FEDERAL TRADE COMMISSION

16 CFR Parts 801, 802 and 803

Premerger Notification; Reporting and Waiting Period Requirements

AGENCY: Federal Trade Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: These proposed rules would amend the premerger notification rules that require the parties to certain mergers or acquisitions to file reports with the Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, and to wait a specified period of time before consummating such transactions. The reporting and waiting period requirements are intended to enable these enforcement agencies to determine whether a proposed merger or acquisition might violate the antitrust laws if consummated and, when appropriate, to seek a preliminary injunction in federal court to prevent consummation. During the eight years the rules have been in effect, the Federal Trade Commission, with the concurrence of the Assistant Attorney General for Antitrust, has amended the premerger notification rules several times in order to improve the program's effectiveness and to lessen the burden of complying with the rules. These proposed revisions are intended to improve the program's effectiveness by amending the definition of the term "control" as it applies to partnerships and other entities that do not have outstanding voting securities.

DATE: Comments must be received on or before April 6, 1987.

ADDRESSES: Written comments should be submitted to both (1) the Secretary, Federal Trade Commission, Room 136, Washington, DC 20580, and (2) the Assistant Attorney General, Antitrust Division, Department of Justice, Room 3214, Washington, DC 20530.

FOR FURTHER INFORMATION CONTACT: Kenneth M. Davidson, Attorney, Evaluation Office, Bureau of Competition, Room 394, Federal Trade Commission, Washington, DC 20580. Telephone: (202) 326-3300.

SUPPLEMENTARY INFORMATION:

Regulatory Flexibility Act

The proposed amendments to the Hart-Scott-Rodino premerger notification rules are designed to improve the effectiveness of the premerger notification program. They alter the approach to rulemaking proposed on September 24, 1985 (50 FR 38742, see Proposal 1) by narrowing the types of transactions that would have been made reportable by the previously proposed rules. The Commission has determined that none of the proposed rules is a major rule, as that term is defined in Executive Order 12291. The proposed rules will not result in: An annual effect on the economy of $100 million or more; a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or significant adverse effects on competition, employment, investment, productivity, innovation or the ability of United States-based enterprises to compete with foreign-based enterprises in the domestic market. None of the amendments would expand the coverage of the premerger notification rules in a way that would affect small business. Therefore, pursuant to section 605(b) of the Administrative Procedure Act, 5 U.S.C. 605(b), as added by the Regulatory Flexibility Act, Pub. L. 96-354 (September 19, 1980), the Federal Trade Commission certifies that these rules will not have a significant economic impact on a substantial number of small entities. Section 603 of the Administrative Procedure Act, 5 U.S.C. 603, requiring a final regulatory flexibility analysis of some rules, is therefore inapplicable.

Paperwork Reduction Act

The Hart-Scott-Rodino Premerger Notification rules and report form contain information collection requirements as defined by the Paperwork Reduction Act. 44 U.S.C. 3501 *et seq.* These requirements have been reviewed and approved by the Office of Management and Budget (OMB Control No. 3084-0005). Because the proposed amendments would affect the information collection requirements of the premerger notification program, the proposed amendments have been submitted to OMB for review under section 3504(h) of the Paperwork Reduction Act. Comments on that submission may be directed to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503, Attention: Don Arbuckle, Desk Officer for the Federal Trade Commission.

Background

Section 7A of the Clayton Act ("the act"), 15 U.S.C. 18a, as added by sections 201 and 202 of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, requires persons contemplating certain acquisitions of assets or voting securities to give advance notice to the Federal Trade Commission (hereafter referred to as "the Commission") and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice (hereafter referred to as "the Assistant Attorney General"), and to wait certain designated periods before the consummation of such acquisitions. The transactions to which the advance notice requirement is applicable and the length of the waiting period required are set out respectively in subsections (a) and (b) of section 7A. This amendment to the Clayton Act does not change the standards used in determining the legality of mergers and acquisitions under the antitrust laws.

The legislative history suggests several purposes underlying the act. Congress wanted to assure that large acquisitions were subjected to meaningful scrutiny under the antitrust laws prior to consummation. To this end, Congress clearly intended to eliminate the large "midnight merger," which is negotiated in secret and announced just before, or sometimes only after, the closing takes place. Congress also provided an opportunity for the Commission or the Assistant Attorney General (who are sometimes hereafter referred to collectively as the "antitrust agencies" or the "enforcement agencies") to seek a court order enjoining the completion of those transactions that the agencies deem to present significant antitrust problems. Finally, Congress sought to facilitate an effective remedy when a challenge by one of the enforcement agencies proved successful. Thus, the act requires that the antitrust agencies receive prior notification of significant acquisitions, provides certain tools to facilitate a prompt, thorough investigation of the competitive implications of these acquisitions, and assures the enforcement agencies an opportunity to seek a preliminary injunction before the parties to an acquisition are legally free to consummate it, reducing the problem of unscrambling the assets after the transaction has taken place.

