
AN OVERVIEW

Guide II is the second in a series of guides prepared by the Federal Trade Commission's Premerger Notification Office ("PNO"). It describes the criteria used to determine whether a transaction is subject to the requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a (§ 7A of the Clayton Act or "the Act"), and uses a hypothetical transaction to illustrate the application of the Premerger Notification Rules (the "Rules").

Other Guides in this series provide additional information. Guide I is an overview of the program and the way it operates and Guide III contains "A Model Request for Additional Information and Documentary Material (Second Request)."

The Guides are not intended to address specific proposed transactions. If you are analyzing a transaction, we suggest that you consult the Act, the Rules, and the other Guides in this series, as well as the Federal Trade Commission's website at <http://www.ftc.gov/bc/hsr>. If you have a specific question on a proposed transaction and your question is not addressed in these reference sources, call the PNO between the hours of 8:30AM and 5:00PM, Monday through Friday, except holidays, at (202) 326-3100.

I. INTRODUCTION

Title II of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 established the Federal Premerger Notification Program (the “Program”). The Program is designed to provide the Federal Trade Commission (the “FTC” or “Commission”) and the Department of Justice (the “DOJ”) with information about large mergers and acquisitions before they occur. The parties to certain proposed transactions must submit a Notification and Report Form for Certain Mergers and Acquisitions (the “Form”)¹ with information about their businesses to the enforcement agencies and wait a specified period of time before consummating the transactions. During that “waiting period,” the antitrust enforcement agencies analyze the likely competitive effects of the proposed transaction. If either agency believes that further information is needed in order to complete the competitive analysis, then it may request additional information and documentary material from the parties. Issuance of this “second request” extends the waiting period for a specified period, usually 30 days, after the parties have complied with the request. The additional time provides the reviewing agency with the opportunity to analyze the information and to take appropriate action before the transaction is consummated. If the agency believes that a proposed transaction may violate the antitrust laws, it may seek an injunction in federal district court to prohibit consummation of the acquisition.

¹ FTC Form C4 (rev. 06/06/06).

² The Premerger Notification Rules are found at 16 C.F.R. Parts 801, 802 and 803. The Rules also are identified by number, and each Rule beginning with Rule 801.1 corresponds directly with the section number in the C.F.R. (so that Rule 801.40 would be found in 16 C.F.R. § 801.40). In this Guide, the Rules are cited by Rule number.

³ The 2000 amendments to the Act require the Commission to revise certain thresholds annually based on the change in the level of gross national product. A parenthetical “(as adjusted)” has been added where necessary

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later, the Rules treat this transaction as two separate acquisitions, either or both of which may be reportable. In both acquisitions, the acquiring person is Zed Corporation. Mrs. and Mr. Beta, together, are the acquired person in the acquisition of Beta Prodr I

⁵ See 16 C.F.R. § 801.13.

⁶ See 16 C.F.R. §§ 801.13, 801.14.

a. “Held as a result of the acquisition”

All voting securities, NCI and assets currently being acquired are held as a result of the acquisition. In addition, Rule 801.13⁷ explains when you must aggregate previously-acquired voting securities, NCI or assets with those that you plan to acquire in order to determine what is held as a result of the acquisition. Different principles apply to asset, voting securities and NCI acquisitions.

(1) Aggregating previously-acquired voting securities or NCI

Rule 801.13(a)(1)⁸ requires that you add any voting securities that you currently hold of the same issuer to any voting securities that you propose to acquire to determine what voting securities of that issuer will be held as a result of the planned acquisition. There are some special circumstances, however, described in Rule 801.15,⁹ in which the prior, simultaneous, or subsequent acquisition is exempt from notification and need not be included in the calculation.

Rule 801.14,¹⁰ requires that you aggregate the value of all of the voting securities of all of the issuers included within the acquired person that you will hold as a result of the acquisition. Thus, if you hold less than 50% of the voting securities of one subsidiary company and plan to acquire voting securities of the parent or a different subsidiary of the same parent, you would aggregate these holdings to determine the value of the securities held.

Rule 801.13(c)(1)¹¹ requires that you add any NCI that you currently hold of the same non-corporate entity to any NCI that you propose to acquire to determine what NCI will be held as a result of the planned acquisition. Rule 801.14,¹² requires that you aggregate the value of all NCI included within the acquired person that you will hold as a result of the acquisition as determined by Rule 801.13(c). Under Rule 801.13(c)(2),¹³ an acquisition of NCI which does not confer control of the unincorporated entity is not aggregated with any other assets or voting securities which have been or are currently being acquired from the same acquired person.

