Before the
United States Federal Trade Commission
Washington, D.C.

In re

Computer & Communications Industry Association (CCIA) Response to the Federal Trade Commission's Request for Comments on Hart- Scott-Rodino Coverage, Exemption, and Transmittal Rules, Project No. P110014.

Docket No. FTC-2020-0085

COMMENTS OF
THE COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION (CCIA)

In response to the FTC's Advanced Notice on Proposed Rulemaking (ANPRM), published in the Federal Register at 85 FR. 77053 (2020-21753), referred to as the 16 CFR parts 801-803: Hart-Scott-Rodino Coverage, Exemption, and Transmittal Rules; Project No. P110014, the Computer & Communications Industry Association ("CCIA")[1] submits the following comments.

I. Introduction

The FTC said that it "seeks to gather information on seven topics that will help determine the path for future amendments to the Hart Scott Rodino Act (HSR Act) rules and interpretations of those rules."[2] CCIA commends the FTC opening a public consultation before engaging in amendments to the HSR Act and its implementing rules. CCIA welcomes the opportunity to provide its views on this public consultation.

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[1] CCIA is an international nonprofit membership organization representing companies in the computer, Internet, information technology, and telecommunications industries. Together, CCIA's members employ nearly half a million workers and generate approximately a quarter of a trillion dollars in annual revenue. CCIA promotes open markets, open systems, open networks, and full, fair, and open competition in the computer, telecommunications, and Internet industries. A complete list of CCIA members is available at http://www.ccianet.org/members.
[2]https://www.ftc.gov/news-events/press-releases/2020/09/ftc-doj-seek-comments-proposed-amendments-hsr-rules-advanced

To ensure that tech-related innovation continues to play a positive role in the global economy, sound competition policy and antitrust enforcement both must play a crucial role in protecting competition across markets. Merger control, as part of the antitrust toolkit, remains a key element in maintaining a dynamic economy. To that end, competition authorities have applied merger control rules vigorously in recent years. This includes transactions where the merger effects on innovation and competition have been analyzed, particularly in the case of R&D intensive industries. To date, the HSR Act has allowed the antitrust agencies to reach a healthy balance between reviewing mergers that might raise competition issues while making efficient use of their resources without chilling innovation in the transactional space due to excessive regulatory oversight.

By the same token, the U.S. antitrust agencies for years have been right to recognize that vertical mergers are typically pro-competitive in nature, and require a different approach when enforcing antitrust. Vertical mergers usually bring about substantive pro-consumer efficiencies. For example, vertical integration typically helps to lower costs, and increase the stability of supply of an important input. Furthermore, the combination of talent from the different workforces can promote new ideas that eventually become new products and/or services for the benefit of consumers.

CCIA believes that any changes to the HSR Act and its implementing rules should not distort the healthy balance that currently exists with respect to merger control especially with respect to employee's compensation. For example, Restricted Stock Units (RSUs) are a standard feature of many transactions-both within and outside of the tech industry- and are integral to procuring and retaining talent.[3] Companies use them to incentivize professionals not only to join them, but to invest in their success. And they provide generous compensation to founders and gifted employees alike. Retention bonuses are another type of incentive used to attract and retain key employees post-closing to help maximize the success of the acquisitions.

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[3] *Restricted Stock and Restricted Stock Unit Utilization Today* - and Planning Points, XXVII AYCO Comp. & BENEFITS DIGEST X (Oct 11, 2019), https://www.ayco.com/content/dam/ayco/pdfs/us/en/compensation-benefits-digest/2019/digest_1910.pdf.
David Knowpling et al., *Restricted Stock Units (RSUs) Are Everywhere, But Are They Right For You?* Aon (2014), https://rewards.aon.com/en-us/insights/articles/2014/are-restricted-stock-units-right-for-you.

Maintaining this healthy balance is the reason why CCIA considers it important to submit its views with respect to four main issues as included in the public consultation, namely: (i) Employee compensation; (ii) Convertible voting securities; (iii) Board oversight; and (iv) fair market determinations.

II. Elements of employee compensation that should not be used to determine the value of a transaction

The FTC's ANPRM includes questions relating to employee compensation (e.g., bonus payments, retention payments, payments for contingent employee compensation) and suggests reevaluating whether employee compensation should be included when evaluating acquisition price. The FTC seems to be evaluating whether employee compensation, as well as other categories of payments that are currently excluded from the acquisition price (such as transaction expenses and debt) should be included in the acquisition price of the target for purposes of determining whether the Size of Transaction test is met. In particular, CCIA is concerned with the possibility of adding equity compensation (such as stock options and restricted stock units, or RSUs[4]) to the purchase price for the purposes of the HSR Act thresholds.