Subsection 7A(d)(1) of the act, 15 U.S.C. 18a(d)(1), directs the Commission, with the concurrence of the Assistant Attorney General, in accordance with 5 U.S.C. 553, to require that the notification be in such form and contain such information and documentary material as may be necessary and appropriate to determine whether the proposed transaction may, if consummated, violate the antitrust laws. Subsection 7A(d)(2) of the act, 15 U.S.C. 18a(d)(2), grants the Commission, with the concurrence of the Assistant Attorney General, in accordance with 5 U.S.C. 553, the authority (A) to define

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the terms used in the act, (B) to exempt additional persons or transactions from the act's notification and waiting period requirements, and (C) to prescribe such other rules as may be necessary and appropriate to carry out the purposes of section 7A.

On December 15, 1976, the Commission issued proposed rules and a proposed Notification and Report Form ("the Form") to implement the act. This proposed rulemaking was published in the **Federal Register** of December 20, 1976, 41 FR 55488. Because of the volume of public comment, it became clear to the Commission that some substantial revisions would have to be made in the original rules. On July 25, 1977, the Commission determined that additional public comment on the rules would be desirable and approved revised proposed rules and a revised proposed Notification and Report Form. The revised rules and Form were published in the **Federal Register** of August 1, 1977, 42 FR 39040. Additional changes in the revised rules and Form were made after the close of the comment period. The Commission formally promulgated the final rules and Form, and issued an accompanying Statement of Basis and Purpose on July 10, 1978. The Assistant Attorney General gave his formal concurrence on July 18, 1978. The final rules and Form and the Statement of Basis and Purpose were published in the **Federal Register** of July 31, 1978, 43 FR 33451, and became effective on September 5, 1978.

The rules are divided into three parts, which appear at 16 CFR Parts 801, 802 and 803. Part 801 defines a number of the terms used in the act and rules, and explains which acquisitions are subject to the reporting and waiting period requirements. Part 802 contains a number of exemptions from these requirements. Part 803 explains the procedures for complying with the act. The Notification and Report Form, which is completed by persons required to file notification, is an appendix to Part 803 of the rules.

Changes of a substantive nature have been made in the premerger notification rules or Form on five occasions since they were first promulgated. The first was an increase in the minimum dollar value exemption contained in § 802.20 of the rules. This amendment was proposed in the **Federal Register** of August 10, 1979, 44 FR 47099, and was published in final form in the **Federal Register** of November 21, 1979, 44 FR 60781. The second amendment replaced the requirement that certain revenue data for the year 1972 be provided in the Notification and Report Form with a requirement that comparable data be provided for the year 1977. This change was made because total revenues for the year 1977 broken down by Standard Industrial Classification (SIC) codes became available from the Bureau of the Census. The amendment appeared in the **Federal Register** of March 5, 1980, 45 FR 14205, and was effective May 3, 1980.

The third set of changes was published by the Federal Trade Commission as proposed rules changes in the **Federal Register** of July 29, 1981, 46 FR 38710. These revisions were designed to clarify and improve the effectiveness of the rules and of the Notification and Report Form as well as to reduce the burden of filing notification. Several comments on the proposed changes were received during the comment period. Final rules, which adopted some of the suggestions received during the comment period but which were substantially the same as the proposed rules, were published in the **Federal Register** of July 29, 1983, 48 FR 34427, and became effective on August 29, 1983. The fourth change, replacing the requirement to provide 1977 revenue data with a requirement to provide 1982 data on the Form, was published in the **Federal Register** of March 26, 1986, 51 FR 10368.

In addition, the Notification and Report Form, found in 16 CFR 803 (Appendix), has undergone minor revisions on two other occasions. The new versions were approved by the Office of Management and Budget on December 29, 1981, and February 23, 1983, respectively. Most recently, the information collection requirements of the Notification and Report Form were approved by the Office of Management and Budget on September 30, 1985, for a period of three years.

