KIRKLAND & ELLIS LLP

ALERT

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Avoiding Pre-Closing Antitrust Risk in Transactions with Competitors

Antitrust law requires that parties to a merger or acquisition remain and act like separate entities – and continue to compete – during the pre-closing Hart-Scott-Rodino Act ("HSR") review process, through to the closing of the deal.

This presents business challenges beyond the legal issues as to what can be shared, and when? How can companies price the deal, conduct effective due diligence, determine what real synergies and cost-savings can be achieved, and plan for post-closing integration, future production, sales, marketing, and new product strategies, without being viewed as ***"jumping-the-antitrust gun"*** on their transaction?

Sensitivity to this issue is warranted. "Gun-jumping" has been a focus of the U.S. Department of Justice ("DOJ") for several years. The Federal Trade Commission ("FTC") has held informal hearings on the issue.[1]

Regulators can raise gun-jumping concerns about – and seek to delay – deals that otherwise merit prompt HSR clearance. This can occur even after regulatory clearance is granted.[2]

That said, merging parties ***can*** both meet the business demands of preparing for integration and minimize antitrust risk, even if they are direct competitors. Recent statements by the FTC General Counsel, Bill Blumenthal, make clear that regulators appreciate the necessity for and reasonableness of certain pre-merger coordination. Thus, according to this latest pronouncement, the FTC will take a "nuanced," as opposed to a "wooden," approach when analyzing pre-closing conduct.[3]

Against this backdrop, we set forth some guidelines and basic ***"do's and don'ts"*** for accomplishing pre-closing business goals while minimizing the inherent antitrust risks in any communication with a competitor.

I. What Is Gun-Jumping?

The pre-closing actions of any merging parties are subject to potential government scrutiny – and liability – for improper gun-jumping. Particular caution is required for "horizontal" transactions, *i.e.* those between existing or potential competitors in any product category, even those tangential to the principal line(s) of business.

Pre-closing exchanges of competitively sensitive information and coordinated activities can raise gun-jumping concerns. Likewise, deal terms that transfer any effective operational control or provide highly favorable interim terms to the buyer are also viewed as improper by the regulators.[4]

United States antitrust authorities have two means of targeting alleged gun-jumping. *First,* they can pursue the matter as a technical violation of the HSR Act if an acquiring company obtains "beneficial ownership" of a target company before the deal closes. HSR penalties are roughly $11,000 per day for the entire period of the claimed gun-jumping. The meter on such fines can start running during due diligence – before the companies even file their HSR notification – and continue until the deal closes. Regulators also can seek equitable relief (including, potentially, disgorgement of profits) under the HSR Act.[5]

Second, antitrust authorities can bring a Sherman Act "restraint of trade" claim, which exposes the company to civil treble damage claims. Or, the authorities can proceed under both the HSR Act and the Sherman Act. Private claims also can be brought under the Sherman Act.

There are similar concerns over gun-jumping – and potential liability – in several foreign jurisdictions, including the EU, France, Germany, Mexico, Taiwan, and the United Kingdom. Their respective regulators have established various fines for improper pre-closing conduct. In the EU, the amount of the gun-jumping fine is discretionary, based on the nature, seriousness, and duration of the violation.

In short, concerns about improper pre-closing conduct can distract regulators – in all jurisdictions – from the pro-competitive benefits of your company's transaction, complicating the review and delaying the clearance process and, thus, the closing.

II. What Is Permissible Pre-Closing Conduct?

There is no formal guidance from the DOJ, the FTC, or the EU on pre-closing coordination, nor does any appear to be forthcoming. Blumenthal's recent remarks are helpful because he provides welcome insights from a regulator's perspective. Of particular note, he acknowledges that the most recently reported gun-jumping enforcement actions "were easy cases that involved egregious conduct." These cases involved clear *per se* violations of the Sherman Act's prohibitions against price-fixing.[6]

However, the facts of those cases underscore the importance of having – and adhering to – a well-explained antitrust compliance program that requires Law Department clearance ***before*** any communications with competitors regarding prices, production plans, customers, or any other competitively sensitive topic. Any antitrust compliance guidelines should ***include*** a warning to treat an acquisition partner as a separate entity and, if appropriate, as a competitor, until ***all*** required antitrust clearances and approvals are received and the deal closes.

