

Gun-Jumping and Premerger Information Exchange: Counseling the Harder Questions*

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Counseling on the appropriate bounds of information sharing and coordination between parties to an acquisition or merger in the pre-closing period can be one of the more difficult and time-consuming challenges faced by antitrust practitioners. Timely and thorough pre-closing information exchange and coordination is a necessary ingredient for successful transactions, but such activities may be subject to scrutiny under Section 1 of the Sherman Act,¹ and, for transactions requiring premerger filing, under the Hart-Scott-Rodino Antitrust Improvements Act, codified as Section 7A of the Clayton Act.²

Until a deal is closed, the antitrust authorities take the view that the parties are required to compete as separate and independent entities. Antitrust concerns arise when parties to a transaction engage in activities that have the potential to diminish competition before closing or, in the event the deal is not consummated, after abandonment. Parties can encounter these risks when they take steps prior to closing to coordinate market actions, transfer operational control, or prematurely integrate the companies—collectively known as “gun-jumping”—or when they exchange competitively sensitive information that could facilitate coordination.

Notwithstanding the risk of antitrust scrutiny, the urge to coordinate activities and share information is often both strong and legitimate. Even before the acquisition agreement is executed, sensitive information often must be exchanged to facilitate necessary due diligence and valuation by the buyer.³ Once the parties have signed a merger or acquisition agreement, they are highly motivated to begin planning for integration, and such planning typically requires the exchange of

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¹ 15 U.S.C. § 1. In FTC enforcement actions against conduct that would violate Section 1 of the Sherman Act, the matter is brought under Section 5 of the FTC Act, 15 U.S.C. § 45. Although somewhat of a simplification, given that Section 5 is broader than Section 1, unless otherwise noted below I will generally refer to Section 1 to encompass both Section 1 and Section 5.

² 15 U.S.C. § 18a.

³ I refer to “buyer” and “seller” for simplicity, recognizing that in many transactions each party is both a buyer and seller.

confidential information and a certain level of coordination. In addition, the parties may wish to avoid inefficient (sometimes duplicative or wasteful) investments by one party or the other during the pre-closing period.

Early and thorough planning, which of course also requires information exchange, has been identified as a critical factor in the success of transactions.⁴ The antitrust agencies recognize the importance of these activities,⁵ and have provided a large volume of guidance over the years on appropriate premerger activities.⁶ The basic counseling problem is that, although the clear do's and don'ts are relatively easy to understand, most of the counseling questions relate to the closer calls, where it is harder to draw the line between appropriate and inappropriate premerger activities. The agencies have not provided detailed guidance on many of the scenarios that can arise. And

⁴ See, e.g., Paul Pautler, *The Effects of Mergers and Post-Merger Integration: A Review of Business Consulting Literature* (Jan. 21, 2003), available at <http://www.ftc.gov/be/rt/businessreviewpaper.pdf> (FTC Bureau of Economics review of business literature supporting the conclusion that early planning for integration is a critical component for successful mergers); Paul Bonanto, *Antitrust Counsel, DuPont, Remarks at a Roundtable Sponsored by the FTC Bureau of Economics, Understanding Mergers: Strategy and Planning, Implementation and Outcomes 310-18* (Dec. 10, 2002), available at <http://www.ftc.gov/be/rt/xscriptpanel5.pdf> [hereinafter *Bonanto Remarks*] (discussing critical importance of effective integration planning for a smooth startup).

⁵ See U.S. Dep't of Justice & Federal Trade Comm'n, *Commentary on the Horizontal Merger Guidelines 59* (2006), available at <http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf> ("The agencies are mindful of the parties' need to provide sensitive efficiencies-related information and, in that vein, the Agencies note that the antitrust laws are flexible enough to allow the parties to adopt reasonable means to achieve that end lawfully."); William Blumenthal, *General Counsel, Federal Trade Comm'n, The Rhetoric of Gun-Jumping, Remarks Before the Association of Corporate Counsel Annual Antitrust Seminar of Greater New York Chapter: Key Developments in Antitrust for Corporate Counsel 3* (Nov. 10, 2005), available at <http://www.ftc.gov/speeches/blumenthal/20051110gunjumping.pdf> [hereinafter *Blumenthal Speech*] ("we are mindful that many forms of premerger coordination are reasonable and even necessary and that care needs to be taken not unduly to jeopardize the ability of merging firms to implement the transaction and achieve available efficiencies").

