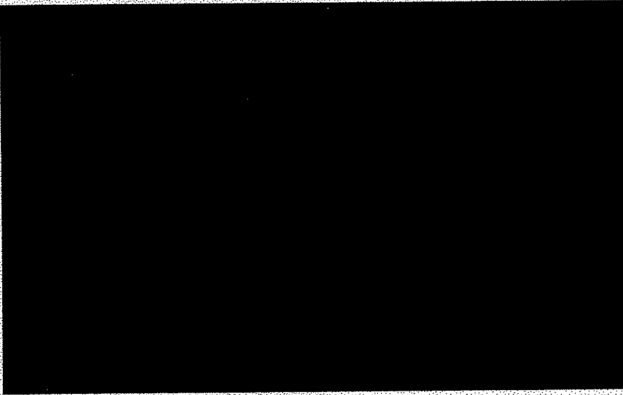
801.10

Verne, B. Michael

From: [redacted]
Sent: Monday, February 07, 2005 9:18 AM
To: Verne, B. Michael
Subject: HSR Question About Allocation of Purchase Price to Noncompetes

> Dear Mr. Verne,
>
> I would appreciate your informal guidance on a Hart-Scott-Rodino transaction valuation question.
>
> Our client (the "Purchaser") is proposing to acquire 100% of the issued and outstanding capital stock of a corporation owned by two shareholders (the "Sellers"). Five days after the closing of the stock sale, the Purchaser will pay the Sellers an additional amount for all inventory located in the Sellers' business locations as of the closing date.
>
> The Stock Purchase Agreement provides that the Purchaser will pay the Sellers an aggregate purchase price of $47,500,000 for their shares and for five-year noncompetition agreements to be entered into by the Sellers at closing. The Purchaser and the Sellers have agreed to allocate $2,000,000 of the $47,500,000 purchase price to the non-competition agreements. The Purchaser estimates that it will pay the Sellers an additional $4,500,000 for the inventory located in the Sellers' business locations.
>
> Under these facts, will the $2,000,000 that the parties have allocated to the noncompetition agreements count towards the acquisition price for purposes of determining whether the Size of the Transaction Test is met? I understand that in some situations the Premerger Notification Office staff has taken the position that value allocated to employment agreements or agreements for consulting services entered into by the sellers of a business and containing noncompetition covenants does not count towards the acquisition price. The reasoning in these situations seems to be that these agreements involve payments in the future for services to be rendered in the future, and that the value allocated to the employment or consulting agreements is payment for future services rather than payment for voting securities or assets. I also understand, on the other hand, that the Premerger Notification Office staff has also taken the position that payments for non-competition agreements should be treated as though they were payments for intangible assets in determining whether a filing is required. It may be significant that, under our facts, the Sellers are entering into stand-alone noncompetition agreements, not noncompetition agreements wrapped in employment or consulting agreements involving future services. The question seems to boil down to whether the Sellers' promise to perform the noncompetition covenants in the future can be analogized to a "service" that will be performed over five years, even though the entire $2,000,000 allocated as consideration for the noncompetition covenants will be paid at closing.
>
> If the $2,000,000 allocated to the noncompetition agreements counts towards the acquisition price, the size of the transaction test will likely be met and a Hart-Scott-Rodino filing will be necessary. If the $2,000,000 allocated to the noncompetition agreements does not count towards the acquisition price, it is possible that the combined value of the stock and assets to be acquired will not reach $50,000,000 and no HSR filing will be necessary.
>
> If you would like to discuss this matter in more detail, please do not hesitate to call.
>
> Thank you in advance for your assistance.
>

Very truly yours,



ADVISED THAT BECAUSE THE NON-COMPETE AGREEMENTS WERE BEING ENTERED INTO WITH ALL SHAREHOLDERS, THE PRESUMPTION IS THAT THEIR VALUE IS PART OF THE CONSIDERATION FOR THE V/S. N. OVUKA CONCURS. SEE ABA #32

B [signature]

2/7/05

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