The guidelines we set forth below – which are based on our experience counseling clients during the pre-closing period, as well as on our discussions with DOJ and FTC personnel and practitioners – are designed to provide merging companies with a path to effective – and legal – pre-closing due diligence and planning for post-closing integration.

In all deals involving horizontal elements (*i.e.* actual or potential competing products or services), a "Deal Team" should be designated and then insulated – as to information learned during the deal negotiation and due diligence process – from the groups at each company with day-to-day business and operational responsibility. Establishing a Deal Team prevents the legitimate information exchanges and planning activities that merging parties can (and should) engage in from "spilling over" into the parties' competitive efforts.

A Deal Team can take any of several forms. For example, the larger the deal is in size and competitive overlap significance, the wiser it becomes to consider outsourcing the detailed due diligence and integration planning efforts to a third-party, industry-knowledgeable consultant. Regardless of whether the Deal Team is comprised of insiders or third parties, all members, as well any other company personnel involved with the transaction, should be familiar with the guidelines below.

Again, the bottom line is that competition should – and must – continue unabated until closing.

A. General Pre-Closing Guidelines

- An Acquirer ***may*** make ***unilateral*** decisions regarding the future of the combined entity and – internally – do what is necessary to carry out those decisions. Likewise, an Acquirer and the Target can jointly plan for the consolidation. However, they should ***not*** work together to implement the plans for the merged company prior to closing. They should *not* establish joint product development teams or co-mingle personnel. That the companies wish to avoid the cost and burden of separate pre-closing planning tracks is *not* a justification for pre-closing integration.
- An Acquirer ***may*** prohibit the Target from taking actions outside of the ordinary course of business prior to closing, to ensure it obtains from the Target

the assets it agreed to acquire. However, the fact that the merger agreement includes such an "ordinary course of business" provision does *not* justify the acquirer's pre-closing involvement in the day-to-day activities of the Target.

- Relatedly, an Acquirer ***may not*** limit the Target's ability to conduct its business in the ordinary course prior to closing. In a recent action, the DOJ challenged a requirement that the Target seek the Acquirer's prior approval before extending certain customer discounts and standard contract terms. An Acquirer may *not* dictate to the Target the prices and terms of trade to be offered to Target's customers, or what customers it may *not* approach, or limit Target's participation in trade shows and other business development opportunities. Prices, sales terms, customers, and sales territories ***must not*** be agreed upon prior to closing.
- An Acquirer and the Target ***may not*** hold themselves out to customers or suppliers as a combined entity or business. While it may be desirable to have joint meetings with at least some customers to provide them advance notice of and comfort with a proposed deal, Legal Counsel should be involved in determining whether the parties should initiate any such joint meetings with customers and what the parameters of any such meetings should be. Blumenthal addressed this issue specifically in his speech. He drew a distinction between jointly marketing the transaction – which is ***permitted*** – and jointly marketing the parties' products – which is ***prohibited***. There is nothing improper about running joint advertisements, or making joint statements to customers, that announce or support the merger. The prohibitions apply to joint efforts to promote or sell products or services.
- An Acquirer and the Target must be particularly careful when sharing competitively sensitive information during due diligence and contract negotiations. ***Competitively sensitive information should only be shared if there is a self-evident, deal-related reason for doing so.*** If competitively sensitive information is exchanged in a proposed asset acquisition, it should flow from the Target to the Acquirer, not vice versa. If workable from a timing and efficiency standpoint, an independent third party (business development team, auditor, investment bank, consultant, etc.) can be used to collect, aggregate, and analyze any particularly competitively sensitive information from the merging parties for use after closing in making pricing, new product or output decisions.
- ***In no event should competitively sensitive information be used for any purpose other than evaluating the deal.*** Where possible, competitively sensitive information should only be accessed by those actually conducting due diligence or negotiating a deal and should *not* be available to people engaged in day-to-day operations or responsible for setting prices on competing products or services.
- What constitutes "competitively sensitive" information varies industry-by-industry and deal-by-deal. One litmus test is whether the business people would be willing to share the same information with a competitor which was not its deal partner.

