

An issue of substance

The FTC is proposing positive steps to harmonize HSR treatment of corporations, partnerships and LLCs. But there's more to be done to elevate substance over form

by Jon Dubrow

The Federal Trade Commission deserves credit for its effort to promote fair, consistent treatment of corporations and "non-corporate entities" under the Hart-Scott-Rodino Act. But more remains to be done even if its proposed changes to the Act's premerger notification rules are implemented. Probably the most significant aspect of the FTC's proposed rules is a fundamental shift in the way partnerships and limited liability companies are treated. The changes would affect HSR reportability both at the time of formation and in post-formation transfers of interests in those entities. Many additional transactions involving partnerships and LLCs would become HSR reportable. Deals currently under contract, in negotiation or under consideration that will not close by the end of June should be analyzed under the proposed rules.

A common criticism of the HSR rules has been that they have often elevated form over substance. This frequently has meant differing treatments for transactions involving corporations compared with those involving partnerships. Many deals involving partnerships or LLCs have been unreportable; they would be reportable if they involved formation of a new corporation. However, a combination of two rivals can raise the same competitive issues whether accomplished through a corporation or a partnership.

The proposed rules attempt to eliminate some of these different results driven purely by transaction structures. It seems warranted to provide similar reporting treatment to different forms of transactions that raise comparable substantive issues.

The proposed rules create a new definition of "noncorporate entity" to govern

partnerships and LLCs. The measures would capture transactions involving the formation of, or transfer of interests in, noncorporate entities when a party will control that entity by having the right to 50% or more of its profits, or its assets on dissolution.

The formation of a new joint venture partnership or LLC will be reportable if any party will hold a controlling interest valued at \$50 million or more in the entity. Acquisitions of interests in an existing noncorporate entity would be potentially reportable if the acquiring person will get a controlling interest valued at more than \$50 million.

Another significant goal of the proposed changes is to treat partnership "intracompany" transactions in the same way as corporate intracompany transactions. A party that holds 50% or more of the voting securities of another company can acquire additional shares without reporting because that transaction is deemed to be intracompany. However, under current rules, a party that holds a controlling interest in a partnership or LLC, and therefore "holds" its assets, may need to file when it increases from a controlling position to 100% ownership.

The proposed rules extend intracompany treatment to noncorporate entities, so an acquisition of additional interests in an entity by a party that already controls it will be exempt from HSR reporting. This is clearly a sound shift in antitrust policy; it should eliminate HSR filings for many transactions that have essentially no competitive impact because they do not involve change of control over assets or a business.

The FTC should be commended for its efforts to eliminate some long-standing, but

seemingly arbitrary, rules and interpretations that created different analysis for functionally similar transactions. Nevertheless, some significant differences in the treatment of corporate and noncorporate entities will remain even if the rules are implemented.

For example, formation of a large corporate venture with no controlling shareholder can be reportable if one of the forming members acquires shares worth over \$50 million. However, formation of an equivalent venture in a noncorporate form will not be reportable under the proposed rules, since no person will be acquiring a controlling interest.

While these issues of consistency and fairness are on the table, the FTC should also consider seeking ways to eliminate other situations in which form appears to be elevated over substance in the HSR rules. One involves the different results that apply to the treatment of the acquisition value for stock transactions compared with asset deals. In overly simple terms, an acquisition of a business in a stock deal is likely to have a lower HSR valuation than acquisition of the same business in an asset transaction. The lower valuation may lead to a stock transaction not being reportable, while an equivalent asset transaction would be reportable.

The FTC's proposed rules are a step in the right direction, but more can be done if the ultimate goal is to elevate substance over form. n

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