The fifth set of changes to the rules and the Notification and Report Form was published by the Federal Trade Commission as proposed rule changes in the **Federal Register** of September 24, 1985, 50 FR 38742. Those thirteen proposed revisions were designed to reduce the cost to the public of complying with the rules and to improve the program's effectiveness. Numerous comments were received on the thirteen proposals. The Commission decided to adopt nine of the proposals (one in significantly modified form), to reject one proposal for budgetary reasons, and to defer action on the other three. The proposal to require reporting by owners of "acquisition vehicles" (Proposal 1 of the September 24, 1985, proposed amendments); the proposed exemption of certain asset acquisitions, including the acquisitions of current supplies, new durable goods, and some types of real estate (Proposal 5); and, the proposal to increase the "controlled issuer" threshold that would have expanded the exemption for transactions valued at $15 million or less in § 802.20(b) and for certain foreign transactions described in § 802.50 and § 802.51 (Proposal 6). Final rules, which adopted some of the suggestions received from public comments, were published this day in the **Federal Register** and will become effective on April 10, 1987. These changes included further revisions to the Notification and Report Form.

The current set of proposals to change the premerger notification rules grows out of the comments to Proposal 1 of the September 24, 1985, **Federal Register** notice, the proposed "acquisition vehicle" rules. The underreporting problem that the "acquisition vehicle" approach was designed to solve is extensively discussed in that notice of proposed rulemaking. It explains both how in some circumstances an acquisition made by a partnership is not subject to the reporting and waiting obligations of the act, and how in similar circumstances an acquisition made by a newly formed corporation that has no controlling owner is not subject to the obligations of the act. The proposed rules would have required both types of transactions to be reported.

The proposed "acquisition vehicle" rules received the second largest number of public comments. They were discussed by comments 2, 4, 7, 15, 16, 18, and 19. While the comments differed on numerous points, and not all were critical, three significant points emerged: First, it is likely the proposed rules would generate a large number of notification filings; second, the rules might be subject to evasion by relatively simple expedients; and finally, there are less inclusive approaches that could accomplish the primary objective of the "acquisition vehicle" proposal.

Because of the importance of these issues to the effectiveness of the premerger program, the Commission has reconsidered its proposal and developed a new approach that applies only to partnerships and other entities that do not issue voting securities. While not based directly on suggestions from the public comments, the Commission believes its new proposal is responsive to the concerns raised in those comments.

The Commission invites interested persons to submit comments on the nature and scope of the problems described in the Proposed Statement of Basis and Purpose, as well as on the

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appropriateness of the proposed amendments to the rules as solutions to those problems.

The Commission also invites responses to the following specific questions:

1. Does the partnership control proposal sufficiently decrease the possibility that a competitively significant transaction might occur without being reportable under the premerger notification program?

2. The American Bar Association ("ABA"), in its comments on the "acquisition vehicle" rules, proposed to amend the definition of control in a manner similar to the partnership control approach. The ABA suggested that the rules include an alternative definition of control that would apply to all acquiring persons that do not otherwise meet the act's section 7A(a)(2) size-of-person test. With respect to such persons, control would be ascribed to that "owner" holding the largest interest in the acquiring person equal to or greater than 25 percent, regardless of whether such person was otherwise exempt from reporting. The percentage ownership interest would be determined in accordance with the method proposed by the Commission in the "acquisition vehicle" rules and retained in the partnership control rule. Is the ABA proposal, or some other variant, a preferable alternative to the partnership control rule?

3. What are the costs and benefits of the partnership control proposal?

4. What are the costs and benefits of the ABA proposal?

Proposed Statement of Basis and Purpose for the Commission's Revised Premerger Notification Rules

Section 801.1(b) Control

Having considered the comments received concerning the proposed "acquisition vehicle" rules published on September 24, 1985, 50 FR 38742, the Commission has decided to propose a different and less inclusive regulation. It appears that the "acquisition vehicle" approach would have required filings in connection with numerous competitively insignificant transactions, such as management buyouts. Since the Commission is not aware of any transaction to date that violated the antitrust laws but was not reported under the premerger notification program because the acquisition vehicle was not a controlled entity, it seems inappropriate to employ an approach that is likely to require notifications for a host of competitively insignificant transactions.

The Commission remains concerned, however, about the possibility under the existing rules that an anticompetitive transaction might occur without being reported under the premerger notification program. For example, there have been a number of unreportable transactions involving firms in the same industry. The Commission therefore proposes to expand the definition of "control" for purposes of the rules. This change, together with § 801.90 (which provides that the use of any particular acquisition vehicle "for the purpose of avoiding the obligation to comply with the requirements of the act shall be disregarded, and the obligation to comply shall be determined by applying the act . . . to the substance of the transaction") should insure that competitively significant transactions of this type will be reported under the premerger notification program. If, however, the proposed rule becomes effective and unreportable acquisitions raising competitive concerns occur, the Commission will promptly consider returning to the approach underlying its previously proposed "acquisition vehicle" rules.

