permit management of the [redacted] to work on a proposed integration plan to be used for integrating the [redacted] with Company A's other operations after the acquisition, rather than devoting their attention to completing the audit. Recently, Company C prepared financial statements as of year end 1993 in accordance with generally accepted accounting principles and furnished them to a law firm as part of an attorney/client communication. These financial statements have been provided to no one except for the law firm.

Based on the most recent balance sheet prepared by Company C in accordance with the cash-basis method of accounting, Company C's total assets are less than $10 million. On the year end 1993 balance sheet prepared at the request of Company A's law firm, Company C's assets are greater than $10 million. As is done every month, Company C will issue a cash-basis method balance sheet as of the end of January 1994. This balance sheet will be issued before any HSR filings are made in connection with the transaction.

Discussion and Analysis

Pursuant to Section 801.11 of the FTC's rules, the total assets of a person "shall be as stated on the last regularly prepared balance sheet of that person." § 801.11(c)(2). To qualify as a regularly prepared balance sheet, a balance sheet must "have been prepared in accordance with the accounting principles normally used by such person . . .."

§ 801.11(b)(2). The FTC's statement of purpose issued at the time the rules were adopted makes it clear that unaudited balance sheets prepared by management for internal purposes may qualify as being "regularly prepared":

> "Regularly prepared", as used in both subparagraphs [of § 801.11(c)], means that the statement was prepared both at the time a statement would normally be prepared and in the normal fashion that such a statement would be prepared. Internal balance sheets prepared for management and not audited or disseminated to the public may satisfy this standard. 43 F. Reg.No. 147, p.33474.

Furthermore, as you correctly pointed out, the FTC staff has consistently taken the position that a "special purpose balance sheet," such as one specifically prepared in connection with the proposed transaction are not "regularly prepared." See Premerger Notification Practice Manual (1991) Interpretation 157 ("[A] balance sheet must be regularly prepared, and the FTC staff has consistently stated that a special purpose balance sheet is not 'regularly prepared'"); Interpretation 160 ("[A] balance sheet prepared for purposes of a particular transaction usually is not regularly prepared.").

Even if a separate, special purpose balance sheet is prepared on an annual basis, it is not "regularly prepared" unless it is "prepared in accordance with the accounting principles normally used by" the person in question. Section 801.11(2); see also Premerger Notification and Practice Manual, Interpretation 165 (indicating that an annually prepared balance sheet, because it was prepared in accordance with normal accounting procedures, could qualify as the "last regularly prepared" balance sheet). However, such a special purpose balance sheet would constitute the "last regularly prepared" balance sheet "only until the next regular annual statements or other balance sheets are issued." Id. (emphasis added)

Conclusion

Based on the foregoing, our conclusion is that, with regard to Company C, its "last regularly prepared balance sheet" is its last balance sheet prepared on the cash-basis method of accounting. The year end 1993 balance sheet prepared in accordance with generally accepted accounting principles is not a "regularly prepared" balance sheet for two reasons:

1. It is not prepared in accordance with the accounting principles normally used by Company C, and accordingly, does not satisfy § 801.11(b)(2); and

2. It was not prepared at the time a statement would normally be prepared, nor was it prepared in the normal fashion that such a statement would be prepared, and thus, it is inconsistent with the purpose underlying the FTC's rules.

Accordingly, because the total assets of Company C as stated on its last balance sheet prepared on the cash-basis method of accounting are less than $10 million, the acquisition by Company A of Company C is not reportable because Company C does not satisfy the size-of-person test of the Clayton Act. Further, even if the year end 1993 balance sheet prepared by Company C and furnished to legal counsel in connection with the transaction was somehow deemed to be "regularly prepared," it would not be, because of the subsequent issuance in the normal course of the January 1994 balance sheet, the "last" such balance sheet prior to the filing of the Notification and Report Form relating to the Company A/Partnership B transaction.

In our telephone conversations, you indicated that you believed the conclusions set forth above were correct, provided that the facts set forth above were accurate, and in particular, that Company C has used the cash-basis method of accounting in preparing balance sheets in the past in the normal course of business. Based on your advice, we have advised Company A and Company C that the acquisition of Company C by Company A is not reportable.

If you disagree with any of the analysis or conclusions set forth above, we respectfully request that you contact the undersigned immediately so that we may discuss any questions or concerns you may have. Otherwise, we will move forward on the basis set forth above, and will not make a filing with regard to the Company A/Company C transaction based on our interpretation of the authorities and your advice concurring with our interpretation. A filing will be made with respect to the Company A/Partnership B transaction.

Very truly yours,