ATTORNEYS

June 14, 1999

Richard B. Smith, Esq.
Premerger Notification Office
Federal Trade Commission
Bureau of Competition, Room 303
Washington, DC 20580

FEDERAL TRADE COMMISSION
PREMERGER NOTIFICATION OFFICE
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Dear Mr. Smith:

The purpose of this letter is to request clarification of any reporting obligations of the parties to the following transactions:

Transaction One

Company Y markets and sells telecommunications products and services. Company X operates a marketing facility in a particular medium that would allow X and Y to develop new Y products that could not be developed without access to a facility using the medium of the kind owned by X. The facility would also allow Y to market Y's existing products in a new fashion through the facility. X and Y have executed a co-marketing agreement in order to do this. The companies satisfy the size-of-the-person test, and they are not competitors. In order to get Y to agree to the arrangement, X has agreed to purchase voting stock of Y, for an amount of money that satisfies the size-of-the-transaction test. X will control less than ten percent of Y, however, and will have no representation on Y's Board of Directors.

The co-marketing arrangement will account for only a part of Y's sales of its products and services; it will garner the majority of its sales from activities conducted wholly apart from X. Although it intends to vote its Y stock, X intends to limit its involvement with and influence over Y to the exercise of its contractual rights under the co-marketing agreement. Any actions proposed by X will be proposed within the four corners of the co-marketing agreement and will be proposed solely to further the success and profitability of the co-marketing arrangement. None will require approval of the Y shareholders.

Although X will exercise significant control over the presentation of Y products in the X facility, X will not have, nor does it intend to seek, control or influence over

prices charged by Y for Y products or services. X also intends to enter into other co-marketing arrangements of a similar nature with other companies. Although it does not presently intend to acquire voting securities of the companies, it may do so in order to persuade the companies to execute the co-marketing agreements.

Would the Pre-merger Notification Office consider these circumstances to be consistent with the exercise of the investment-only exemption, 16 CFR § 802.9? In a previous telephone conversation, Nancy Ovuka indicated that, under similar circumstances, X and Y would not have a reporting obligation. In fact, that seems to be the correct outcome. The circumstances do not suggest that X has any intention of influencing the "basic business decisions" of Y. The two companies are not competitors, and X will not have a seat on Y's Board of Directors. The co-marketing agreement defines each party's rights sharply, and does not include the right to set or influence prices or to participate in Y's business outside of the context of the co-marketing agreement.

If you agree that X and Y need not file under these circumstances, would your opinion change if, assuming all else remains the same:

- X and Y were competitors; or
- X did not intend to enter into similar agreements with other companies, but viewed the co-marketing arrangement as unique?

Transaction Two

The second hypothetical is divided into three parts, each building on the other:

a. Company X will obtain nonvoting preferred stock in Company Y in an amount which, if converted immediately after the acquisition, would give X approximately ten percent of the voting stock of Y. X will pay more than $15,000,000 for the stock, and both companies satisfy the size-of-the-person test. Along with the nonvoting preferred stock, X will also have the contractual right to nominate one individual for election to the Board of Directors of Y. Y's current Board will be contractually obligated to recommend to the shareholders that X's nominee be elected to Y's Board at the next shareholders' meeting. The nonvoting preferred Y shareholders cannot vote for the election of Y directors, so X will have no power to elect its nominee. Nevertheless, both parties to the agreement fully expect that X's nominee will be elected to the Board. If X's nominee is elected, the new director will have approximately twelve percent of the voting power of the entire Y board.

