

# Antitrust Alert

## FTC Amends HSR Rules on Treatment of Unincorporated Entities

by Paolo Morante

The Federal Trade Commission has approved for publication new rules requiring a filing under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the HSR Act) in connection with certain acquisitions and transfers of interests in, and formations of, “unincorporated entities.” Under the new rules, the term “unincorporated entity” includes, among others, partnerships, cooperatives, business trusts, and LLCs. The objective of the new rules is to reconcile, as far as practicable, the treatment of unincorporated entities with the treatment of corporate entities under the HSR Act.

The new rules will take effect 30 days after publication in the Federal Register, which is expected any day. In other words, the new rules should become effective on or about April 1, 2005, and will apply to all transactions closing on or after the effective date.<sup>1</sup>

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### Old Rules vs. New Rules

Until now, an acquisition of interests in an unincorporated entity was reportable only if the statutory thresholds were met and, as a result of the acquisition, the acquiring person would hold all of the interests in that entity. Moreover, partnership formations were not reportable and the formation of an LLC was reportable only under very particular circumstances. Under the new rules, as detailed below, an acquisition or transfer of interests in an unincorporated entity is potentially reportable if the transaction effects a change in control of the unincorporated entity. Similarly, the formation of an unincorporated entity is potentially reportable if, as a result of the formation, at least one person will control the newly formed entity.

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## Acquisitions of Interests in Existing Unincorporated Entities

Under the new rules, the acquisition or transfer of interests in an unincorporated entity will be reportable if the statutory size-of-transaction and size-of-persons tests are satisfied,<sup>2</sup> no exemptions apply, and, as a result of the transaction, a person that did not have control of the unincorporated entity before the transaction will acquire that control. With respect to unincorporated entities, the new rules define “control” as the right to receive either 50 percent or more of the entity’s profits or 50 percent or more of the entity’s assets upon dissolution.<sup>3</sup> Consistent with this approach, an acquisition of 100 percent of the interests in an unincorporated entity by a person that already has control of that entity (which was potentially reportable under the previous regime) will no longer be reportable.

For valuation purposes, the new rules provide that the value of the interests in the unincorporated entity that the acquiring person will hold as a result of the transaction equals the sum of (i) the acquisition price of the interests being acquired (provided the acquisition price has been determined) plus (ii) the fair market value of any interests in the same unincorporated entity held by the acquiring person prior to the transaction. If the acquisition price of the interests to be acquired has not been determined, then the value of the interests held by the acquiring person as a result of the acquisition equals the fair market value of all such interests, including any that the acquiring person may have held prior to the acquisition. For purposes of the size-of-persons test, however, a person that controls an unincorporated entity will be deemed to hold all of the assets of that entity.

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## Formation of Unincorporated Entities

The new rules eliminate the exemption applicable to partnership formations and subject the formation of any unincorporated entity to reporting and waiting period requirements if (a) as a result of the formation, at least

one person will “control” the new entity; (b) the value of that controlling interest exceeds \$53.1 million (as adjusted); and (c) in cases where the value of the controlling interest does not exceed \$212.3 million (as adjusted), the size-of-persons test is satisfied. The definition of “control” for these purposes is the same as described above.

A filing is required from each person that will hold a controlling interest in the newly formed unincorporated entity. Each such controlling person is deemed to be an acquiring person, and the statutory waiting period begins to run only when a completed filing is received by the agencies from each acquiring person. No filing is required from the newly formed entity, which is deemed to be the acquired person.

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## Exemptions Applicable to Unincorporated Entities

Consistent with the treatment of nonprofit corporate joint ventures, the formation of a nonprofit unincorporated entity is exempt from the requirements of the Act. Similarly, the new rules exempt the acquisition of interests in an unincorporated entity that holds non-exempt assets valued at \$53.1 million (as adjusted) or less.<sup>4</sup>

Also exempt are financing transactions that confer control of a new or existing unincorporated entity if (a) the acquiring person is contributing only cash to the unincorporated entity; (b) the purpose of that cash contribution is to provide financing to the unincorporated entity; and (c) the terms of the financing agreement are such that the acquiring person will no longer control the entity after it realizes its preferred return.

As noted above, the acquisition of interests in an unincorporated entity that is already controlled by the acquiring person is similarly exempt.

Finally, the new rules exempt transactions involving the conversion or reorganization of an unincorporated entity into a new entity, *provided that* (a) no new assets are contributed to the new entity; and (b) either (1) the acquiring person does not increase its percentage

holdings in the new entity as compared to its holdings in the original entity or (2) the acquiring person already controlled the original entity.

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## Endnotes

<sup>1</sup> The new rules will not apply to unincorporated entities that were under investigation by the antitrust agencies and supplied information or documents under compulsory process prior to the effective date.

<sup>2</sup> The size-of-persons test is satisfied if one person has annual net sales or total assets of at least \$10.7 million, and the other person has annual net sales or total assets of at least \$106.2 million. This test must be satisfied if the transaction is valued at more than \$53.1 million but no more than \$212.3 million. If the transaction is valued at above \$212.3 million, the size-of-persons test does not apply. As a result of the 2001 amendments to the HSR Act, these thresholds are subject to annual adjustment.

<sup>3</sup> The contractual power to appoint 50 percent or more of the individuals exercising functions similar to those of directors has been removed from the definition of “control” for purposes of unincorporated entities.

<sup>4</sup> This exemption applies to acquisitions of corporate voting securities as well and represents an expansion of the former exemption in this area.

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