Most acquisitions include negotiated terms relating to employee compensation and benefits matters for those employees who choose to join the acquiring company (such as provisions laying out which party will bear the economic burden of employee entitlements, or commitments from the buyer with respect to future compensation levels). Employee compensation may include stock options or RSUs, which are standard compensation methods in numerous industries, and are not exclusive to M&A deals or the tech industry.[5] These terms may impact the total anticipated cost of the transaction to the buyer but they are generally not

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[4] *Restricted Stock and Restricted Stock Unit Utilization Today* - and Planning Points, XXVII AYCO Comp. & BENEFITS DIGEST X (Oct 11, 2019), https://www.ayco.com/content/dam/ayco/pdfs/us/en/compensation-benefits-digest/2019/digest_1910.pdf.
David Knowpling et al., *Restricted Stock Units (RSUs) Are Everywhere, But Are They Right For You?* Aon (2014), https://rewards.aon.com/en-us/insights/articles/2014/are-restricted-stock-units-right-for-you.

[5] As a matter of example Verizon, Starbucks and Bank of America use this type of compensation. See https://advisorhub.com/bofa-to-give-free-stock-to-thousands-of-employees-including-fas/; https://www.thestreet.com/opinion/3-costly-changes-starbucks-is-making-to-silence-disgruntled-employees-13634654; and https://www.verizon.com/about/careers/stock-together.

considered to be part of the acquisition price, as the employee compensation is not paid to the sellers in the acquisition (in their capacity as such) and instead is part of the cost of operating the acquired business in the future.

For example, buyers often award equity grants (such as stock options or RSUs in the acquiror) to the target company employees in an acquisition, but this is a standard compensation method in numerous industries, not exclusively used in M&A deals or the tech industry. The goal behind companies using equity compensation as part of their compensation packages to employees is to attract talent, to keep that talent incentivized to add value to the company, and to align the employees' incentives with the creation of shareholder value. In other words, compensation in the form of stock-based incentives represent an advance promise to pay for future employment services. They have no value prior to the vesting date, and do not represent consideration for the target company's assets, voting securities, or non-corporate interests. In fact, equity compensation granted to employees typically must vest before the employee can receive the underlying shares, based on certain conditions usually linked to the employees' retention or future job performance. Once the employee meets such conditions, the stock is no longer restricted and becomes transferable to the employee holding the award. If the employee leaves before vesting or does not perform as required, however, the stock is not transferred.

The treatment of equity grants in acquisition agreements varies widely from deal to deal; in some transactions the equity grants may be expressly addressed in the acquisition agreement (e.g., a contractual covenant from the buyer to issue a minimum value of equity to the acquired company employees) while in other transactions there may be equity grants that aren't mentioned in the contract at all but are instead addressed only in the employee offer letters signed between the acquirer and the employees. In either scenario, these equity grants are not part of the acquisition price paid to the sellers but are rather part of the go-forward cost of operating the acquired company. Moreover, the ultimate value of these equity grants will depend on the performance of the combined company following the closing and thus cannot reliably be determined at the time of the acquisition. By way of example, in an acquisition buyer may grant stock options to the target company's employees with and exercise prices that is equal to the buyer's stock price as to the closing date of the acquisition; in such a case, the stock

option would only have intrinsic value to the employee if the combined companies' stock price increases in the future Hence, the value of employee's compensation, including stock-based awards like options and RSUUs, should continue to be excluded from the value of the underlying acquisition.

Similarly, retention bonuses are a form of compensation distributed annually in most cases over a set period, generally three to four years following acquisition. Importantly, retention bonuses are typically not guaranteed and require that an employee meet temporal and performance benchmarks. In sum, they are anticipated payments for future work, aggregated as a total available pool for the acquired talent at the time of acquisition but unpaid until individual employees qualify for bonus distribution in the years after the acquisition closes. Indeed, in many instances retention bonus pools are not fully distributed due to employee turnover or other factors.