The Commission is proposing a rule that would expand the definition of control to include persons owning 50 percent or more of partnerships or other entities that do not issue voting securities. They would be required to report acquisitions by the entities they own, just as persons must currently report acquisitions by corporations if they own 50 percent or more of the outstanding voting securities of those corporations. Unlike the previously proposed "acquisition vehicle" rules, this proposal would not require minority owners to report acquisitions.

The Commission is also proposing to change the existing alternative definition of control, which is based on the contractual power to designate members of an entity's board of directors or analogous body. The proposed change—from the power to designate a majority to the power to designate 50 percent—will result in a uniform 50 percent criterion for all three definitions of control in the rule.

Before discussing the operation of the proposed partnership control rule, it should be helpful to examine some of the considerations that led the Commission to move from an "acquisition vehicle" approach to the new "control of partnership" approach. First, the drafting of an acquisition vehicle rule has certain inherent problems. That approach tends to be overinclusive and, at least arguably, might not deter a person determined to avoid the notification obligation. Second, further examination of the kinds of potentially significant acquisitions that are not reported under the current rules indicates they are likely to be acquisitions by partnerships dominated by one person. While unreported takeovers by corporations and other business entities in which ownership is fragmented are theoretically possible, they do not yet appear to have been sources of competitive problems. Accordingly, because it is possible to draft a less complex rule that would make acquisitions by persons who control partnerships reportable, the Commission has decided it is more appropriate to determine whether existing underreporting problems can be adequately addressed by adopting this more limited approach.

Problems With the Acquisition Vehicle Approach

The overinclusiveness of the acquisition vehicle approach is derived from its structure. It disregards, for purposes of determining reporting obligations, the existence of the acquiring entity. Thus, that approach could require a notification from every person who, through its holdings of voting securities in an acquisition vehicle, was deemed to be acquiring more than a $15 millon interest in a target. With the recent proliferation of large leveraged management buyouts, this approach would likely have generated a large number of filings concerning transactions that have little or no competitive significance.

Leveraged buyouts are commonly made by shell corporations formed for the purpose of making the acquisition. As the Commission stated today in this **Federal Register** in the statement of basis and purpose describing § 801.11(e), shell corporations "typically have had no sales and frequently have no assets other than the cash or loans used to make the acquisition. Thus, when they are not controlled by any other entity, the acquiring person has no competitive presence. In such instances the acquisition does not combine businesses but merely changes the ownership of a single ongoing business; it therefore cannot reduce competition. Accordingly, the Commission has concluded that no purpose is served by requiring such acquisitions to be reported." Similarly, because management buyouts usually do not combine businesses, no purpose is served by requiring such transactions to be reported, as would an acquisition vehicle rule.

Of course, an acquisition vehicle (whether heavily leveraged or not) might include among its owners competitors or

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potential competitors of the acquired entity. In such instances there would be a reason to require reporting. Unfortunately, it is difficult to formulate a criterion that would exempt competitively insignificant groups but would not also exempt competitively significant groups. As a result, there is a strong tendency in the acquisition vehicle approach, exacerbated by the growing popularity of management buyouts, to require a substantial number of unnecessary additional filings.

The proposed "acquisition vehicle" rules sought to solve underreporting problems for both known and theoretically possible means of avoiding the obligations of the act. The comprehensive scope of those proposed rules is, in part, responsible for the substantial problems of overinclusiveness and enforceability. The Commission now believes it is more appropriate initially to direct its rulemaking at persons who make acquisitions through partnerships they dominate. Until now, the most significant unreported transactions of which the Commission is aware were all acquisitions by partnerships that were dominated by one person. Consequently, the Commission believes it need not require any reporting by minority shareholders of corporate acquisition vehicles.

Should the Commission find persuasive evidence that this form of transaction appears to be omitting from the premerger notification system competitively significant transactions, it would reexamine the acquisition vehicle approach.

Control of Partnerships and Other Entities That Have Not Issued Voting Securities

There have been widely publicized instances in which acquisitions were structured to be made by partnerships rather than corporations, and were not reported under the act, even though the partnerships were owned and operated principally by one person, and that person was a competitor of the acquired person. That result is inconsistent with the treatment of corporations that are dominated by one person, and with the objectives of the act and the rules.