Blumenthal focused on the important issue of what to do about matters that ***require*** pre-merger implementation. An example would be a ***significant capital project*** that must be dealt with jointly prior to closing because the project would be rendered unnecessary post-closing. In such a case, according to Blumenthal, the parties should expect from the agencies "a fact-intensive review that examines all factors that might be pertinent," rather than a "bright-line" test. Ultimately, regulators will focus on whether the coordinated steps were "necessary to achieve the ***legitimate*** objectives of the merger agreement."

B. Guidelines Concerning Pre-Closing Information Exchanges

Whenever information is to be exchanged, companies are well-advised to sign a non-disclosure agreement detailing the information to be exchanged and the identity of those who will have access to it.

Although information exchanges, like coordinated conduct, can lead to gun-jumping charges, deal partners can exchange a substantial amount of information without raising such concerns.

Merging companies may share the following with little antitrust risk:

- Balance sheets, income statements, and tax returns;
- Current and projected sales revenues, costs, and profits by broad product categories;
- Lists and descriptions of current products, manufacturing operations, distribution assets, real estate and leases, and general business activities;
- Information regarding IT and data processing systems;
- General information regarding existing joint ventures or similar relationships with third parties (giving due consideration to confidentiality obligations to third

parties);

- Human resources information;
- Information regarding pending legal claims against the company (with due regard for the attorney-client privilege);
- Information regarding environmental risks; and
- Information in the public domain or of a type regularly disclosed to third parties such as stock analysts.

Other, more competitively sensitive information should only be sought and exchanged if there is a self-evident, deal-related reason for doing do, and only with prior Law Department approval and implementation of appropriate safeguards.

As explained earlier, what constitutes "competitively sensitive" varies by industry. As noted, if your business people would be concerned about sharing specific information with a competitor, that information should not be shared with your deal partner either, unless appropriate protective measures as outlined herein are taken.

As in any competitively sensitive situation, both your company's Law Department and your deal partner's Law Department should document – and be able to justify – all pre-closing conduct and information exchanges, with a legitimate deal-consummation related purpose.

Merging companies that are actual or potential competitors should not share the following without first implementing special screening procedures:

- Detailed information regarding pending or future bids;
- Prices or deal terms in competitive, or "overlap," markets, e.g., non-public price lists, internal pricing strategies, or information on customer-specific rebates, discounts, or other terms of sale;
- Current or future business plans, marketing plans, bidding strategies, or product-specific production estimates;
- Detailed information about ongoing R&D efforts, including new products in the pipeline (unless such plans have already been disclosed to the public);
- Sales figures broken down by customer if this information is generally not known to competitors (but, providing no-name customer lists ("customer A, customer B", etc.) and aggregated sales figures (e.g., by type of product or geography) is generally permissible);
- Actual customer and supplier contracts or terms of trade (but, providing form contracts and contracts with pricing and other competitively sensitive terms redacted is usually permissible);
- Cost information on an individual product/SKU basis (but, providing aggregated cost information is usually permissible); and
- Profit margins on an individual product/SKU basis (but, providing aggregated historical figures is usually permissible).

One legitimate purpose for the exchange of competitively sensitive information is the joint preparation of a cost-savings or efficiencies study. Such a detailed and authoritative study – often needed for deal valuation purposes – also can be useful in explaining the motives and benefits of the transaction to antitrust authorities. Thus, a credible and specific cost-savings and efficiencies study may facilitate and expedite the clearance of the transaction by the regulators.

Some regulators have expressed concern that such cost-savings and efficiencies studies can require improper information exchanges. Accordingly, any joint efforts in this regard – which are often necessary for such studies to be sufficiently concrete and detailed – should be carefully scrutinized by and approved by the company's lawyers.

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Companies, their lawyers, and employees need to be attuned to gun-jumping concerns in doing deals. That said, it is clear that the antitrust regulators understand the legitimate business need for due diligence and pre-closing integration efforts. Such efforts can be undertaken when done appropriately and in ways that do not – before closing – lessen any competition that then exists between the deal parties.