⁶ In addition to complaints, this guidance primarily takes the form of analyses to aid public comments and agency speeches discussing enforcement actions. See, e.g., *Blumenthal Speech*, supra note 5, at 2 n.6 (citing speeches). Guidance is also available from former agency officials. See, e.g., M. Howard Morse, *Mergers and Acquisitions: Antitrust Limitations on Conduct Before Closing*, 57 *Bus. Law.* 1463 (2002); John M. Sipple, *Gun Jumping and Exchanges of Competitively Sensitive Information* (Corp. Counseling Comm., ABA Section of Antitrust Law), Winter 2000, available at <http://www.abanet.org/antitrust/committees/counsel/newsletters.html>.

although the agencies have brought ten enforcement actions relating to premerger activities over the last 15 years, these actions all ended in settlement and all alleged fairly egregious conduct. Thus, they are of limited value when counseling on the closer questions.

Two recent positive developments have helped to shed light on some of these harder counseling questions. First, FTC General Counsel William Blumenthal recently delivered a speech in which he reviewed common misconceptions regarding the antitrust limits of appropriate premerger activities. His remarks were intended to “calibrate” the legal standards so as not to overly discourage appropriate and efficient premerger activities.⁷ Blumenthal’s remarks are a welcome confirmation from (one of) the agencies that the current state of the law is not overly hostile to certain pre-closing activities, and a reminder of the importance of carefully considering the efficiencies of premerger activities in weighing the potential for anticompetitive harm.

Second, the ABA Section of Antitrust Law recently published a premerger coordination handbook containing a detailed review of current law that offers insight and analysis from the private bar on many of the difficult questions that arise in the pre-closing period.⁸

Armed with these recent insights, it is useful to review and assess how some of the harder questions should be treated. In this article, I present a number of common but difficult business issues that confront parties to a merger or acquisition as they move from due diligence to transition planning, drawing upon the applicable legal framework and strategic considerations to help think about these issues.

BASIC LEGAL FRAMEWORK

Any assessment of antitrust risk from the pre-closing conduct of merging parties must be informed by past applications of Section 7A of the Clayton Act and Section 1 of the Sherman Act to these activities. Section 7A prohibits the transfer of beneficial ownership or operational control (discussed further below) before the end of the HSR waiting period. Section 1, of course, prohibits contracts, combinations, and conspiracies that unreasonably restrain trade, and applies to pre-closing information sharing and coordination between parties to a yet-to-be-consummated transaction.

Complaints filed by the Department of Justice alleging illegal pre-closing activities often allege violations of both Section 7A and Section 1 based on the same alleged misconduct.⁹ However, there

⁷ Blumenthal Speech, *supra* note 5, at 3.

⁸ ABA SECTION OF ANTITRUST LAW, PREMERGER COORDINATION: THE EMERGING LAW OF GUN JUMPING AND INFORMATION EXCHANGE (2006) [hereinafter GUN JUMPING HANDBOOK].

⁹ See, e.g., Complaint for Equitable Relief and Civil Penalties ¶¶ 64–84, *United States v. Gemstar-TV Guide Int’l, Inc.* 2003-2 Trade Cas. (CCH) ¶ 74,082 (D.D.C. 2003) (No. 03-00198), available at <http://www.usdoj.gov/atr/cases/f200700/200737.htm> [hereinafter Gemstar Complaint];

are important differences in the application of the two statutes. First, Section 7A applies only in transactions where HSR notification is required and applies only until the end of the HSR waiting period. In contrast, Section 1 applies in any transaction whether subject to HSR notification or not, and its application continues until closing (assuming the transaction would yield a single economic entity incapable of conspiring with itself under *Copperweld*¹⁰). Second, whereas a Section 1 violation requires a showing of harm to competition, a violation of Section 7A does not. Third, certain acts that violate Section 1 may not violate Section 7A. For example, information exchanges may facilitate coordination in violation of Section 1. However, exchange of information does not typically implicate beneficial ownership or operational control, and thus, without more, does not raise Section 7A concerns.¹¹

