

FEDERAL TRADE COMMISSION  
PREMERGER NOTIFICATION

January 17, 1996

PRIVILEGED AND CONFIDENTIAL

VIA FACSIMILE

Ms. Alice Villavicencio  
Mr. Richard Smith  
FEDERAL TRADE COMMISSION  
Premerger Notification Office  
Bureau of Competition  
Room 303  
Washington, D.C. 20580

Subject: Hart-Scott-Rodino Act Notification

Dear Ms. Villavicencio and Mr. Smith:

This letter is a follow-up of our prior discussions regarding a proposed transaction involving our client. We understand that the Hart-Scott-Rodino Act (the "Act") requires that any person who acquires securities of any other person and meets the threshold requirements of the Act must file a premerger Notification and Report Form (the "Notification"). Accordingly, this letter is to request confirmation that, based on the terms of the transaction specified below (the "Transaction"), the requirements of the Act are not met and, as such, the Notification need not be filed. Specifically, we believe that the requirements of the Act are not met because: (i) the acquiring person is acquiring convertible securities with no present right to vote; and (ii) the contractual rights granted to the acquiring person herein relate to nominating rights granted to such party and do not convey any voting rights upon the acquiring party.

Please be advised as follows:

1. Parties to the Transaction/Summary of Transaction. Company A is a corporation (the "Acquired Person") which intends to issue a promissory note in the amount of \$20 million in favor of Company B (the "Acquiring Person"). The note is subordinated to all senior indebtedness of Company A and is convertible into Common Stock, one of the two (2)

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(A)(b) OF THE  
Please understand

classes of voting common stock of Company A.<sup>1</sup> The convertible promissory note is being issued pursuant to a Note Purchase Agreement by and among Company A, Company B and certain individual shareholders of Company A (the "Principal Shareholders"). The Principal Shareholders are two (2) individuals who are unrelated to each other and who together own or control a majority of the combined voting power of the Class A Common Stock and the Common Stock of Company A.<sup>2</sup> Voting for directors is non-cumulative and accordingly, the holders of in excess of 50% of the combined voting power of the Class A Common Stock and the Common Stock will be able to elect all of the directors of Company A.

The promissory note provides for a seven (7) year term and requires Company A to pay interest to Company B on a quarterly basis at a rate of six percent (6%) per annum. Interest-only payments are due on a quarterly basis.

So long as Company B holds at least three percent (3%) of Company A's Common Stock or common stock issued or issuable upon conversion of the Notes, Company B will have the right to designate that number of nominees to Company A's Board of Directors equal to the voting power represented by such common stock (rounded upward) but in no event less than one or more than two nominees.<sup>3</sup> The Principal Shareholders executed the Note Purchase Agreement in their individual capacities and agreed thereby to vote all of their respective shares of common stock in the Company for the nominees of Company B. In this regard, the Principal Shareholders have agreed by contract with Company B to elect the nominees designated by Company B to the Board of Directors of Company A. In the event that any nominee of Company B ceases to serve as a director of Company A for any reason, the Note Purchase Agreement

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<sup>1</sup> The other class of voting common stock, Class A Common Stock, is identical in all respects to the Common Stock except for voting rights, conversion rights and nontransferability of the Class A Common Stock. The holders of Class A Common Stock are entitled to ten (10) votes per share and holders of Common Stock to one vote per share, both classes voting together as one class on all matters to be voted on by shareholders, including the election of directors, except to the extent class voting is otherwise required under the corporate law of the state of incorporation of Company A. The Class A Common Stock is convertible into Common Stock on a share-for-share basis at any time at the option of the holder. The Class A Common Stock is nontransferable and accordingly must be converted into Common Stock in the event the holder desires to sell or otherwise transfer Class A Common Stock.

<sup>2</sup> One individual owns or controls 37.7% of the total voting common stock and the second individual owns or controls 16.4% of the total voting common stock.

<sup>3</sup> Provided, however, that if Company B holds less than five percent (5%) of Company A's Common Stock or common stock issuable or issued upon conversion of the Notes, it shall be entitled to nominate no more than one (1) nominee.

requires Company A to use its best efforts to cause the vacancy to be filled by a nominee proposed by Company B.

The Acquired Person and the Acquiring Person meet the size-of-the-person test for purposes of the Act.