⁷ See 16 C.F.R. § 801.13.

⁸ See 16 C.F.R. § 801.13(a)(1).

⁹ See 16 C.F.R. § 801.15.

¹⁰ See 16 C.F.R. § 801.14.

¹¹ See 16 C.F.R. § 801.13(c)(1).

¹² See 16 C.F.R. § 801.14.

¹³ See 16 C.F.R. § 801.13(c)(2).

¹⁴ *See* 16 C.F.R. § 801.13.

¹⁵ *See* 43 Fed. Reg. 33478-9 (1978).

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the Rules, the value of publicly traded voting securities that are to be acquired is the higher of “market price” or “acquisition price.” Thus, if the voting securities are trading at \$50 a share, and you have a contract to buy a block for \$60 a share, the \$60 value is used. If the acquisition price of publicly-traded shares has not been determined, the value is the market price. For non-publicly traded voting securities, the securities are valued at their “acquisition price” or, if the “acquisition price” has not been determined, at “fair market value.” Previously acquired securities are valued in similar ways pursuant to Rules 801.10 and 801.13.¹⁷ NCI are valued in the same manner as non-publicly traded voting securities. In an acquisition of assets, Rule 801.10(b)¹⁸ provides that the assets must be valued at their “fair market value” or, “if determined and greater than the fair market value,” at their “acquisition price.”

The terms “market price,” “acquisition price,” and “fair market value” are defined for premerger notification purposes in Rule 801.10(c).¹⁹ For useful information concerning the “valuation rule”, please visit <http://www.ftc.gov/bc/hsr/hsrvaluation.shtm> and <http://www.ftc.gov/bc/hsr/801.10summary.shtm>.

(1) Determining market price

In transactions subject to § 801.30, *e.g.*, open market stock purchases, the “market price” is the lowest closing quotation or bid price within 45 days prior to receipt by the issuer of the notice required by Rule 803.5(a) from the acquiring person, which must be delivered to start the waiting period. In transactions to which Rule § 801.30 does not apply, *e.g.*, purchases from a “controlling” stockholder or directly from the issuer, the “market price” is the lowest closing quotation or bid price within the 45 calendar days preceding the closing of the acquisition, but not extending back prior to the day before execution of the agreement or letter of intent to merge or acquire. The “45-day rule” will enable you to determine whether a particular transaction will

¹⁷ See 16 C.F.R. §§ 801.10 and 801.13.

¹⁸ See 16 C.F.R. 801.10(b).

¹⁹ See 16 C.F.R. S 801.10(c).

²⁰ See 16 C.F.R. § 801.10(c)(2).

addition, will assume \$10 million in liabilities, the acquisition price is \$95 million.

(3) Determining fair market value

²¹ See 16 C.F.R. § 801.10(c)(3).

²² See Rule 801.13(a), 16 C.F.R. § 801.13(a).

²³ See 16 C.F.R. § 801.10(c)(1).

²⁴ See 16 C.F.R. § 801.10(c)(3).

²⁵ See 16 C.F.R. § 801.10(b).

separately identified, the Rules require that the value be determined by the market price.²⁶ In this transaction, the market price can be determined because the voting securities are publicly traded. Resource shares sell, at the time of your research, for \$100 a share; thus, the value of the 4500 Resource shares that Zed will obtain is likely to be about \$4.5 million.²⁷ If Zed already owned other Resource voting securities, you would add the current market price of those shares

²⁶ See Rule 801.10(a)(1)(ii), 16 C.F.R. § 801.10(a)(1)(ii).

²⁷ See Rule 801.10(c)(1), 16 C.F.R. § 801.10 (c)(1).

²⁸ See 16 C.F.R. § 801.12(b).

voting securities²⁹:

- a) \$50 million (as adjusted);
- b) \$100 million (as adjusted);
- c) \$500 million (as adjusted);
- d) 25%, if valued at greater than \$1 billion (as adjusted); and
- e) 50%, if valued at greater than \$50 million (as adjusted).

Because the Rules provide that all voting securities held by the acquiring person after an acquisition are “held as a result of the acquisition,” the thresholds are designed to act as exemptions to relieve parties of the burden of making another filing every time additional shares of the same person are acquired. As such, when notification is filed, the acquiring person is allowed one year from the end of the waiting period to cross the threshold it indicated in the filing.³⁰ If within that year the person reaches the stated threshold or any lower threshold, it may continue acquiring shares up to the next threshold for five years measured from the end of the waiting period. The acquiring person must file again, however, before it can cross that next higher threshold. The 50 percent threshold is the highest threshold regardless of the corresponding dollar value, because it indicates the acquisition of control.

