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PREMERGER NOTIFICATION

Exemptions

The Difficulty of the § 802.51 Exemption for Technology Companies

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Under the U.S. Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, 15 U.S.C. § 18a (''HSR Act'') and the regulations promulgated under it, there are a myriad of exemptions to the HSR Act's filing and waiting-period requirements when foreign companies are involved. One such exemption may apply to acquisitions of the voting securities of a foreign issuer depending upon, among other factors, the value of the foreign issuer's sales in/into the U.S. Sales for services rendered abroad are generally excluded from such a valuation.

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In today's digital and cloud-based computing age, the question for some technology companies becomes: how do you treat services rendered on foreign servers. Under current interpretations of the HSR Act and the relevant regulations, sales for services rendered on foreign servers would not count towards the foreign issuer's sales in/into the U.S. for the purposes of the potentially applicable exemption. This article outlines this interpretation and describes the complications this can cause for companies involved in a relevant transaction.

Generally speaking, the HSR Act mandates that parties to a transaction are required to provide notice to the U.S. Federal Trade Commission (''FTC'') and Department of Justice (''DoJ'') (an ''HSR filing''), if, as a result of the transaction, a party to the transaction will hold assets or voting securities of another person valued in excess of $75.9 million and the parties satisfy a particular size-of-person test. This latter test is inapplicable for transactions valued above $303.4 million. The HSR Act also provides for a period of time during which the parties must wait before consummating the transaction. *See* 15 U.S.C. § 18a(b). However, under the HSR Act itself, and the regulations adopted to enforce the HSR Act, there are a series of exemptions that permit parties to forego an HSR filing and close a transaction before the mandatory waiting period.

One such exemption applies to acquisitions of the voting securities of a foreign issuer (''foreign issuer exemption''). *See* 16 C.F.R. § 802.51. For acquisitions by a U.S. person, such a transaction is exempt if the issuer, and all entities that it controls, holds assets located in the U.S. with an aggregate value below $75.9 million and made aggregate sales in or into the U.S. below $75.9 million in its most recent fiscal year. *See* 16 C.F.R. § 802.51(a). For acquisitions by a foreign person, the transaction is exempt if the acquiring person will not obtain control, as that terms is defined by the HSR Act, of the issuer as a result of the transaction. Where control will be gained, the transaction will still be exempt if the issuer and all entities it controls holds assets located in the U.S. with an aggregate value below $75.9 million

and made aggregate sales in or into the U.S. below $75.9 million in its most recent fiscal year. *See* 16 C.F.R. § 802.51(b). A question for many companies looking to this foreign issuer exemption is often: what constitutes sales in or into the U.S., particularly when the foreign party being acquired offers a service?

The Premerger Notification Office (''PNO'') at the FTC, which assists the FTC with administering the HSR Act by, among other activities, providing both formal and information interpretations of the HSR Act, has provided guidance addressing this question. In particular, the PNO has repeatedly noted that, for the purpose of this exemption as it applies to service, (as opposed to the sale of goods,) the location of the revenue is where the service is rendered. *See* Information Interpretations 0509017; 1206008; 1405003, *available at* http://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations (stating ''I think we have been consistent in saying that a service that is provided outside of the US is not a sale into the US even if the customer is US.''). This appears to be regardless of whether advertisements are made in the U.S. or the location of the customer. *Id.*

Where this interpretation becomes most interesting and difficult is for technology companies offering on-line services. In such instances, the PNO's informal interpretations indicate that the location of the sale for the service offered depends upon the *location of the company's servers*. *See* Information Interpretations 0509017. Hence, if an on-line company provides a service to its customers using servers located abroad, such sales do not constitute sales in or into the U.S. for purposes of the foreign issuer HSR exemption.

Such an interpretation provides difficulties for companies examining their requirements under the HSR Act. Take the following example. A foreign target company has a U.S. subsidiary that relies on servers in both the U.S. and Mexico. All of the servers carry out the same function and rely on the same intellectual property. Customer's data is merely split between the servers based on geographic location. Customers in the South East have their data handled by the servers in Mexico while customers in the North East have their data routed through servers in the U.S. Under the current interpretations of this exemption, only those sales to customers using the servers in the U.S. would constitute sales in or into the U.S.

Companies, such as the target in the example above, often find it difficult and confusing to accurately determine which data flows to which servers, and how to properly split sales according to the location of the servers. This becomes even more complex when varying servers are used for a single customer. In the example above, imagine if the target's U.S. subsidiary has a large customer with offices throughout the U.S., such that the customer's data is handled by servers in both the U.S. in Mexico. Because the servers all carry out the same function, it may be next to impossible to accurately apportion its sales for this customer by the location of the server. Yet, this is precisely what the current interpretation of the exemption requires companies to determine.

In such instances, companies may face the tough choice of playing it safe and making an HSR filing, which carries with it the information gathering burden, legal fees, filing fee, and waiting period; or, failing to file believing the target sufficiently apportioned its sales by server, risking a $16,000 per day fine if the U.S. agencies determine that the acquisition did require an HSR filing. *See* 15 U.S.C. § 18(a)(g), as amended (imposing a $16,000 civil penalty for each day during which the parties violated the HSR Act).

With the ever-increasing use of cloud-based computing, including relying upon servers located globally, it is only going to become more difficult for companies to accurately determine whether they can qualify for the foreign issuer exemption to the HSR Act. Given the high risks of getting an analysis wrong, companies involved in a transaction may have little choice but to make the requisite HSR filing. Not only will this unnecessarily burden the parties to a transaction, it will also put an even heavier caseload onto the DOJ and FTC for transactions that could otherwise be exempt if not for the difficulty of complying with the current interpretations of the foreign issuer exemption.

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