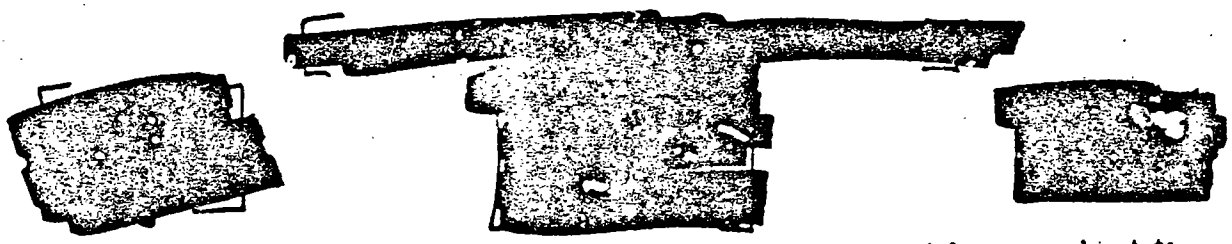

September 12, 1984

DELIVERED BY NETWORK COURIER

Wayne Kaplan, Esq.
United States Federal Trade Commission
Seventh & Pennsylvania Avenue, N.W.
Washington, DC 20004

Re: Interpretation of Regulations Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976

Dear Mr. Kaplan:

This letter is to confirm our telephone conversation of September 10, 1984 concerning the interpretation of the definition of "control" contained in 16 C.F.R. §801.1(b) of the regulations promulated under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act"). The facts given in this letter represent actual circumstances even though the names used are fictitious to preserve the confidentiality of this transaction.

As we discussed on the telephone, our client ("Mr. Smith") is currently a 20 percent stockholder in Subsidiary Company ("Subsidiary"). The remaining 80 percent of the stock was purchased from our client's brothers by Parent Company ("Parent"), a publicly-held corporation, in 1981 pursuant to a stock purchase agreement (the "1981 Agreement"). In consideration for our client agreeing to remain a 20 percent stockholder of Subsidiary and to serve as its President and Chief Executive Officer, the 1981 Agreement provides, among other things, our client with substantial operational control over the on-going operation of Subsidiary. A third-party ("Third Party") has proposed to acquire the Parent through a cash-out merger. Prior to the effective time of the merger, Smith, Inc., a corporation recently formed by Mr. Smith with few assets, will acquire approximately 20 percent of Parent's assets through purchase of the stock of a subsidiary of Parent. The assets to be acquired by Smith, Inc. through the stock purchase will include the 80 percent of Subsidiary's stock now owned by Parent. The cash-out merger by Third Party clearly meets the test under the HSR Act and a pre-merger notification filing will be made for that transaction.

Neither our client, Mr. Smith, nor Smith, Inc. nor a combination of the two meet the $10,000,000 total asset test. As indicated above, the 1981 Agreement gives Mr. Smith substantial control over the direct operations of Subsidiary and Subsidiary has assets in excess of $10,000,000. However, Mr. Smith does not have a contractual right, either under the 1981 Agreement or otherwise, to appoint a majority of the Board of Directors of Subsidiary.

The 1981 Agreement provides as follows:

> (Subsidiary) and Parent as the entity which the parties contemplate will control Subsidiary, hereby covenant that Subsidiary shall . . .
>
> (1) Within limits of reasonable busine[illegible] and the general scope of the business of (Sub[illegible] as it presently exists, allow (Mr. Smith) to es[illegible] and maintain the business policies and to direct [illegible] the operations, of (Subsidiary) without interference from or contravention by the Board of Directors of (Subsidiary) or by (Parent). Notwithstanding the foregoing, nothing herein shall be construed to authorize any (Subsidiary) capital expenditure in excess of $500,000 or borrowings in the aggregate in excess of $500,000 or undertakings for the procurement of supplies or furnishing of materials for a term in excess of one year, except by direction of the Board of Directors of (Subsidiary). Furthermore, Mr. Smith hereby acknowledges the policy of (Parent) that any capital expenditure or borrowing in excess of $5,000,000 by any (Parent) subsidiary must be approved by the Board of Directors of (Parent). Neither the (Subsidiary) Board of Directors nor the (Parent) Board of Directors shall unreasonably withhold the requisite approval or direction for any (Subsidiary) capital expenditure or borrowing proposed by (Mr. Smith).
>
> (2) Not deplete the operating capital of (Subsidiary) by loans or advances to (Parent) or any (Parent) affiliate or to any third party without the

> consent of (Mr. Smith) nor otherwise act in any way which would deprive (Subsidiary), acting through its chief executive officer, of the ongoing use of all working capital presently available to (Subsidiary) and any additions to such working capital arising by virtue of the Pre-Tax Earnings and profits of (Subsidiary).

As we understand the guidelines promulgated under the HSR Act and as we discussed during our telephone conference, Subsidiary's assets would only be considered to be a part of the assets of Mr. Smith if Mr. Smith "controlled" Subsidiary by owning over 50 percent of the voting stock of Subsidiary or by having the contractual power to designate a majority of the Board of Directors of Subsidiary. As discussed above, Mr. Smith owns only 20 percent of the stock of Subsidiary. Furthermore, although Mr. Smith has substantial control over the direct operations of Subsidiary through the provisions of the 1981 Agreement cited above, Mr. Smith does not have the contractual power to appoint a majority of Subsidiary's Board of Directors.

As we discussed during our telephone conference, the HSR Act is a technical act and is interpreted literally by the FTC. It is our understanding that the FTC does not expand by interpretation the language in the HSR Act. As a result, a person who may deemed to control the operations of a company will not be deemed to "control" the company under the provisions of 16 C.F.R. §801.1(b) unless that person either owns 50 percent of the stock of the company or actually has the contractual power to appoint a majority of the Board of Directors.

As we also discussed during our telephone conference, the FTC recognizes that parties may create a contractual relationship that is so complex that the FTC may deem one of the parties to have a contractual right to appoint a majority of a Board of Directors. We do not believe, however, that this is the situation with our client. Parent, as the majority stockholder of Subsidiary, has the right to appoint a majority of the Board of Directors of Subsidiary. Although Mr. Smith is given broad discretion to operate Subsidiary without seeking

[redacted]

specific approval from the board of directors, there is no other language in the 1981 Agreement that should be construed to give Mr. Smith power to appoint a majority of the Board of Directors of Subsidiary. Furthermore, there are no other agreements that gives him that power.

Unless, we are notified to the contrary before September 19, 1984, we shall advise Mr. Smith to proceed according to the interpretation of the HSR Act and the guidelines promulgated thereunder as outlined in this letter. Please advise us immediately if we have misinterpreted anything we discussed on the telephone or if this analysis is in any way incorrect as applied to the facts outlined in this letter. We would appreciate it if your office would stamp the enclosed extra copy of this letter as "Received" and return it to the courier who delivers this document.

Very truly yours,

[redacted]

[redacted]

[redacted]

B Parent
80%
Sub 20% held by client Smith

A to acquire B Parent & of B Sub.

Prior to A acq Smith will form Smith Inc + will acquire the stock of a sub of B which holds 20% of ~~Sub~~ Parents assets including the 80% of B sub stock not held by Smith as an individual