In some instances, founders may be included in the pool of employees who might be awarded stay bonuses and these bonuses can sometimes be large if the retention of the founder is deemed critical to the success of the acquired technology or business. It may be tempting to consider whether these retention bonuses could be used as an alternate form of acquisition value or consideration to frustrate HSR reporting calculations. However, this would run counter to the interests of founders and shareholders, who seek immediate payment for the current value of the acquired company without future contingencies attached to those payments. For this reason, shareholders who are employees have a strong incentive to negotiate payment for their shares (i.e., for the value of the company) at the time of acquisition as consideration as part of the share acquisition price, rather than as potential, but conditional, retention bonuses.   Retention bonuses, which must be earned in exchange for the employee's future services to the acquiring company, do not offer certainty of payment based on the current value of the target company at the time of acquisition, but remain contingent.

The importance of talent retention to post-acquisition success, the continuing employment and performance requirement, and the unpredictability of the total amount of retention bonuses ultimately paid for any particular transaction demonstrate that these are

payments for future services and are not appropriately considered part of the acquisition price. HSR reporting focuses on payments to acquire control of an entity, not employee compensation for future work, and thus properly excludes retention bonuses.

CCIA is concerned with the possibility that including employee compensation when valuing a deal under the HSR Act could have a negative impact on the start-up ecosystems. Including employee compensation in the acquisition price would add substantial uncertainty and burden to the calculation of the acquisition price for HSR purposes since it would require many judgment calls and artificial line-drawing to determine which types of compensation should be included or excluded. Unlike when the acquirer gains control of the acquired assets or shares, the acquirer does not acquire ownership or control of employees' future services regardless of whether it issues e.g. RSUs, retention bonuses, or any other form of future compensation. And this is the case even for those employees deemed particularly important to the operation of the acquired firm.

Under such conditions, numerous questions arise as to how the FTC would determine which type of compensation would need to be included for the purposes of the HSR filings and which should not. For example, would bonuses or equity compensation be treated differently from salaries? Would it matter if the cash bonus is to reward the employees for past performance or if the bonus contingent on future performance? Would stock options be treated differently from RSUs or retention bonuses? As these questions illustrate, it would be impossible to establish a bright-line rule that doesn't have unexpected consequences, particularly given that employee compensation arrangements vary widely from company to company – and likewise the treatment of such compensation varies widely among M&A deals based on the terms negotiated by the parties.

As noted above, employees compensation, e.g. in the form of RSUs or retention bonuses, are typically intended to incentivize the target firm's employees to remain with the acquiring firm post-acquisition and often to meet certain performance goals. Whether and how many employees will (i) remain with the acquiring firm long enough for the RSUs or the retention bonuses to vest and (ii) achieve the performance metrics required for vesting are entirely

unknown at the time of acquisition. If employee compensation were included in the acquisition price it could encourage buyers to pay less compensation to the acquired company's employees (or to shift the compensation package in response to the amended rules) and could deter some acquisitions altogether.

Under the current startup ecosystem, entrepreneurs frequently aim to develop new technologies targeted at acquisition by established firms for incorporation into incumbent systems and products.[6] CCIA understands that should the HSR Rules be amended to include future compensation as part of the acquisition price, companies might be discouraged from acquiring start-ups, which would ultimately chill innovation.[7] The obligation to report a deal to the antitrust authorities implies delaying the closing of transactions and conditioning acquisitions of start-ups to regulatory decisions. A rule change mandating that transaction valuations include a form of employee compensation that is unknown at the time of acquisition - and typically is uncertain for several years post-transaction- would create significant uncertainty in the valuation calculation process. In a fast moving sector, time is of the essence and burdening start-ups with onerous oversight requirements due to the need to report employee's future compensation will surely impact the start-up ecosystem dynamics resulting in start-ups exiting the sector or in less innovation. In fact, including employees' compensation in the valuation of deals would overlook the basic premise that HSR valuations are based on the payment amount, at a time certain, to acquire control of voting shares or assets. Future and indefinite payments separate and distinct from the value of the acquired voting shares or assets should, therefore, not be counted when valuing a transaction.

