HSR Act Amendments Published March 8, 2005: Reconciling Disparate Treatment of Partnerships, LLCs, and Other Unincorporated Entities

The Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act") requires that the parties to certain mergers and acquisitions file an HSR Notification and Report Form ("HSR Form") with the FTC and the Antitrust Division and wait a specified period of time before consummating the proposed transaction. The HSR Act provides that the Federal Trade Commission, in consultation with the Antitrust Division of the Department of Justice, can develop rules ("HSR Rules") necessary and appropriate to carry out the purposes of the Act.

The latest iteration of those rules (which have the effect of amending the HSR Act) was published in the Federal Register on March 8, 2005. These amendments have the practical effect of extending reporting obligations to the formations of certain unincorporated entities and to acquisitions of controlling interests in such entities. They are intended to reconcile, as far as practicable, the treatment of unincorporated entities with treatment of corporate entities under the HSR rules. The final rules will take effect on April 7, 2005.

Treatment of Acquisitions of Unincorporated Entities

The primary impetus for these changes is the rise in the number and significance of acquisitions of both corporate and noncorporate interests by various kinds of unincorporated entities, including limited liability corporations and partnerships. As a result of multiple informal staff interpretations of the rules over the years, several inconsistencies between the application of the HSR Act to corporations and its application to unincorporated entities had developed, and these amendments are intended to reconcile these discrepancies to the extent practicable.

Acquisition of Noncorporate Interests: Changes of Control. Prior to the amendments, the HSR Act applied solely to acquisitions of voting securities or assets. Neither the Act nor the HSR Rules specifically addressed whether interests in unincorporated entities were deemed to be voting securities or assets. However, the FTC Premerger Notification Office had issued informal interpretations that partnership interests and, by analogy, other noncorporate interests, are neither assets nor voting securities, and thus acquisitions of noncorporate interests historically have not been subject to the requirements of the Act.

This approach produced some strange results. For example, a person who acquired a controlling but less than 100 percent interest in an unincorporated entity was not deemed to be acquiring any assets or voting securities of the entity, and the acquisition was not subject to the requirements of the Act. However, if the acquiring person would hold 100 percent of the interests in the unincorporated entity as a result of the acquisition, the acquisition was deemed to be an acquisition of all of the underlying assets of the unincorporated entity and treated as a potentially reportable asset acquisition. To further complicate matters, despite the fact that an acquiring person holding less than a 100 percent controlling interest in the entity as a result of the acquisition was not deemed to have acquired any of the underlying assets of the entity, that person was immediately deemed to hold those same assets for purposes of determining whether it met the size-of-person test because it would have the right to either 50 percent of the profits or 50 percent of the assets of the acquired entity upon dissolution.
Thus, while a filing was required in order to gain 100 percent control of an unincorporated entity, no filing was required to gain anything less than a 100 percent controlling interest. For example, a person who held either no interest or a minority interest in a noncorporate entity and acquired a 99 percent controlling interest in the entity was not required to file an HSR Form—but 1 percent more and a filing was required. Moreover, if a person already held a 99 percent interest in an unincorporated entity and then acquired the remaining 1 percent interest, a filing was required at that point, despite the fact that the acquisition of the remaining minority interest would have no competitive relevance.

In order to resolve these anomalies, the Commission concluded that, consistent with the treatment of corporations, all changes in control of unincorporated entities should trigger antitrust review. The newly revised Section 802.1(f)(1) of the HSR Rules makes acquisitions of noncorporate interests that confer control of an unincorporated entity fully reportable.

**Intraperson Transfers.** The old rules exempted certain intraperson transactions—transactions in which the acquiring and acquired persons are the same person by reason of holdings of voting securities. As a result, asset transfers between corporations—such as asset transfers from a corporation to a controlling shareholder or from one corporate subsidiary to another subsidiary of the same parent—were exempt from the HSR Act, while the same transfer of assets from a noncorporate entity to another entity under common control or to an unincorporated entity that controls the noncorporate entity was not exempt, simply because of the fact that unincorporated entities do not issue voting securities.

In both cases, the parent entity holds the assets of the controlled entities both before and after the transaction. However, the requirement that common control be “by reason of holdings of voting securities” resulted in an inconsistent application of the exemption. The Commission has amended Section 802.30(a) of the HSR Rules to replace this requirement with the appropriate control test (as revised by the proposed rules) for each type of entity involved in the transaction. For corporations, the test of common control is still tied to holding 50 percent or more of the outstanding voting securities of the corporation. For unincorporated entities, the test is linked to having the right to 50 percent or more of the profits of the entity or the right in the event of dissolution to 50 percent or more of the entity’s assets.

