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December 15, 1994

BY OVERNIGHT MAIL

Hy Rubenstein, Esq.
Premerger Notification Office
Bureau of Competition
H-303
Federal Trade Commission
Washington, D.C. 20580

Re: Investment in Limited Liability Company

Dear Mr. Rubenstein:

In a telephone conversation in early November I asked whether the purchase of an interest in a limited liability company would be considered the acquisition of either voting securities or assets, so as to involve a reportable transaction. You said that you wanted to review my inquiry with others on the FTC staff and requested that I put my request in writing and provide details on the management of the LLC. My delay in writing was caused by the twists and turns in the parties' negotiations. An answer to my original inquiry would now, however, be very much appreciated.

The Proposed Transaction

Our client, a Delaware corporation, created last March a Delaware limited liability company under ch. 18 of the Delaware code. The LLC is in the business of growing an agricultural commodity and has commenced operations to the extent of purchasing real property, contracting with agricultural experts, and other start-up activities. While our client has put only about $1,000 in equity in the LLC, our client has actually advanced about $7 million to the LLC, which has been expended on the land acquisitions and other start-up matters. The LLC has had no sales, and its most recently prepared balance sheet shows assets of less than $10 million. Currently, our client is the only member of the LLC.

In the proposed transaction an independent entity that is organized in a foreign country will commit to invest in the LLC US$18 million in equity in three payments, $6 million at closing,

$6 million one year later, and the final $6 million two years after closing. As part of the transaction, our client will commit to invest in the LLC $30 million in equity, increasing its existing investment to $10 million by closing and investing $10 million more at the end of the first and second years. Both the foreign entity and our client will provide bank letters of credit to the LLC to assure the availability of funds to make the above-mentioned equity payments.

Although our client's equity investment in the LLC and its share of profits and losses and distributions of assets will be 62.5 percent and the foreign entity's will be 37.5 percent, each of our client and the foreign entity is to have an equal voice in managing the LLC. For accounting reasons -- in order to avoid having to consolidate the LLC with our client -- our client must limit its role in the LLC's management to 50 percent.

Would the Foreign Entity's Membership Interest in the LLC Be Either a Voting Security or an Asset?

The nature of the interest which the foreign entity will purchase is determined by Delaware law. Section 18-101 of the Delaware Limited Liability Company Act contains the following definitions:

> (8) "Limited liability company interest" means a member's share of the profits and losses of a limited liability company and a member's right to receive distributions of the limited liability company's assets.
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> * * *
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> (11) "Member" means a person who has been admitted to a limited liability company as a member as provided in § 18-301 of this title or, in the case of a foreign limited liability company, in accordance with the laws of the state or foreign country or other foreign jurisdiction under which the foreign limited liability company is organized.

A photocopy of § 18-301, entitled Admission of members, is enclosed. Section 18-101 also contains the following definition:

> (10) "Manager" means a person who is named as a manager of a limited liability company in, or designated as a manager of a limited liability company pursuant to, a limited liability company agreement or similar

instrument under which the limited liability company is formed.

Section 18-402, entitled Management of limited liability company, states:

> Unless otherwise provided in a limited liability company agreement, the management of a limited liability company shall be vested in its members in proportion to the then current percentage or other interest of members in the profits of the limited liability company owned by all of the members, the decision of members owning more than 50 percent of the said percentage or other interest in the profits controlling; provided, however, that if a limited liability company agreement provides for the management, in whole or in part, of a limited liability company by a manager, the management of the limited liability company, to the extent so provided, shall be vested in the manager who shall be chosen by the members in the manner provided in the limited liability company agreement. The manager shall also hold the offices and have the responsibilities accorded to him by the members and set forth in a limited liability company agreement. Subject to § 18-602 of this chapter [treating resignation of manager], a manager shall cease to be a manager as provided in a limited liability company agreement. Unless otherwise provided in a limited liability company agreement, each member and manager has the authority to bind the limited liability company.

I am familiar with the Commission's long-standing treatment of the acquisition of a less than 100% interest in a partnership as being the acquisition of neither a voting security nor an asset. The subject interest in the LLC seems to involve rights that are equivalent to those of a partner. There is no voting security, at least as commonly understood, involved.

There are additional reasons for treating an LLC as a partnership. LLCs are, as you know, a new form of entity which allows for partnership taxation treatment. An LLC affords the limited liability of a limited partnership without requiring a general partner having unlimited liability. LLC statutes typically require an operating agreement akin to a partnership agreement. LLCs also typically share other characteristics of a limited partnership, including:

1. Limited Life. LLCs typically have a limited duration of existence and will dissolve upon expiration of the term. In

addition, upon the bankruptcy of a member, dissolution of a member, death of a member, or withdrawal of a member, the LLC is dissolved unless continued by a majority of the remaining members. This is contrary to a corporate structure where the bankruptcy, dissolution, or death of a stockholder does not have any effect on the corporate entity. In addition, the existence of a corporation is typically perpetual.

2. Restrictions on Transferability. There are severe restrictions on the ability of persons to transfer interests in LLCs, as is generally true of partnerships. Shares of corporate stock are generally freely transferable.

3. Centralized Management. Partnerships and LLCs are often, although not always, managed by the members. This is contrary to a corporate structure which mandates management by a board of directors.

If at least two of the three above factors are met, the LLC is treated as a partnership for federal tax purposes. The LLC described herein is structured to be treated as a partnership for federal tax purposes. Moreover, LLCs are much akin to partnerships generally and differ in most respects from corporations.

If you need additional factual information, please call me at [redacted]

Thank you very much for your assistance.

Sincerely yours,

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