Section 7A. For transactions subject to HSR notification, it is a violation of the HSR Act for a person to acquire voting securities or assets of another until both persons have filed notification and the HSR waiting period has expired. Penalties for violations of the Act include fines of up to \$11,000 per day.¹² The HSR Act and rules do not define “acquire,” but do define an “acquiring person” as one who will “hold” voting securities or assets as a result of an acquisition, and further define “hold” in turn to mean “beneficial ownership.”¹³ Although “beneficial ownership” is not defined in the Act or rules, the Statement of Basis and Purpose accompanying the issuance of the HSR rules states that

Complaint for Equitable Relief and Civil Penalties ¶¶ 31, 37, *United States v. Computer Assocs. Int'l, Inc.*, 2002-2 Trade Cas. (CCH) ¶ 73,883 (D.D.C. 2002) (No. 01-02062), available at <http://www.usdoj.gov/atr/cases/f9200/9246.htm> [hereinafter *Computer Associates Complaint*]. The FTC does not have authority to seek civil penalties under Section 7A or to bring claims under Section 1. The FTC can challenge premerger conduct under Section 5 of the FTC Act, 15 U.S.C. § 45(a), which prohibits “unfair methods of competition.” Section 5 prohibits conduct that violates Section 1 of the Sherman Act, and to some (unclear) extent conduct that is beyond the reach of Section 1. Past FTC practice indicates that the FTC may bring actions under Section 5 alleging competitive harm from coordination or information sharing, but would likely refer matters to the DOJ to pursue under Section 7A where the primary allegation is a transfer of beneficial ownership absent competitive harm.

¹⁰ *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984).

¹¹ It may, however, be the case that information exchanges could facilitate a transfer of operational control under Section 7A. See, e.g., *Computer Associates Complaint*, supra note 9, ¶¶ 25, 37(f) (collecting and disseminating competitively sensitive information facilitated operational control by buyer); *Gemstar Complaint*, supra note 9, ¶ 60 (sharing of pricing information permitted parties to merge operations).

¹² 15 U.S.C. § 18a(a), (g).

¹³ 16 C.F.R. §§ 801.2(a), 801.1(c) (2006).

“the existence of beneficial ownership is determined in the context of a particular case,” and details some of its attributes as follows: “the right to obtain the benefit of any increase in value or dividends, the risk of loss of value, the right to vote the stock [and] the investment discretion (including the power to dispose of the stock).”¹⁴ Although early enforcement actions brought under Section 7A tended to be framed squarely in terms of these four financial and control indicia of beneficial ownership,¹⁵ more recent actions focus more broadly on allegations of transfer of operational control.¹⁶

Some degree of beneficial ownership is transferred the moment a merger agreement is signed. For example, the agreement will typically specify a purchase price which in itself transfers some risk of gain or loss in the pre-closing period to the buyer. Other provisions that may transfer indicia of beneficial ownership include those restricting the sale of assets or significant investments without the buyer’s consent. As noted in the Input/Output Complaint, although execution of the agreement transfers some indicia of beneficial ownership, it typically is not enough by itself to transfer beneficial ownership.¹⁷ However, as additional attributes of beneficial ownership or operational control are transferred in the pre-closing period and combined with those granted by the agreement,

¹⁴ 43 Fed. Reg. 33,450, 33,458 (1978).

¹⁵ 15 See *United States v. Atlantic Richfield Co.*, 1992-1 Trade Cas. (CCH) ¶ 69,318 (D.D.C. 1991) (payment of acquisition price and assumption of rights to gains and losses conveyed beneficial ownership before HSR waiting period lapsed); *United States v. Atlantic Richfield Co.*, 1992-1 Trade Cas. (CCH) ¶ 69,803 (D.D.C. 1992) (right to vote all of target’s shares conveyed beneficial ownership before filing HSR).

