[redacted]

May 18, 1995

BY FACSIMILE

Richard B. Smith
Premerger Notification Office
Federal Trade Commission
6th Street & Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Dear Mr. Smith:

As discussed in our telephone conference call with [redacted] and other attorneys on Friday, April 21, 1995, this letter outlines a proposed transaction and discusses certain issues raised under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act").

Specifically, the issue is whether, in the formation of a corporate joint venture subject to 16 C.F.R. § 801.40, for purposes of the size-of-transaction test under 15 U.S.C. § 18a(a)(3)(B), an acquiring person must aggregate the value of the assets contributed to the joint venture as consideration for its voting securities with the value of a contractual pledge of the same voting securities for the benefit of the joint venture. We believe that it is not appropriate to add the value (if any) of the contractual pledge to the value of the assets contributed for purposes of the size-of-transaction test and seek confirmation of this view from the Federal Trade Commission staff.

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SUMMARY OF TRANSACTION

Formation of Joint Venture

Three entities, A, B and Trust, each of which is its own ultimate parent, will form a new corporation ("Newco") which will in turn acquire the assets of a debtor in possession ("Debtor"). The proposed transaction will result in the conclusion of Debtor's Chapter 11 bankruptcy proceedings.

A has assets or net sales of more than $10 million and less than $100 million. A will contribute $15 million in cash to Newco in exchange for its approximately 49.5% of the voting securities of Newco.

B has assets or net sales in excess of $100 million and will acquire approximately 25% of Newco voting securities in exchange for waiving claims it has against Debtor. Among these claims is a judgment claim of approximately $6 million and unliquidated and contingent claims of undetermined value, the aggregate of which is less than $15 million. Given that A is paying $15 million for its 49.5% interest in Newco, the value of B's voting securities would appear to be approximately $7.5 million. Under a Newco Shareholders' Agreement, B will have a call option ("Call"), exercisable once during the first five years after the closing of the asset acquisition, to purchase all of the shares of Newco held by Trust. The Call price rises each year, from $13.5 million in Year One to $23 million in Year Five. The parties understand that the exercise of the Call may require HSR Act filing.

Trust is a liquidating trust composed of claims against Debtor and will serve as a conduit for payment of the claims of various creditors of Debtor (but not including B). At the close of the transactions, Trust will have assets of more than $10 million but less than $100 million. Trust will receive approximately 25% of the voting securities of Newco as part of the consideration for the acquisition of Debtor's assets. Trust has an option to put its shares back to Newco in Years Four and Five ("Put") at the Call price applicable in those years.

Newco will have, in the aggregate, assets of greater than $10 million but less than $100 million.

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Asset Acquisition

Newco will acquire substantially all the assets and certain liabilities of Debtor pursuant to an Asset Purchase and Liability Assumption Agreement. The consideration paid by Newco consists of the following: (a) $30 million in cash; (b) approximately $40 million in the aggregate of three promissory notes payable to Debtor ("Notes"); (c) assumption of approximately $17 million in liabilities of Debtor; (d) approximately 25% of the stock of Newco; and (e) waiver of B's claims against Debtor.

Debtor will assign all consideration received for its assets to Trust, and B will be released from certain claims that Debtor has against B.

Newco's obligations under two of the Notes (approximately $35 million) and Newco's obligation to pay the Put price in the event of a Put by the Trust will be secured by a lien on substantially all the assets of Newco and by A's and B's pledge of their Newco securities to Trust ("Pledge"). The Pledge will be released when the Trust is no longer a shareholder of Newco, whether by B's exercise of the Call, Trust's exercise of the Put or otherwise.

DISCUSSION

In the formation of Newco, only B satisfies the "size-of-person" test under § 801.40(b). Newco's acquisition of Debtor's assets is exempt because both Newco and Debtor have assets and net sales of less than $100 million. As a result, the size-of-person test under 15 U.S.C. § 18a(a)(2)(C) is not satisfied.

B's acquisition of Newco shares is potentially reportable if B's contribution of assets should be aggregated with the Pledge, and if so, the total value is $15 million or more. As previously indicated, the value of B's contribution of assets (its waiver of claims) would appear to be approximately $7.5 million. As a result the critical issue is whether B's "portion" of the Pledge constitutes B's "guarantee" of a Newco obligation for purposes of § 801.40(c)(2) and should be valued and aggregated with the other consideration contributed by B to Newco for purposes of the "size-of-transaction" test. Under § 801.10(a)(2) and (c)(3), such a determination is to be done in good faith by the Board of Directors of B.

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The only guidance on point is Interpretation 137 of the Premerger Notification Manual (American Bar Association, 1991) which states in the commentary that:

> The provision of § 801.40(c)(2) that requires inclusion of loans made or guaranteed by any person contributing to the formation of the joint venture relates only to determination of the assets of the joint venture for purposes of § 801.40(b) and determining whether any exemption applies. This section does not affect the valuation of the joint venture's voting securities for purposes of the size of transaction test.

A / D

Even if the foregoing commentary is not the current FTC staff position, and the value of a loan guaranty were aggregated with other consideration for purposes of the size-of-transaction test, it is by no means clear that B's portion of the Pledge in this case is the equivalent of a loan guaranty. A loan guaranty typically puts at risk all the assets of the guarantor, up to the value of the loan guaranteed. Here, in contrast, B's general assets are not at risk; rather, the only thing at risk is the very shares B receives in the transaction. Since the shares represent an interest in Newco's net assets which at formation consist of the initial capital contributions and since B has already included the fair market value of the shares for purposes of the size-of-transaction test, it would be double counting to value the pledge at the fair market value of the shares pledged. Under these facts, the pledge represents minimal additional consideration.

Further, even if B's portion of the Pledge were deemed to be a guaranty of Newco obligations, the Pledge would likely reduce the value of B's Newco shares. B's Board of Directors would have to factor this into their analysis in determining a valuation of B's Newco shares, and, accordingly, the value of the consideration given to Newco.

In sum, we believe that the size of transaction test is not satisfied in connection with B's acquisition of Newco securities and that no HSR Act filings should be required for the proposed transaction.

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Richard B. Smi[redacted]
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We would appreciate the staff's views on this matter. Please call me, at [redacted] at your convenience and, if necessary, we will arrange for a conference call with counsel for the interested parties.

Sincerely yours,

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cc: [redacted]

5/24/95 Advised writer the B must make a good faith determination of its pledge, which I concluded was part of the acquisition price for Newco's non-publicly traded voting stock. If such estimate could not be made (and added to the 7.5 MM which B was paying for its 25% of Newco voting stock), then B's board must make a "fair market value" determination of the 25%. The discussion on pg 113 of the ABA publication respecting letter #137 suggests that the guarantee may well have value (although it may well be less than the amount guaranteed) which must be added to the cash contribution. Since B will not control Newco, the acquisition price, if determined, must exceed 15 MM for B (or any other person involved in the formation of Newco which meets the size of person test) to have a reporting requirement

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R B Smith