801.10(b) and (c)(2) and (3)

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FEDERAL TRADE COMMISSION
PREMERGER NOTIFICATION OFFICE
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CONFIDENTIAL **VIA TELECOPIER - (202) 326-2050**

John M. Sipple, Jr., Esq.
Chief, Premerger Notification Office
Bureau of Competition
Federal Trade Commission
Washington, D.C. 20580

Dear Mr. Sipple:

At your request, I am writing this letter to describe the transaction that we discussed by telephone today. The transaction summarized below involves my client ("X") and an unrelated party ("Y"):

> X is in the business of selling certain consumer products to retailers. The products are manufactured to X's specifications by selected manufacturers, and they are sold bearing various trademarks and trade names owned by X, along with other marks licensed by X on a nonexclusive basis.
>
> X has entered into a purchase contract with Y, pursuant to which Y will purchase from X the inventory of most of X's product line, plus a small amount of related tangible personal property. After the closing, to the extent that retailers return products previously sold to them by X, X will settle with the retailers, and Y will purchase the products from X.
>
> The purchase contract provides that at closing X and Y will enter into a Trademark License Agreement and a Distribution Agreement (collectively, the "Agreements"). The Agreements pertain to products of the kind purchased from X's inventory and to one other type of product (collectively, the "Products"). Pursuant to the Agreements, Y will be entitled

(1) to procure Products from manufacturers approved by X and (2) to apply X's trademarks to the Products on an exclusive basis and to apply to the Products on a nonexclusive basis those marks currently licensed by X on a nonexclusive basis. During the term of the Agreements, Y must pay X a distribution fee set at a percentage of X's sales of trademarked Products. The fee will be set at a flat level in the first year, will increase in the second year, and will increase again if an annual sales threshold is exceeded. The term of the Agreements is five years. If cumulative fees during the five-year term exceed a specified amount, the Agreements will automatically renew for one additional five-year term.

The fee level that triggers the right of renewal was calculated on the basis of X's historical sales, plus a growth factor. However, X is retaining all rights to a segment of its product line that represented roughly one-third of its sales in the most recent year, while giving Y the right to affix the trademarks to one additional Product category that X has not heretofore sold. Hence, in order to qualify for the renewal term, Y will have to cultivate substantial sales of the new Product or significantly expand sales volume in existing Products.

I would very much appreciate any guidance that the Premerger Notification Office might provide with respect to the following questions:

(1) Does entering into the Agreements constitute an asset acquisition for purposes of Section 7A of the Clayton Act?

(2) If question (1) is answered affirmatively, is the asset acquisition under the Agreements limited to the exclusive trademark license, without reference to the nonexclusive trademark license (such that the value attributable to the latter would not figure in the acquisition price or the fair market value)?

(3) I assume that the post-closing purchase of inventory is properly viewed as an integral part of the asset acquisition by reason of 16 C.F.R. § 801.13(b) or otherwise. If this assumption is correct and/or if question (1) was answered affirmatively, can the acquisition price be a "determined" one within the meaning of 16 C.F.R. § 801.10(b)?

(4) Whether or not the acquisition price is determinable, Y must determine the fair market value of the assets to be acquired. Interpretation #116 in the Premerger Notification Practice Manual suggests that the "most appropriate formulation . . . would be to determine how much the buyer would pay at present in cash for the [assets] being acquired, without any contingent payment." If Y is required to value the exclusive trademark license, how should Y account for the fact that the license may terminate in five years? In other words, how can the assumption of an all-cash purchase be reconciled with a contingency that itself hinges on the amount of contingent payments made in the first five years?

Please feel free to respond by telephoning me at the above-listed number. Because X and Y are anxious to complete the transaction as soon as practicable, I would greatly appreciate your early attention to this matter. Thank you very much for your consideration.

Respectfully,

7/21/93 The writer was advised that the PMN Office's response to question (1) is affirmative. In response to question (2), the grant of a non-exclusive trademark license need not be included in the acquisition price or the fair market value determination since it "does not involve the acquisition of an asset" (See ABA letter #49). (However, if seller exiting the business (which does not appear to be the case here), such purchase must be included in the size-of-transaction test.) In response to question (3), the seller appears to have records of inventory returned from retailers. Such records must be used by purchaser to generate a "good faith" estimate of post-closing inventory which will be bought by purchaser. This estimated dollar figure must be included in the "acquisition price" since it is part of the purchase contract between X and Y. In response to question (4), the buyer must attempt to place a value on what will be paid for the exclusive trademark during the first 5-years. However, the second five year period appears too speculative at this time and the buyer need not attempt to assign a value to it. If the total of the actual payments and the estimated payments for the inventory and the exclusive trademark during the first 5-year term exceed 15MM, then a filing need be made. The buyer's board (or its delegee) must, if price is 15MM or less, determine the fair market value of the assets.

RBSmith