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[6] A recent report by the Silicon Valley Bank finds that, although some companies prepare for an IPO, "[s]tartups say the most realistic goal is acquisition"—fifty percent of startups surveyed in 2019 expect to be acquired whereas only 18% percent saw an IPO as a realistic long term goal." *Silicon Valley Bank 2019 Startup Outlook US Report,* Silicon Valley Bank, https://www.svb.com/globalassets/library/uploadedfiles/content/trends_and_insights/reports/startup_outlook_report/us/svb-suo-us-report-2019.pdf (last visited Jan. 8, 2021)

[7] As economic research demonstrates, there is a strong link between the potential for acquisition of small entities, their access to investment, and innovation. *See, e.g.,* Gordon M. Phillips & Alexei Zhdanov, *R&D and the Incentives from Merger and Acquisition Activity,* at 34, Nat'l Bureau of Econ. Research (Aug. 2012), http://www.nber.org/papers/w18346 ("Our results show that the possibility of an acquisition amplifies the potential gains from innovation - particularly so for smaller firms.")

Moreover, because including employee compensation in the evaluation of transactions would likely increase the number of deals that will be reported to the authorities, transactions will be structured differently and capital will move from founders and target employees towards venture capitalists. As such, innovators whose exit or growth strategies depend upon being acquired will be discouraged from innovating as their certainty over compensation will diminish. It would be unfortunate to see that capital moves away from innovators to investors because of undue regulatory oversight requirements based on future compensation. Consequently, innovators would have less bargaining power when negotiating deals and they may end up having to commit to longer retention periods with the acquiring company, rather potentially creating new companies and continuing to innovate.

Because one of the biggest incentives for risk taker innovators is the potential for being acquired, CCIA urges the FTC to take into account the start-up ecosystem dynamics before changing the formula to value transactions and require the inclusion of future compensation for the purposes of reporting deals to the antitrust authorities.

III. The value of convertible voting securities should not be used to determine the value of a transaction

The FTC's ANPRM includes questions relating to convertible voting securities (e.g., debentures, options, warrants) and suggests reevaluating whether those should be reportable under the HSR Act when the interests are issued. The FTC seems to be evaluating whether this form of securities that do not have the present right to vote should be exempted from the HSR notification rules.

In corporate finance, convertible securities are commonly used in commercial transactions or as a financial instrument to raise capital in transactions. Convertible securities give the holder the underlying right to acquire a company's equity in the future, but generally do not give the holder any present rights that are typically associated with being a shareholder such as the right to vote or the right to receive dividends.

An option to acquire equity in the future does not amount to a present change in control, so little is to be learned about the competitive significance of the proposed transaction from this information. Startups, particularly in the tech sector, regularly use convertible securities like SAFEs and convertible notes to raise money. Early stage startups in particular use convertible securities to raise money from investors as a precursor to raising an initial round of preferred stock.

CCIA is concerned with the possibility of the FTC requiring convertible securities to be valued when issued and included in the transaction price for HSR purposes. The HSR Act's reporting requirements already require convertible securities to be reported when exercised if the applicable thresholds are met, which we believe is the appropriate approach. Until convertible securities are exercised, they do not provide the holder with the right to vote or otherwise exert control over the issuer, and indeed it is possible that the securities might never be exercised and thus the holder might never have any voting rights or influence over the issuer. Furthermore,requiring notification of convertible voting securities would present administrative difficulties since many convertible securities do not represent any value that can be calculated under the current HSR rules. For example, if a stock option is issued which entitles the holder thereof to acquire shares in the future at the present market price in the future, the stock option may have value in the future (if the stock price increases) but does not have any intrinsic value at the time of issuance. Having to account for future buying options would pose significant challenges given the uncertain worth of those options in the future. The value of the financial instrument is determined at a later time in a post-deal context, and it may well be the case that those stock options are never exercised.

The challenge of amending the current rules to include convertible securities when evaluating a transaction goes beyond the uncertainty and challenges determining the value of such securities. Because convertible securities are a very common financial instrument, especially for investments instart-ups, this would imply that the FTC will be expanding the scope of antitrust reviews to more of the start-up investments taking place in the market.[GS8] Oftentimes, investors prefer convertible securities as a means to structure the appropriate risk and reward structure for their investment in a startup. For example, an investor might prefer a

convertible note over regular non-convertible debt, because the convertible note provides the downside protection of a debt instrument but also allows the investor to share in the upside potential if the startup is successful, at which point the investor could convert the debt into equity. Start-ups need to secure capital access at future instances during the life cycle of their product development, and convertible notes are one instrument available to them. If convertible notes require additional regulatory approvals that are not applicable to regular non-convertible debt, investors may be deterred from investing in convertible notes which could result in less investment and/or higher cost of capital for startups. Consequently, the deterring effect that having to report a deal would have on investors might deter corporate finance from completing some investments in the start-up ecosystem, to the detriment of innovators.