2. Analysis of the Act. Based on our analysis of the Act, as applied to the Transaction, we do not believe that the threshold requirements of the Act are met. As such, we believe that no Notification will be required. Our analysis can be summarized as follows:

a. The Acquisition of Convertible Securities is Not Reportable. Section 7A(c)(2) of the Act exempts "acquisition of bonds, mortgages, deeds of trust, or other obligations which are not voting securities." Thus, the first question is whether the note which is convertible into common stock constitutes "voting securities" for purposes of the Act. 16 C.F.R. section 801.1(f)(1) of the Hart-Scott Transitional Rules (the "Rules") defines "voting securities" to include "any securities which at present or upon conversion entitled the owner or holder thereof to vote for the election of directors of the issuer." The term "conversion" is defined by Section 801.1(f)(3) of the Rules to mean the "exercise of a right inherent in the ownership or holding of particular voting securities to exchange such securities for securities which presently entitle the owner or holder to vote for directors." We understand that the staff of the Federal Trade Commission (the "Commission") have determined that because at present or at some future time convertible notes may be exchangeable for voting securities, they are themselves voting securities and their acquisition is not exempt under Section 7A(c)(2) of the Act. See ABA Premerger Notification Manual (the "Manual"), Interpretation No. 27.

Section 802.31 of the Rules, however, furnishes an exemption for the acquisition of convertible voting securities from the requirements of the Act in certain circumstances. In particular, section 801.1(f)(2) of the Rules defines a "convertible voting security" as a "voting security that carries no present right to vote." Therefore, so long as the convertible note does not enable Company B to have a present right to vote for the directors of the issuer, the note constitutes a convertible voting security within the contemplation of the Act and its acquisition is exempt from the reporting requirements of the Act.<sup>4</sup>

b. The Contractual Agreement to Allow Company B to Nominate Certain Directors to the Board of Company A Does not Constitute a Present Right to Vote Under the Act. An issue arises however, as to whether the Note Purchase Agreement conveys upon Company B a present right to vote under the Act. Pursuant to the terms of the Note Purchase Agreement, the Principal Shareholders agree to vote their shares for the Company A Board of Director nominees proposed by Company B. Indeed, Manual Interpretation No. 94, would seem to provide that the acquisition of a combination of present voting rights and convertible voting

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<sup>4</sup> We note, however, that the subsequent conversion of the notes into common stock would, itself, be a potentially reportable event. See Section 801.32 of the Rules.

securities may be deemed to be an acquisition of presently voting securities for purposes of the Act.

We believe that Manual Interpretation No. 94 is inapplicable to the present situation and that Manual Interpretation No. 54 is controlling in the instant case. Importantly, Company B is merely granted a contractual right to nominate individuals to serve on the Board of Directors of Company A. Company B will not vote in the election of the nominated directors. Manual Interpretation No. 94 is premised upon the fact that the acquiring party obtained "present voting rights" in the acquired party by virtue of its contractual agreement. Here, no such voting rights are acquired by Company B.

The nominating right provisions of the Note Purchase Agreement do not result in a reportable transaction among the parties. Manual Interpretation No. 54 provides that shareholders who enter into voting agreements are not subject to the reporting requirements of the Act. Although Company B is not a shareholder of Company A, we believe that the Note Purchase Agreement which grants Company B certain nomination rights is subject to the same analysis as is provided for in Manual Interpretation No. 54. As such, it is a contractual agreement which falls outside of the scope of the Act.

Further, the Commentary to Manual Interpretation No. 241 provides additional insight in this regard when it provides that the "[e]xecution of shareholder voting agreements . . . are normally viewed as nonreportable events . . . because they are not, by themselves, acquisitions." See ABA Premerger Notification Manual Interpretation No. 241. Further, the rights granted to Company B by virtue of the Note Purchase Agreement are personal to the note holder and are not a characteristic of the note. See, e.g., ABA Premerger Notification Manual Interpretation No. 94.

c. Conclusion and Understanding. In conclusion, and with reference to the Act's requirements, we understand that:

i. The acquisition of a convertible note in the amount of \$20 million may be a reportable event if the convertible note carries with it a present right to vote in the acquired party. However, where there is no present right to vote, only the conversion of the note is likely to result in a reportable transaction.

ii. The Note Purchase Agreement by and among Company A, Company B and the Principal Shareholders does not confer upon Company B a "present right to vote securities" within the contemplation of the Act.

iii. Since the Note Purchase Agreement does not entitle Company B to a present right to vote the securities of Company A, neither Company A nor Company B are subject to the reporting requirements of the Act as a result of the Transaction.

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Federal Trade Commission  
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Please confirm our understanding that the requirements of the Act are not met and, accordingly, no filing of the Notification is required. If you have any questions or need any further information, please do not hesitate to call.

In addition to any verbal response, we respectfully request a written response as soon as practicable. If no written response will be given, please let us know. Otherwise, please let us know when we might expect any such response.

As the parties are anxious to proceed with the Transaction, your prompt attention to this request would be greatly appreciated. Please direct any response or inquires to the undersigned.

Respectfully submitted

[REDACTED]