Acquisitions by partnerships can avoid premerger review as a result of two principles of premerger reporting: one, a formal rule for calculating assets of an entity, 16 CFR 801.11(e), and the other, a Premerger Notification Office informal interpretation that a partnership is its own "ultimate parent entity" (that is, a partnership is not controlled by its partners). Section 801.11(e) directs that an entity without a balance sheet not include, in determining its size, any assets that are contributed to the entity for the purpose of making an acquisition. Thus, for example, if a partnership is formed to buy a $1 billion company and the partners contribute $1 billion in cash, the acquisition of the company by the partnership is not reportable. The partnership does not meet the $10 million minimum size criterion of section 7A(a)(2) of the act because § 801.11(e) directs the partnership not to count the $1 billion that will be used to pay for the acquisition. The informal interpretation deems the acquisition to have been made by the partnership itself, which has no other assets, rather than its partners, who may well have other assets.

Of course, if the partnership were employed in the acquisition "for the purpose of avoiding the obligations to comply with the requirements of the act," its existence would be disregarded and the obligations of the act would be determined by applying the act and the rules to the substance of the transaction. 16 CFR 801.90. For example, some persons might be tempted to make an acquisition through a partnership for the purpose of delaying their premerger notifications to the antitrust agencies until they were required by the Federal securities laws to announce their acquisition publicly. If a partnership were used for the purpose of delaying or avoiding reporting, § 801.90 would attribute the acquisitions to the partners individually. They would be required to comply with the obligations of the act personally prior to consummating the transaction.

The Commission now proposes to require partners, rather than partnerships, to report transactions in certain other circumstances. It proposes to accomplish this result by amending the rule defining control, § 801.1(b), to provide that a partnership or other unincorporated entity will be deemed to be controlled by any person who owns 50 percent or more of the entity. Thus, a partner who met the statutory $10 million minimum size criterion and owned 50 percent or more of the partnership would be required to report acquisitions made by the partnership. The rule would be analogous to the circumstances in which a corporation is deemed to be controlled by one or more of its shareholders. It would thereby abolish the overly general presumption that partnerships are always independent entities.

This change would mean, in the example of the acquisition of the $1 billion company discussed above, the transaction could be reportable if one of the partners was entitled to fifty percent or more of the firm's profits (or, upon dissolution, of its assets), and that partner's total assets or net annual sales were $10 million or more. That controlling partner, or its parent, would become the "ultimate parent entity" pursuant to § 801.1(a)(3). It would therefore be deemed to be the person making the acquisition.

This proposed attribution of control to persons owning such large economic interests in entities that do not issue voting securities seems to be a more appropriate way to apply the premerger notification procedures. As matters currently stand, for example, a person can make a purchase through a limited partnership in which it is the general partner and 95 percent beneficial owner. If, pursuant to § 801.11(e), the partnership does not meet the size-of-person criteria of section 7A(a)(2), and the partnership was not created for the purpose of avoiding compliance with the act, the transaction would not be reportable because the partnership is deemed to be its own ultimate parent entity. It seems more appropriate for such transactions to be reportable by any person that dominates the acquiring entity. That is what the proposed rule seeks to do.

In the past, the Premerger Notification Office has not deemed partnerships to be controlled. Section 801.1(b) provides, in part, that control exists if one person can "designate a majority of the directors of a corporation, or in the case of unincorporated entities, of individuals exercising similar functions." The Commission staff has declined to equate partners with "individuals exercising similar functions" to "directors of a corporation." This interpretation was adopted principally because the variable structure of partnerships made it too difficult to specify an objective set of criteria by which to attribute control. For example, partnerships can provide for equal operating authority for all partners or can restrict those rights in any of a number of ways. However, in formulating the acquisition vehicle proposal, the Commission developed the concept of attributing control of unincorporated entities on the basis of beneficial interests. See, for example, proposed § 801.5(b)(2), 50 FR 38748. While not perfect, this concept, which relies on the entitlement to profits or to assets in the event of dissolution, seems an adequate indicator of control where one person has a right to 50 percent or more of the profits or is entitled to 50 percent or more of the assets upon dissolution. At the very least, it seems unlikely that such an entity would be

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permitted to continue its existence if it operated in any way that was adverse to the wishes of the 50 percent owner. Consequently, quite apart from any concern about intentional avoidance of the act's obligations, the Commission considers this proposal to be an appropriate supplement to its existing definition of control.

