NEW HSR RULES REGARDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES TO BECOME EFFECTIVE ON APRIL 7, 2005

On April 7, 2005, new rules promulgated under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act") by the Federal Trade Commission will become effective. The HSR Act requires premerger notification to the FTC and Department of Justice for certain mergers or acquisitions of voting securities or assets. The principal intent of the amendments included in the new rules, which can be accessed at http://www.ftc.gov/opa/2005/02/fyi0516.htm, is to reconcile treatment under the HSR Act of transactions involving noncorporate entities such as partnerships and limited liability companies with transactions involving corporations. As a result, the so called "partnership exemption," which has generally allowed parties to ignore HSR concerns where noncorporate interests are involved, may no longer be relied upon.

The new rules will materially impact the HSR implications of (i) acquisitions of interests in preexisting partnerships or limited liability companies; (ii) formations of noncorporate entities such as partnerships or limited liability companies; and (iii) intraperson transfers of assets from partnerships or limited liability companies. The new rules also notably expand the HSR rule that exempts acquisitions of interests in entities that hold assets, the direct acquisition of which would be exempt, and adds an exemption to clarify that the acquisition of noncorporate interests in certain financing transactions will be exempt.

The New Rules May Cause Acquisitions of Interests in Partnerships or Limited Liability Companies to Be Reportable Under the HSR Act Where an Acquisition Would Confer Control of the Relevant Noncorporate Entity

Currently, an acquisition of an interest in an existing partnership or limited liability company only implicates notification obligations under the HSR Act where an Acquiring Person would hold 100% of the interests of the entity as a result of the proposed acquisition. This has the anomalous effect of not requiring notification where a potentially competitively sensitive event occurred -- i.e., where control of a partnership or LLC has transferred from one person to another. At the same time, the existing policy mandates notification in many circumstances that could have no conceivable competitive impact (i.e., where a holder of 99% of the interests in a noncorporate entity -- including the general partner or managing member interest -- obtained the remaining 1% interest).

The new rules may trigger a potential filing event when an Acquiring Person would hold 50% or more of the interests of a partnership or LLC as a result of a proposed acquisition, justifying this change by stating that "[c]onsistent with the treatment of corporate entities, meaningful antitrust review should occur at the time that control of an unincorporated entity changes and not after control is already acquired."

Formations of Noncorporate Entities May Trigger Notification Requirements

To date, the formation of a partnership has always been outside the coverage of the HSR Act, and the formation of an LLC has been potentially reportable only under very limited circumstances.[1] This policy will now change. Under Rule 801.50 of the new rules, a formation of a noncorporate entity such as a partnership or LLC may trigger notification obligations where one of the venturers would control the entity upon formation. "Control" is determined by having the right to 50% or more of an entity's profits or 50% or more of an entity's assets upon dissolution. The size-of-person test (requiring a controlling venturer to have sales or assets in excess of $10.7 million and the entity to have assets in excess of $106.2 million or the controlling venturer to have sales or assets in excess of $106.2 million and the entity to have assets in excess of $10.7 million) and the size-of-transaction test (requiring the controlling venturer to hold in excess of $53.1 million worth of the interests in the newly formed entity) would need to be satisfied to trigger filing obligations.

The Exemption for Intraperson Transfers Will Be Enlarged

Under existing HSR rules, a transfer of stock or assets from a corporation to a controlling shareholder, or from one controlled corporate subsidiary to another controlled corporate subsidiary, is exempt under Rule 802.30, which exempts acquisitions where "by reason of holdings of voting securities, the acquiring and acquired persons are . . . the same person." Because of the use of the phrase "by reason of holdings of voting securities," similar transfers involving noncorporate entities have not been exempt under this rule. Thus, for instance, a transfer of assets from a partnership to a controlling individual partner has, to date, been potentially reportable, even though the acquiring partner already indirectly controls the assets being transferred.

The new rules expand Rule 802.30 to exempt transactions where the acquiring and acquired persons are the same by any means, whether by "holdings of voting securities" or otherwise.

The Exemption for Acquisition of Interests in Entities That Hold Primarily Exempt Assets Is Being Expanded

Rule 802.4 exempts acquisitions of voting securities of entities that hold certain assets, the direct acquisition of which would be exempt. This exemption has principally been limited to acquisitions of voting securities of corporate entities that hold real estate. The new rules modify this exemption in two significant ways. First, the exemption will apply to acquisitions of interests in noncorporate entities that hold assets, the direct acquisition of which would be exempt. Second, the exemption will be expanded to exempt acquisitions of interests in entities that principally hold assets whose direct acquisition would be exempt under any exemption provided by the HSR rules or the HSR Act. Of particular interest, the new rule will exempt

[1] Under Formal Interpretation No. 15 (which is now being repealed), the FTC has treated the formation of an LLC as reportable only if (1) two or more preexisting, separately controlled businesses were being contributed to the LLC and (2) at least one member would control the LLC.

acquisitions of interests in entities that would hold only cash or cash equivalents. This is intended to exempt the formation of joint venture acquisition vehicles, whether structured as a corporation or as a noncorporate entity.[2]

Certain Financing Transactions Involving Noncorporate Entities Will Be Exempt

The new rules also include a new exemption (Rule 802.65) for acquisitions of a controlling interest in a noncorporate entity where that controlling interest is acquired in connection with certain financing transactions. The rule exempts an acquisition where (i) the acquiror is contributing only cash to the entity; (ii) the purpose of the contribution is to provide financing to the noncorporate entity; and (iii) the acquiror will cede control once the acquiror realizes its preferred return. This new exemption is intended to clarify that the HSR Act will not apply to bona fide financing transactions where the lender acquires a controlling noncorporate interest effectively as secured debt.

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If you have any questions about the new rules, please contact our HSR specialist, Jonathan J. Konoff (212-728-8627, jkonoff@willkie.com) or the attorney with whom you regularly work.

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[2] Under existing rules, the formation of a corporate joint venture special purpose acquisition vehicle has triggered HSR filing obligations under certain circumstances.