In addition, the changes to Section 802.30(a) broaden the scope of the exemption to include transactions where at least one of the acquired persons is the same person, instead of requiring that all acquiring and acquired persons be under common control. As a result, the exemption now covers acquisitions where there is more than one acquired ultimate parent entity (“UPE”). For example, where two entities, A and B, each have a controlling interest (either the right to 50 percent of the profits or 50 percent of the assets upon dilution) in unincorporated entity X, and X sells certain assets to entity Y, the transfer of assets from X to Y is exempt if both these entities are under the common control of A, despite the fact they may not both be under the common control of B. To hold otherwise would require A to file for the acquisition of assets that it already controls.

The Commission’s amendments also extend the application of the existing exemption in Section 802.30(b) for the formation of wholly owned corporate subsidiaries to the formation of any type of wholly owned entity.

**Formations.** Under the HSR Rules, unless exempted, the formation of a corporation or joint venture (other than in connection with a merger or consolidation) is generally subject to the requirements of the HSR Act provided that either: (1) the acquiring person (in this case the contributor) has annual net sales or total assets of $106.2 million or more, the joint venture or other corporation (in this case the acquired person) will have total assets of $10.7 million or more, and at least one other acquiring person has annual net sales or total assets of $106.2 million or more, or (2) the acquiring person (in this case the contributor) has annual net sales or total assets of $10.7 million or more, the joint venture or corporation (in this case the acquired person) will have total assets of $106.2 million or more, and at least one other acquiring person has annual net sales or total assets of $10.7 million or more.

By comparison, under the old rules, the formation of any noncorporate entity was generally not subject to the Act, with one exception—the formation of certain limited liability companies (“LLCs”). Pursuant to the FTC Premerger Notification Office’s Formal Interpretation 15, which was meant to address the inconsistent treatment of corporations and LLCs in this context, the “formation” of an LLC was reportable provided that two or more existing, separately controlled businesses were contributed to the LLC and at least one of the members would control the new entity (i.e., hold the right to 50 percent
or more of the profits or the right upon dissolution to 50 percent or more of the assets of the LLC).

The Commission has now amended Section 801.50 to extend the application of the Act to the formation of all noncorporate entities if that results in a change of control of assets, including those LLC formations that are currently outside the scope of Formal Interpretation 15. The formation of a noncorporate entity is now reportable provided that one or more of the forming parties acquires a controlling interest in the newly formed entity and either: (1) the acquiring person has annual net sales or total assets of $106.2 million or more and the newly formed entity has total assets of $10.7 million or more; or (2) the acquiring person has annual net sales or total assets of $10.7 million or more and the newly formed entity has total assets of $106.2 million or more.

Additional Changes. In addition to the principal modifications discussed above, the rulemaking implements a number of other changes to the HSR Act, including:

- Section 801.1(b) (eliminating the alternate control test for unincorporated entities);
- Section 801.1(f) (defining the meaning of a “non corporate interest”);
- Section 801.2(d) (clarifying the application of the Act to consolidations);
- Section 801.2(f)(2) (distinguishing between the acquisition of non corporate interests and the formation of a new unincorporated entity);
- Section 801.2(f)(3) (clarifying when an acquisition of control of a not-for-profit corporation is an acquisition of the underlying assets of the entity); and
- Section 801.10(d) (defining how to value the acquisition of non corporate interests).

In addition, there are certain ministerial changes adapting Sections 801.4, 802.40, and 802.41 to both corporations and unincorporated entities as well as technical corrections to Sections 801.13, 801.15, and 802.2. Finally, the new rules require minor revisions to the HSR Notification and Report Form: The reporting requirement in Items 1, 2, and 7 have been changed with respect to the formation of new entities. In addition, Item 5(d) must be completed in connection with the formation of an unincorporated entity, and Items 7 and 8 are now applicable to unincorporated entities.

Obviously, like the HSR Act in general, these changes are highly technical and not easily subject to summary. If you have the misfortune of needing to know more about the details of the changes, a more detailed explanation is available through the contacts listed below.

**Further Information**

For further information, readers are encouraged to contact their regular Jones Day attorney or the principal authors of this Commentary, Tom D. Smith (telephone: 202.879.3971; e-mail: tdsmith@jonesday.com), Mia Cohen (telephone: 202.879.3641; e-mail: mfcohen@jonesday.com), and Karen Espaldon (telephone: 202.879.3607; e-mail: kmespaldon@jonesday.com). General e-mail messages may be sent using our Web site feedback form, which can be found at www.jonesday.com.

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