

MEMORANDUM

TO: [REDACTED]

FROM: [REDACTED]

DATE: January 11, 1991

RE: Application of the Jurisdictional Test to Enclosed Fact Pattern

We have several questions about valuing the consideration for the purpose of determining the Size-of-the-Transaction test in the following transaction:

Mr. Jones, an entrepreneur, entered into an agreement several months ago to buy out two subsidiaries from a company owned by him and a single foreign investor. Mr. Jones had sufficient funds to purchase Co. Y, but had to seek funds from other sources for Company X ("CX"). CX's fixed assets were appraised at that time by an industry expert at approximately \$15 million and its current assets have been approximately \$6 million, for a total value of approximately \$21 million. However, an allocation was made in that transaction discounting CX's value to approximately \$11.5 million. (Because of assumed liabilities of approximately \$3 million, Mr. Jones' purchase price was approximately \$14.5 million.) In order to close this transaction, for which Hart-Scott notification had been properly made, Mr. Jones was required to borrow \$13,570,000 from a competitor, Comp (this amount included approximately \$2.0 million for a prepayment to the prior owners of CX regarding a covenant not to compete). In exchange for this loan, Mr. Jones agreed to repay the principal and 12% interest within 60 days and to pay a \$500 thousand fee. In the event he failed to make that payment, Comp was given an option to purchase CX's assets for \$14,490,000. Comp also was required to pay CX approximately \$2 million for a non-competition agreement in the event Comp exercised the option to purchase CX's assets.

OUR QUESTIONS RE: SIZE-OF-THE-TRANSACTION TEST:

1. Does the \$14,490,000 constitute Fair Market Value under §801.10(c)(3) when an industry expert has appraised the fixed assets at approximately \$6 million above the current purchase price, and the basis for that purchase price was understood to be a discounted value?
2. Must the valuation of the consideration in this transaction include the interest on the loan made to Mr. Jones, which has in fact accrued to a value of \$280 thousand, if Comp is willing to forgive that amount?

3. Must the valuation of the consideration include the \$2 million for the non-competition agreement to be paid to CX when the option is exercised?

4. Would it be permissible for the parties to agree now to reduce the purchase price, in order to get below \$15 million, by Comp's not purchasing approximately \$1.7 million in CX's receivables.

Thank you for your attention to this matter. Please advise as soon as possible. My telephone number is [REDACTED]

1. Yes. If the figure (\$14.5MM) represents the Board of Directors of the acquiring person's good faith determination then it is the fair market value for those assets. Note: Value of these assets is either the acquisition price or the fair market value whichever is higher.
2. No. As in the installment contract setting (see S.B.P. for §801.10(c)(2)) interest should be excluded from the valuation of consideration.
3. Yes. According to a long standing policy, covenants not to compete should be included as part of valuation of assets.
4. Yes. If the parties made such an agreement and Comp would not be getting those receivables through a disguised or sham transaction, then it would be permissible to reduce the purchase price.