For all the reasons herewith described, CCIA urges the FTC not to require convertible securities to be taken into account when evaluating a deal for the purposes of determining whether a transaction needs to be reported or not to the relevant antitrust authorities.

IV. Board Oversight

The ANPRM includes questions that suggest the FTC is concerned with the potential for board observers to influence a company's business decisions, and that these rights are not reportable events under the HSR Act. More specifically, the FTC appears to be evaluating whether the acquisition and exercise of these rights "provide opportunities to influence an issuer's business decisions, and thus should be reportable events."

Board observers are individuals who are permitted to participate in the meetings of the board of directors and may receive business information about the company in that capacity, but cannot formally vote. The use of board observers is very common in corporate governance for the purpose of ensuring independent business views are assessed when making important business decisions. Board observers rights are typically contained in the stockholders agreements and are often linked to private equity and venture capital transactions. So, for example, the use of board observers can be often found in start-up venture capital related transactions, where a board observer right is granted to the investor as opposed to designating

one board seat.

CCIA is concerned with the ANPRM´s suggestion to include board observers´ rights for HSR Act purposes. CCIA considers that the use of board of observers is a routine practice in venture capitalism to ensure business decisions benefit from third parties´ independent views. However, because board observers cannot exercise voting rights, the influence these observers may have on a business decision are limited. Also, while board observers are usually entitled to the same information as board directors, companies typically have more leeway to exclude observers from privileged or competitively-sensitive information. As such, the FTC should refrain from making board observers reportable events for the purpose of the HSR Act.

V. Fair Market Value Determinations

The ANPRM seeks comments regarding the factors that go into determining Fair Market Value (FMV), and what additional guidance, if any, the Commission might provide to eliminate difficulties involved in determining FMV, in the specific circumstances where such a determination is required. The ANPRM also asks whether the Commission should require an independent FMV for some transactions to ensure consistency with standard valuation practices.

To determine whether an acquisition meets the size of transaction threshold, parties look to the rule 801.10 valuation rules. Under rule 801.10, a fair market value determination may be necessary for acquisitions in the limited circumstances where the acquisition price is not determined and also for asset acquisitions, even if the acquisition price is determined, because the rule requires a comparison of the fair market value to the acquisition price for such acquisitions. The acquisition price can be undetermined where consideration for the transaction includes contingent payments. In these limited cases, the size of transaction is based on the fair market value of the assets, voting securities, or non-corporate interests being acquired. Also, where a transaction involves the acquisition of exempt assets such as foreign patents, the fair market value of the non-exempt assets determines whether the acquisition is reportable. Under current rule 801.10(c)(3), the fair market value “shall be determined in good faith by the board of directors of the ultimate parent entity included within the acquiring person, or, if unincorporated,

by officials exercising similar functions; or by an entity delegated that function by such board or officials."

The FTC Premerger Notification Office has provided appropriate guidance regarding FMV determination, in general requiring only that fair market value be determined in good faith and be commercially reasonable. For example, where a transaction includes contingent payments, a reasonable formulation of fair market value generally is the amount a third-party buyer, in an arm's length transaction, would pay at present in cash for the stock or assets being acquired without any contingent payment. Where a transaction involves exempt assets, a reasonable formulation of fair market value is what a willing buyer would pay to acquire the nonexempt assets in an arm's length, negotiated transaction, valued as part of an on-going business enterprise. Because the fair market value calculation is based on what a third-party buyer would pay at present, fair market value is typically identical or close to the acquisition price or the amount of consideration the buyer will pay for the transaction.

As recognized by the FTC's Premerger Notification Office current guidance regarding fair market valuation, the acquiring person, or its delegate, is best situated to determine transaction value. For example, acquiring persons conduct significant diligence for purposes of negotiating transaction consideration, and parties often obtain fairness opinions from investment bankers or other analysts for purposes of determining whether the consideration is fair to the acquiring or acquired persons shareholders.

CCIA is concerned that requiring an independent fair market valuation would be redundant and impose unnecessary cost and burden on the parties to the transaction and may potentially delay transaction closings. As noted above, delays may be especially costly in fast moving sectors like technology. CCIA also believes additional guidance from the Commission is unnecessary as the regulations require fair market value be determined in good faith and the Premerger Notification Office already provides that fair market valuation must be commercially reasonable.

Respectfully submitted,

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