Would X's nonvoting preferred stock be deemed presently voting securities by virtue of X's contractual right of nomination? In a recent conversation with [redacted] of our office, [redacted] stated that the PNO would not view nonvoting preferred shares as the constructive equivalent of voting securities as long as

some intervening factor could prevent the election of X's nominee, no matter how remote the likelihood of the intervening event. Again, this analysis seems correct. The right to nominate is not the right to appoint, especially if the nominator has no vote for the election of directors. Even if no dissension is expected, Y shareholders have the power to reject the nomination.

b. Assuming that X's nonvoting preferred shares of Y would not be deemed presently voting securities, would the PNO change its position if the contract, which gives X the right to nominate one director, also provided that Y must use any opportunity it can to cause X's nominee to be appointed? In most cases, this may occur when a vacancy on the Board of Directors allows an interim director to be appointed by the current Board, rather than elected by the shareholders. In a recent telephone conversation with [redacted] stated that any future obligation to appoint a director would still be contingent on the occurrence of a future event at the time the nonvoting preferred securities were acquired, and so could not operate to transform nonvoting preferred into present voting securities. Again, this seems to be the correct result; otherwise, preferred shareholders may have their shares suddenly deemed voting securities by the occurrence of an event over which they have no control.

c. Finally, assuming, for purposes of discussion, that X will have a contractual right to *appoint*, rather than nominate, one director, would the nonvoting preferred be deemed presently voting securities under ABA Letter No. 94? On one hand, X would have the voting power to appoint one director if the nonvoting shares were converted immediately into voting securities, and the contract will give X the right to appoint one director. On the other hand, immediate conversion of the preferred stock would give X ten percent of the voting securities of Y, fully-diluted, but the appointment of one director would represent twelve percent of the Board's voting power. Thus, would the PNO conclude that the direct correlation required by ABA Letter No. 94 is absent here?

Transaction Three

X will acquire nonvoting preferred securities of Y in an amount which, if converted immediately, would satisfy the size-of-the-transaction test. As previously noted, X and Y satisfy the size-of-the-person test. As was the case in parts a. and b. of Transaction Two, X will have the right to nominate a director of Y and the Board of Directors of Y will be contractually obligated to recommend X's nominee for election at the next shareholders meeting and must also appoint X's nominee when and if it is able to do so, as in the case of a vacancy between shareholders' meetings.

In addition, after X's acquisition of nonvoting preferred shares of Y, Y and Company Z will execute a written agreement under which Y will merge with and into Merger Sub (a subsidiary of Z), with Y surviving the merger as a subsidiary of Z. The merger agreement will provide that, immediately after the merger, all nonvoting preferred shares of Y will be exchanged automatically for voting securities of Z. The exchange will occur automatically, with no action required by Y preferred shareholders.

Under these circumstances, would the automatic exchange of Y nonvoting preferred stock for common stock of Z be a "conversion" under 16 CFR § 801.1(f)(3)? In your prior telephone conversations with [redacted] and with me, you have stated that an exchange of nonvoting preferred for voting common would not meet the definition of a "conversion" if possible intervening events could thwart the planned exchange. This is consistent with prior written informal opinions of the PNO.

For instance, in this example, at the time that the nonvoting preferred stock is acquired by X, the shareholders of Y and Z will not yet have formally approved the merger. For that matter, the antitrust authorities reviewing the merger may decide not to approve it, or to approve it with conditions that would be unacceptable to one or both parties to the merger. Any number of events, both likely and unlikely, may occur to prevent the merger, and thus the exchange of nonvoting for voting securities. Therefore, the exchange should not be considered a "conversion" and a potentially reportable event.

Nevertheless, we ask that the PNO confirm the prior oral interpretations that we have received. If you agree with our analysis, would your conclusion change if the nonvoting preferred shareholder were heavily involved in the merger negotiations between Y and Z, even to the point that X could, as a practical matter, determine whether the merger would be approved by the Y and Z shareholders, even though it has no such power by law?

Thank you for your consideration of these questions. We await your response. Please do not hesitate to call me at [redacted] or [redacted] with any questions.

Sincerely yours,

[redacted]

By [redacted]

6/16/99 - Discussed with co-counsel and letter writer. As to Issue One, [illegible] X and Y are competitors, [illegible] 802.9 [illegible] X's entry into [illegible] agreement [illegible] On the facts, 802.9 [illegible] [illegible] ABA Letter #[illegible] [illegible] nonvoting stock for voting stock [illegible] 802.4(c) [illegible] Not a conversion [illegible] the [illegible] in the merger [illegible] still a [illegible] reportable transaction [illegible] ABA Letter #111.

R.B. Smith [redacted]