The 50 percent beneficial ownership requirement would parallel in important respects the treatment of corporations under the existing control rule. Although effective or working control of a corporation can exist as a practical matter with a smaller percentage of shares, § 801.1(b) deems a corporation to be a controlled entity only if one person owns "50 percent or more of the outstanding voting securities" or has a right "presently to designate a majority of the board of directors." While this 50 percent requirement understates actual control of many corporations, the rule is clear and easily determinable. It is also arguably overinclusive because one corporation with two 50 percent owners is deemed to have two ultimate parent entities. Nevertheless, this arguable overinclusiveness correctly reflects the joint control that generally exists in such circumstances. In the Commission's experience, this requirement that both controlling entities file has not prevented persons from fulfilling the premerger notification requirements.

The 50 percent ownership criterion would serve similar functions for determining control of unincorporated entities. It would be an objective and predictable standard. Moreover, the degree of ownership should be sufficient to assure in almost all instances that the entities and those deemed to be controlling owners will act in concert to comply with the act's obligations.

In formulating the 50 percent ownership criterion, consideration was given to whether other indicators of control should be included. For example, the Commission might have proposed treating the sole general partner of a limited partnership as controlling the partnership. While the Commission did not doubt its authority to attribute control on this and on other criteria, the Commission declined to utilize that authority at this time because it might require many unnecessary filings. For example, limited partnerships with sole general partners are common entities whose investments often have little competitive significance. Moreover, if a rule required sole general partners to file notifications, some might attempt to avoid it by appointing a second or third general partner. At present, a rule requiring all general partners to file seems unnecessary and therefore unduly burdensome, but the Commission reserves the option of promulgating such a rule should underreporting of significant acquisitions occur under the currently proposed rule.

Finally, some consideration was given to adopting a rule that would attribute assets of unincorporated entities to all owners, even if they held only a minority interest. This would have been similar to the coverage of the previously proposed acquisition vehicle rule. The Commission does not feel such a proposal is warranted at this time. In the Commission's experience, partnership vehicles that had any potential for anticompetitive consequences have been dominated by a single person or by two persons holding equal rights. Accordingly, the Commission believes it is sufficient at present to extend the scope of the premerger notification program to an unincorporated entity only if at least one person is entitled to either 50 percent of its profits or, upon dissolution, of its assets. However, should competitively significant transactions escape reporting obligations under the proposed new rule because no person controlled the partnerships undertaking those acquisitions, the Commission would reconsider the acquisition vehicle approach.

Changing the Majority Control Criterion

Under the existing rules, an entity is deemed controlled by a person that has a contractual power to designate a majority of the entity's board of directors. Both the current and the proposed rules reflect the Commission's belief that such a person should be deemed by the rules to control the entity whether or not that entity also is deemed to be controlled according to other criteria. Thus, a single entity may be deemed controlled by one person that holds 50 percent of the outstanding voting securities of the entity and also by another person who has a contractual right to appoint a majority of that entity's board of directors (or of individuals exercising similar functions). The Commission has concluded, however, that no purpose is served and some confusion has been generated by inferring control of a board of directors only when one person may appoint more than 50 percent of the directors. It therefore proposes to revise this criterion to parallel the other control concepts based on 50 percent ownership. Under this proposed amendment, an entity would be deemed to be controlled by a person with the right to appoint as few as 50 percent of the entity's directors.

The basis of this decision is illustrated by the following example. Consider a nonprofit joint venture corporation created by two persons that is not subject to proposed § 801.1(b)(1) because it does not issue voting securities, it will not distribute profits and it would disburse assets widely in the event of dissolution. If the power to appoint directors of this venture is split evenly between the two persons forming the entity, such an entity can be deemed controlled solely as a result of the contractual right to appoint directors. There is no reason to treat the control of this corporation differently from a corporation in which the voting shares are split evenly. Both rights are likely to result in an evenly divided board of directors. Accordingly, the proposed rule would deem an entity to be controlled by a person that had a contractual right to appoint half or more of the "directors of a corporation, or in the case of unincorporated entities, of individuals exercising similar functions."

As noted in the discussion above, the Commission has experienced no problems administering its "50 percent or more of the outstanding voting securities" criterion. Even though that requires in appropriate circumstances more than one person to file as the ultimate parent entity of a single issuer, all persons required to file have been able to supply the information required. This experience appears to confirm the Commission's premise that if one person owns 50 percent of an entity it is at least in joint control of the entity. In the case of a person controlling 50 percent of a board of directors (or individuals exercising similar functions), it is even clearer that the entity cannot act without that person's assent. The Commission therefore proposes to infer control if a person has the contractual right to appoint 50 percent or more of the board of directors (or of individuals exercising similar functions).