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[1] Statement of R. Hewitt Pate, Before the Committee on the Judiciary of the United States House of Representatives Concerning Antitrust Enforcement Oversight, July 24, 2003 ("We have also been very active in cases related to our merger enforcement program, filing several cases against *'gun-jumping'* and other violations of the Hart-Scott-Rodino premerger notification and waiting period requirements. It is important that merging parties strictly adhere to the requirements of the HSR Act and maintain their companies as ***separate and independent firms*** during the HSR waiting period.").

[2] Any ***gun-jumping*** is likely to become a focal point in an intensive, substantive antitrust investigation of a deal. For example, in the FTC's recent administrative trial seeking to break up Chicago Bridge & Iron Co.'s consummated acquisition of Pitt-Des Moines Inc., the FTC Staff pointedly probed to see whether Chicago Bridge had improper ***pre-closing access to confidential bidding and cost information.***

Conversely, the government can target merging parties for gun-jumping even if the transaction does ***not*** raise competitive concerns. In a 1999 deal involving Input/Output, which had agreed to purchase Laitrim Corporation's subsidiary DigiCOURSE, the government alleged that the parties jumped the gun when DigiCOURSE executives moved into Input/Output's offices and managed an Input/Output Division. The parties halted the arrangement but were ***fined*** $225,000 for three weeks of gun-jumping, even though the DOJ allowed the HSR period to expire without requesting additional information, demonstrating its lack of concern about the merger's competitive effects. See *United States v. Input/Output, Inc.,* No. 99-0192, Final Judgment (D.D.C. May 13, 1999), available at http://www.usdoj.gov/atr/cases/f203600/203653.htm.

[3] Statement of William Blumenthal, Remarks Before the Association of Corporate Counsel, November 10, 2005, at 7, 14 ("Blumenthal Speech"), available at http://www.ftc.gov/speeches/blumenthal/20051110gunjumping.pdf.

[4] *Id.* at 7.

[5] *See* Section 7(A)g of the HSR Act. While the use of ***disgorgement*** by the FTC in any context is, itself, the subject of controversy, at least one unofficial statement has indicated that, in the gun-jumping context, disgorgement "may remove the potential economic incentive that firms have to evade HSR guidance." Comments of Joseph G. Krauss, then-Assistant Director, Premerger Notification Office, Bureau of Competition, Federal Trade Commission to the District of Columbia Bar Association, October 7, 1998.

[6] Blumenthal Speech at 3. In *U.S. Department of Justice v. Computer Associates International, Inc., et al.,* (http://www.usdoj.gov/atr/cases/f9200/9246.htm), the government sought a $1.3 million fine and injunctive relief under the HSR Act and the Sherman Act, respectively, from Computer Associates and its merger partner, Platinum Technology International, Inc. Among various pre-closing requirements alleged to be improper, Platinum had to seek Computer Associates' ***approval*** for customer discounts and standard contract terms ***before*** a sale could be finalized by Platinum. Computer Associates also installed a vice president at Platinum to review and approve customer contracts. As part of its settlement with the government, Computer Associates agreed to pay $638,000 in civil penalties and was enjoined from agreeing on prices, approving or rejecting customer contracts, and exchanging bid information with all future merger partners.

In *U.S. Department of Justice v. Gemstar-TV Guide International, Inc.,* the DOJ alleged that Gemstar and TV Guide had fixed prices, allocated customers, and violated pre-merger waiting period requirements prior to their merger in July 2000. See http://www.usdoj.gov/atr/cases/f200700/200737.htm. The DOJ alleged the parties coordinated customer deal terms and negotiations, ***agreed*** to "slow roll" customers, shared operational control, sought cross-approval for basic business decisions, and shared confidential pricing and marketing information. In February 2003, Gemstar-TV Guide International reached a settlement with the DOJ that required the company to pay a record $5.67 million in civil penalties -- the maximum fine that was available under the HSR Act. See http://www.usdoj.gov/atr/cases/f200700/200731.htm.

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