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802.51

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December 6, 1999

CONFIDENTIAL

1999 DEC -6 P 4:46

VIA FACSIMILE

Mr. Michael Verne
Federal Trade Commission
Room 323
6th Street & Pennsylvania Avenue, NW
Washington, DC 20580

Re: Hart-Scott-Rodino Matters

Dear Mr. Verne:

This will confirm my conversation with Dick Smith and our subsequent conversation concerning the application of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "Act") to a proposed transaction.

In the proposed transaction, a German company ("Company A") intends to enter into patent cross-license agreements with a Japanese company ("Company B"). These cross-license agreements would prevent blocking patents and allow the two companies to market and produce products that they would otherwise be prevented from bringing to market. Both licenses would cover foreign and U.S. patents. We assume for purposes of this analysis that both parties meet the size-of-persons test.

The license under Company A's patents would be semi-exclusive because Company A would retain the right to use the patents. The license under Company B's patents also would be semi-exclusive, but with one exception: it would be exclusive for a specific field of use for a period of five years. During that time, Company A would have an exclusive license for a particular field of use in certain countries. Company B would not be allowed to use the patents during the 5-year period in the specified countries for the particular field of use. One of the countries in which Company A would have the partially exclusive license is the United States.

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In consideration of the semi-exclusive license under Company B's patents, Company A would pay three percent of the net sales value of products sold under the license until the expiration of the patents or ten years from the date of the first commercial sale. In consideration of the five-year period of partial exclusivity, Company A would pay additional royalties. On top of the initial three percent, Company A would pay an additional two percent on the net sales value of the products sold under the license in the field of use during the 5-year period.

The parties have determined that the present fair market value of the 5-year period of partial exclusivity is more than U.S. $15 million. This estimated value, however, includes royalties from all the licensed patents, both foreign and domestic. The parties' estimate of the value of the 5-year period of partial exclusivity under only the U.S. patent is less than U.S. $15 million.

You confirmed the following application of the Act and 16 C.F.R. § 802.51(1998) to the proposed transaction. The FTC staff has taken the position that although a semi-exclusive license is not the transfer of an asset, the grant of an <u>exclusive</u> patent license is the transfer of an asset, and thus potentially reportable under the Act. <u>See</u> ABA, <u>Premerger Notification Practice Manual</u>, Interpretation 49 (1991). In addition, the grant of a partially exclusive license, such as an exclusive license for a specific use or in a specific geographic territory, is also an asset transfer. <u>See id.</u> The staff has further taken the position that the grant of a patent license that is exclusive only for a particular period of time is an asset transfer. In such a license, the product, time, and geographic limitations go to the value of the asset.

Company B's license under Company A's patents would be nonexclusive and thus not reportable. On the other hand, Company A's license under Company B's patents would be exclusive for 5 years in a particular field of use and geographic territory. This would be the transfer of an asset. Accordingly, because the value of the license under all the patents (both foreign and United States) exceeds $15 million, the transaction could be reportable.

Under 15 C.F.R. § 802.51 (1998), certain acquisitions of assets by foreign persons are exempt from the Act's reporting requirements. Under section 802.51, an acquisition by a foreign person is exempt if the acquisition is of assets located outside the United States or less than $15 million of assets located in the United States.

In determining the location of a "movable asset" for purposes of § 802.51, the FTC staff looks "not only to where the assets were generally located and who owned the assets, but also to the source of the revenues generated by the movable assets." ABA, <u>Premerger Notification Practice Manual</u>, Interpretation 269 (1991). Thus, the portion of the license

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attributable to the foreign patents is "located outside the United States" because the source of the revenues generated is foreign intellectual property. The remaining portion of the license attributable to the U.S. patents is located in the United States.

To value this asset, you stated that Company A should determine in good faith the reasonably expected amount of the royalties to be paid. Under Interpretation 116 of the Premerger Notification Manual, when a payment is contingent, "the acquiring person (but not necessarily its board of directors) should make an effort to determine in good faith the reasonably expected amount of the contingent payment." ABA, Premerger Notification Practice Manual, Interpretation 116 (1991); see also ABA, Premerger Notification Practice Manual, Interpretation 129 (1991).

Therefore, the patent license granted to Company A would be exempt under Section 802.51. The portion of the license attributable to the foreign patents is "located outside the United States." The remaining portion of the license, which is attributable to the U.S. patents, is worth less than $15 million. Accordingly, the license would be an acquisition by a foreign person of less than $15 million in assets located in the United States, and thus not reportable.

Please call me promptly at [redacted] believe that any part of our conversation was misunderstood. Thank you for your assistance

Sincerely,

[redacted]

AGREE WITH THE WRITERS CONCLUSIONS.
B Michael Verne
12/9/99

N. OVUKA CONCURS.