This proposal would modify a Commission staff informal interpretation of § 801.1(b). Currently, the Premerger Notification Office deems a corporation controlled if a person can designate a *majority* of the board as a result of both holding voting securities and having a contractual power to designate directors. In other words, in determining whether an entity is controlled pursuant to § 801.1(b)(2), the staff adds directors elected to the board as a result of holding voting securities to directors designated as a result of a contractual power. Under the proposed amendments, the staff would deem the entity controlled by a person who, as a result of such combined rights, had the

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power to designate 50 percent or more of the directors.

Operation of the Proposed Rule

The Commission proposes to amend its rules by adding to the definition of the term "control" in § 801.1(b). The amendment, proposed new § 801.1(b)(1)(ii), would deem an entity to be controlled by a person entitled to 50 percent or more of the entity's profits, or by a person entitled, upon dissolution, to 50 percent or more of the entity's assets. The amendment would not apply if the entity had outstanding voting securities. The amendment thus creates two systems for determining control: one for entities that issue voting securities, and another for all other entities.

These non-overlapping rules for determining control are each supplemented by the alternate—contractual power to designate—control concept. In other words, proposed § 801.1(b)(1) would not deem an entity to be controlled both under paragraph (b)(1)(i) by a person that holds 50 percent of the voting securities issued by the entity and under proposed paragraph (b)(1)(ii) by another person that has a right to 50 percent of the entity's profits. Because the entity had issued voting securities, proposed paragraph (b)(1)(ii) would not apply; thus the entity would not be controlled on the basis of a right to profits or to assets upon dissolution. In contrast, under proposed paragraph (b)(2) the entity deemed controlled under (b)(1)(i) as a result of voting securities held by one person would be deemed also controlled under proposed paragraph (b)(2) by another person that had a contractual right to appoint 50 percent or more of the entity's board of directors.

Similarly, an entity that was deemed controlled under proposed paragraph (b)(1)(ii), because a person had a right to 50 percent of its profits or assets, would also be deemed controlled under proposed (b)(2) if another person had the right to appoint at least 50 percent of that entity's board of directors (or analogous body). This overlap would be quite rare, however. As explained above, the Commission staff has not deemed partnerships to possess "individuals exercising similar functions" to directors; therefore, proposed paragraph (b)(2) will apply only to other entities that do not issue voting securities.

In addition, the 50 percent or more criteria in paragraph (b)(1)(i), proposed paragraph (b)(1)(ii) and proposed paragraph (b)(2) means that under each paragraph two persons can be deemed to control an entity. It is, thus, theoretically possible that as many as six persons could be deemed to control one entity. However, it would be extraordinary for an entity to allocate those incidents of ownership in such different percentages.

As described above, proposed paragraph (b)(1)(ii) is intended to apply only in circumstances in which paragraph (b)(1)(i) does not apply, that is, it applies only to entities that have not issued voting securities. Typically, this means paragraph (b)(1)(i) will apply to corporations and proposed paragraph (b)(1)(ii) will apply to non-corporate entities. It should be noted, however, that some corporations (for example, entities incorporated under not-for-profit statutes that do not issue voting securities) would be subject to proposed paragraph (b)(1)(ii). Similarly, some unincorporated entities (for example, joint stock companies) issue voting securities. For them, control would continue to be determined by paragraph (b)(1)(i).

For purposes of these rules, the fact that an entity issues securities that have some voting rights is not sufficient to deem them voting securities. Limited partnerships commonly issue certificates subject to the Securities Act of 1933 to limited partners. These partnership shares may be transferable and may entitle their holders to vote on a variety of matters, but typically the entities would not be subject to paragraph (b)(1)(i). The definition of "voting security" in § 801.1(f)(1) states the holder of the security must be entitled "to vote for the election of directors of the issuer, or with respect to unincorporated entities, individuals exercising similar functions." Because most unincorporated entities do not have bodies analogous to boards of directors or do not elect the membership of such bodies, the securities are not "voting securities" within the meaning of the rules.

The rights to profits and to assets, upon dissolution, described in proposed paragraph (b)(1)(ii) are ownership rights and not creditor rights. Thus, the right to assets, upon dissolution, means after all debt obligations have been satisfied. The right to profits would be calculated after payment of any royalty, franchise fee or other expense based on income.