Because Zed is acquiring 100% of the voting securities of Beta Products, it will indicate the 50% filing threshold in its filing regardless of the transaction value.

B. Identifying the Acquiring and Acquired Persons

If the hypothetical transaction were valued in excess of \$200 million (as adjusted), the transaction would be reportable unless an exemption applied. But, because the hypothetical transaction is valued at \$90 million, you must also turn to the size of person test, as you must for all transactions valued in excess of \$50 million (as adjusted) but at \$200 million (as adjusted) or less. The first step in determining your size of person is to identify the “acquiring person” and the “acquired person.” Under the Act, the obligation to report depends on the size of the “persons” involved. “Person” is defined in Rule 801.1 (a)(1) and is the “ultimate parent entity” of the buyer or seller. That is, it is the entity that ultimately controls the buyer or seller.³¹

²⁹ The notification thresholds do not apply to acquisitions of assets or NCI.

³⁰ See 803.7.

³¹ See “control” under 801.1 (b).

³² *See* 16 C.F.R. § 801.1(b).

³³ *See* 16 C.F.R. § 801.1(c).

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person test is satisfied. Generally, a person's annual net sales³⁹ and total assets are as stated on its last regularly prepared annual statement of income and last regularly prepared balance sheet. These financial statements must be as of a date not more than 15 months old, and have been prepared in accordance with procedures normally used by the filing person.⁴⁰

A person should continue to rely on its regularly prepared financial statements until the next regularly prepared statements are available, even if subsequent changes in income or assets have occurred. For example, the most recently prepared statements may show \$9 million in annual net sales and \$8 million in total assets in the previous year, although the person's sales have increased in the current fiscal year such that its annual revenue will exceed \$10 million (as adjusted) when its next statement is issued. For premerger notification purposes, however, the person will not be considered a \$10 million (as adjusted) person until the annual income statement reflecting the increased revenue is prepared. The same analysis would be applied, however, if sales in the current fiscal year have decreased. A company's sales and assets may not be relied on until they are reflected in regularly prepared financial statements.

a. Including controlled entities

The size of person test includes the sales and assets of all entities, both domestic and foreign, included within the person. Any entities controlled by the UPE whose sales and assets are not consolidated in its financial statements must be added to determine the total size of the person. Unconsolidated sales and assets should be added, however, only to the extent that such additions are "nonduplicative." If the UPE's interest in the subsidiary is already reflected on the parent's balance sheet as an asset, then adding together the total assets of the subsidiary and the total

³⁹ As used in the rule, "net sales" means gross revenues less returns, discounts, excise taxes, and the like. "Net sales" is not the equivalent of profits or "net income," however, and therefore the cost of raw materials, wages, interest, and other expenses may not be deducted. *See* The Statement of Basis and Purpose at 43 Fed. Reg. 33472-73.

⁴⁰ *See* 16 C.F.R. § 801.11(b)(2).

⁴¹ *See* the statement of basis and purpose at 43 Fed. Reg. 33473 which provides additional information concerning consolidating a person's sales or assets.

investment or for the production of income, whether or not it actually produces income. You

⁴² See 16 C.F.R. § 801.11(e).

sales to be \$9 million. It also shows total assets to be \$9 million. If either figure had been \$10 million (as adjusted), you could have stopped there and concluded that the size of person in the case of Mr. and Mrs. Beta was at least \$10 million (as adjusted).

In the absence of such a simple solution, however, you must next consider the value of any additional investments owned by Mr. and Mrs. Beta, and any additional revenues these may generate. As provided by Rule 801.11 (d),⁴³ you should not consider Mr. Beta's country residence or the sports car he drives in computing his total assets; similarly, the value of Mrs. Beta's luxury condominium should be omitted from the calculation of her total assets. You should also exclude the value of the Resource Inc. voting securities because, although they are investment assets, their value is already reflected on Beta Products' balance sheet.

⁴³ See 16 C.F.R. § 801.11 (d).

⁴⁴ See Rule 801.40 - 801.50, 16 C.F.R. § 801.40 - 801.50.

⁴⁵ See Rules 802.50 - 802.53, 16 C.F.R. §§ 802.50 - 802.53.

said, you should not rely on this Guide alone to determine your filing obligation. As indicated earlier, you should refer to the Act, the relevant Rules and the Formal Interpretations of the Rules to understand points that are not discussed in this general introduction. Appendix 1,
