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BY FAX

To: Nancy Ovuka, Compliance Specialist, Federal Trade Commission

From: [Redacted]

Subject: Hart-Scott-Rodino Analysis re Proposed Acquisition Transaction

Date: April 17, 1996

This material may be subject to the confidentiality provisions of Section 4(h) of the Clayton Act which restricts release under the Freedom of Information Act.

APR 11 1996
COMMUNICATIONS SECTION
FEDERAL TRADE COMMISSION

As we discussed earlier today, this memorandum will confirm our preliminary analysis as to whether one or more Hart-Scott-Rodino ("HSR") filings will be needed in connection with the formation of a new corporation ("Newco"), by multiple individuals (none of whom would have at least a 50% interest) or the subsequent acquisition by Newco of all of the capital stock of Target Corporation ("Target"), from Seller Corporation ("Seller"), through the merger of a wholly-owned subsidiary of Newco (to be formed) into Target. As I indicated to you, our preliminary analysis, based upon the assumed facts set forth below, is that no HSR filing will be required. We would like to confirm with you that our analysis is correct.

Relevant Assumed Facts

Five to six related individuals (adult siblings and, perhaps, spouses, minor children and trusts), certain unrelated executives to be employed by Newco and one unrelated individual would contribute an aggregate of \$7-8 million (assume \$8 million) in cash to Newco in return for Newco stock. In no event will any one person (including the person's spouse, minor children and trusts, if applicable) own more than 35% of Newco's stock, nor will anyone be given a contractual right to designate at least half of the Newco directors. Newco would borrow approximately \$8 million from a venture capital fund for use in Newco's contemporaneous or subsequent acquisition (in an arm's length transaction) of the capital stock of Target from Seller, in return for the issuance by Newco of a debenture in that principal amount plus a warrant to acquire approximately 17% of Newco common stock. In addition, Newco or its transitory subsidiary would borrow approximately \$36 million from a bank (possibly guaranteed by Newco if loaned to the transitory subsidiary, but without any equity kicker) for use in the acquisition. The total merger consideration would be approximately \$50 million, payable in cash, subject to adjustment

includes interest



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at closing and 60 days thereafter based upon estimated and final balance sheets of Target. The "ultimate parent" of Target is assumed to have more than \$100 million in annual net sales and in total assets. Finally, we have also assumed that there would be no merger, consolidation or other business combination between Target and any other entity "controlled" (for HSR purposes) by any person that would own Newco stock for at least one year following the closing of the acquisition of Target.

HSR Analysis

There are two distinct "transactions" for HSR purposes. First, the formation of Newco is potentially reportable under HSR Rule 801.40. Second, the acquisition by Newco of the stock of Target is potentially reportable under standard HSR analysis. In order for a given "transaction" to be reportable, two distinct HSR tests (the "size-of-parties" test and the "size-of-transaction" test) both must be satisfied with respect to that transaction. The HSR rules are codified at 16 C.F.R. Part 801 et seq.

Formation Transaction

The formation of a corporation (whether as a corporate "joint venture" or otherwise) is always a potentially reportable HSR transaction where the new corporation will not be wholly owned. Because formation transactions involve more than two persons in the same transaction (e.g., two or more shareholders plus the corporation being formed), a special HSR rule, Rule 801.40, was adopted to adapt the standard size-of-parties test to the formation situation.

Even if we were to somehow satisfy the size-of-parties test, however, we would not satisfy the size-of-transaction test under any circumstance based upon the facts described above. In a nutshell, the size-of-transaction test would require that at least one shareholder wind up with stock of Newco that either has a fair value of at least \$15 million or represents at least 50% of the total stock of the corporation. Neither situation would occur in our transaction. No HSR filing is needed in a transaction which does not satisfy the size-of-transaction test.

Acquisition of Stock

Newco's acquisition of Target's stock is a distinct transaction for HSR purposes and must be analyzed separately. Here, although the size-of-transaction test will be satisfied (because Newco will be acquiring more than 15% of the voting securities of Target for approximately \$50 million), the transaction will fail the size-of-parties test.

The relevant size-of-parties test is set forth at 15 U.S.C.A. §18a(a)(2)(C). In order for that test to be satisfied, the "acquiring person" must have at least \$10 million in annual net sales or in total assets. Here, the "acquiring person" will be Newco itself, as Newco is not "controlled" (for HSR purposes) by any other person. See Rule 801.1(b).

Obviously, Newco has no annual net sales at this time. Its total assets are computed in accordance with Rule 801.11. That rule states that the total assets of a person are determined by reference to that person's most recent regularly prepared balance sheet. Where an acquiring person (usually applicable only to a newly formed entity) does not have a regularly prepared balance sheet, the person is required to determine its total assets as they would appear on a balance sheet if one were prepared at that time; but, in this one situation, the person can exclude all cash that will be used in the particular transaction then being analyzed, as well as all cash that will be used to pay expenses incidental to that particular transaction.

In our case, after giving effect to the initial capitalization of Newco as well as the proceeds from the proposed bank loan and mezzanine financing, Newco's assets would likely be under \$1 million after excluding the cash to be used to pay the purchase price and transaction expenses. The minimum needed to satisfy the test is \$10 million. No HSR filing is needed in a transaction which does not satisfy the size-of-parties test.

I would appreciate if you would give me a call so that we may discuss this matter once you have had an opportunity to review this memorandum and consider our analysis. My direct number is [REDACTED]

4/18/96

Transactions are exempt as noted.