As is the case with other control provisions, a person deemed to control an entity under proposed paragraph (b)(1)(ii) is attributed all the assets of the controlled entity. See § 801.1(c)(8). Thus if "A" controls pursuant to proposed paragraph (b)(1)(ii) a partnership B (because "A" is entitled to 50 percent of B's profits, or 50 percent of B's assets upon dissolution), "A" must include the value of all of B's assets in determining A's total assets. "A" must include all of B's assets to determine whether it meets the minimum size criteria of section 7A(a)(2) of the act, even though "A" does not have a right to the other 50 percent of B's profits or assets. Furthermore, if B is entitled to 50 percent of the profits of partnership C, "A" will be deemed to control C also and also must include all the assets of C in determining the size of "A."

List of Subjects in 16 CFR Part 801

Antitrust, Reporting and recordkeeping requirements.

The Commission proposes to amend Title 16, Chapter I, Subchapter H, the code of Federal Regulations as follows:

Accordingly the Commission proposes the amendments set out below.

1. The authority for Part 801 continues to read as follows:

Authority: Sec. 7A(d) of the Clayton Act, 15 U.S.C. 18a(d), as added by sec. 201 of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. 94-435, 90 Stat. 1390.

2. The Commission proposes to amend § 801.1 by revising the introductory text of paragraph (b), paragraphs (b) (1) and (2) and by designating the existing example as example (1), and adding new examples (2) through (4), as set forth below. New language is indicated by arrows: (►new language◄). Deleted language is indicated by brackets: ([deleted language]).

PART 801—COVERAGE RULES

§ 801.1 Definitions.

* * * * *

(b) *Control.* The term "control" (as used in the terms "control(s)," "controlling," "controlled by" and "under common control with") means►:

(1—◄ Either

►(i)◄ [(1)] Holding 50 percent or more of the outstanding voting securities of an issuer [;] ►,◄ or

►(ii) In the case of an entity that has no outstanding voting securities, having the right to 50 percent or more of the profits of the entity, or, having the right in the event of dissolution to 50 percent or more of the assets of the entity; or◄

(2) Having the contractual power presently to designate [a majority] ►50 percent or more◄ of the directors of a corporation, or in the case of unincorporated entities, of individuals exercising similar functions.

Example ►s◄ : ►1.◄ * * *

►2. A statutory limited partnership agreement provides as follows: The general partner "A" is entitled to 50 percent of the partnership profits, "B" is entitled to 40 percent of the profits and "C" is entitled to 10

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percent of the profits. Upon dissolution, "B" is entitled to 75 percent of the partnership assets and "C" is entitled to 25 percent of those assets. All limited and general partners are entitled to vote on the following matters: the dissolution of the partnership, the transfer of assets not in the ordinary course of business, any change in the nature of the business and the removal of the general partner. The interest of each partner is evidenced by an ownership certificate that is transferable under the terms of the partnership agreement and is subject to the Securities Act of 1933. For purposes of these rules, control of this partnership is determined by paragraph (b)(1)(ii) of this section. Although partnership interests may be securities and have some voting rights attached to them, they do not entitle the owner of that interest to vote for a corporate "director" or "an individual exercising similar functions" as required by § 801.1 (f)(1), and thus are not subject to either paragraph (b) (1)(i) or (2) of this section. Consequently, "A" is deemed to control the partnership because of its right to 50 percent of the partnership's profits. "B" is also deemed to control the partnership because it is entitled to 75 percent of the partnership's assets upon dissolution.

3. "A" is a nonprofit charitable foundation that enters into a partnership joint venture with "B", a nonprofit university, to establish C, a nonprofit hospital corporation that does not issue voting securities. Pursuant to its charter all surplus revenue from the hospital in excess of expenses and necessary capital investments is to be disbursed evenly to "A" and "B". In the event of dissolution of the hospital corporation, the assets of the hospital are to be contributed to a local charitable medical facility then in need of financial assistance. Notwithstanding the hospital's designation of its disbursement funds as surplus rather than profits to maintain its charitable image, "A" and "B" would each be deemed to control C, pursuant to § 801.1(b)(1)(ii), because each is entitled to 50 percent of the excess of the hospital's revenues over expenditures.

4. "A" is entitled to 50 percent of the profits of partnership B and 50 percent of the profits of partnership C. B and C form a partnership E with "D" in which each entity has a right to one-third of the profits. When E acquires company X, "A" must report the transaction (assuming it is otherwise reportable). Pursuant to § 801.1(b)(1)(ii), E is deemed to be controlled by "A", even though A ultimately will receive only one-third of E's profits. Because B and C are considered as part of "A", the rules attribute all profits to which B and C are entitled (two thirds of E's profits in this example) to "A."◄

By direction of the Commission.

Emily H. Rock,
Secretary.

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