¹⁶ See, e.g., *Complaint for Civil Penalties for Violation of Premerger Reporting Requirements of the Hart-Scott-Rodino Act* ¶¶ 30–33, *United States v. Qualcomm Inc.* (D.D.C. 2006) (No. 06-00672), available at <http://www.usdoj.gov/atr/cases/f215600/215608.htm> [hereinafter *Qualcomm Complaint*] (merger agreement and post-signing conduct transferred operational control to buyer); *Gemstar Complaint*, supra note 9, ¶¶ 76–84 (parties acquired each other’s assets when, inter alia, they agreed to divide markets and coordinated pricing and other key business decisions); *Computer Associates Complaint*, supra note 9, ¶¶ 34–38 (buyer took control of seller by, inter alia, restricting seller’s right to discount, installing buyer manager at seller’s headquarters to review and approve contracts, making ordinary course business decisions for seller, and disseminating seller competitively sensitive information within buyer); *Complaint* ¶¶ 13–16, *United States v. Input/Output, Inc.*, 1999-1 Trade Cas. (CCH) ¶ 72,528 (D.D.C. 1999) (No. 99-00912), available at <http://www.usdoj.gov/atr/cases/f203600/203653.htm> [hereinafter *Input/Output Complaint*] (transfer of beneficial ownership was triggered, inter alia, when buyer placed certain of seller’s operations and managers under control of restructured buyer division, and held these managers out to customers as buyer employees).

¹⁷ *Input/Output Complaint*, supra note 16, ¶¶ 14–16.

the agencies will at some point conclude that beneficial ownership has transferred even where those additional attributes standing alone would not transfer beneficial ownership.¹⁸

Section 1. Section 1 violations in the context of a merger or acquisition will generally be assessed under the rule of reason on the basis that the activities at issue are designed to protect the value of, and are thus ancillary to, the underlying transaction. Of course, certain egregious acts, such as naked agreements fixing prices or output in the pre-closing period, would likely be treated as per se illegal under Section 1. A Section 1 rule of reason analysis follows the standard assessment of whether the activities harm competition, and, if so, whether the anticompetitive effect outweighs any legitimate business purpose. If that balancing suggests a net procompetitive effect, the practice might still be condemned if reasonably available alternatives produce smaller anticompetitive effects.¹⁹

Collaborations or coordinated market activities that are suspect outside of the merger context will also likely warrant scrutiny when undertaken by merging parties.²⁰ For example, any joint venture that would raise antitrust concerns under Section 1 case law or the agencies' Collaboration Guidelines²¹ will likewise raise gun-jumping issues if undertaken by the merging parties in the pre-closing period.²² Similarly, per se illegal activities, such as market allocation and price coordination, are not saved by the fact that they are undertaken by parties planning to merge.²³

¹⁸ See, e.g., William R. Vigdor, Observations on the Emerging Law of Gun-Jumping, *THE THRESHOLD*, Spring 2006, at 3, 7, available at <http://www.abanet.org/abanet/common/login/securedarea.cfm?areaType=premium&role=at&url=/antitrust/mo/premium-at/at-mergers/spring-2006.pdf>.

¹⁹ See, e.g., ABA SECTION OF ANTITRUST, *ANTITRUST LAW DEVELOPMENTS* 76–79 (5th ed. 2002).

²⁰ As discussed *infra* notes 42–43 and accompanying text, it does not follow that collaborations not suspect outside the merger context will also be not suspect if undertaken by merging parties.

²¹ U.S. Dep't of Justice & Federal Trade Comm'n, Antitrust Guidelines for Collaborations Among Competitors at 18 (2002), available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf> [hereinafter Collaboration Guidelines].

²² Of course, if pre-closing activities would raise issues under the Collaboration Guidelines if undertaken by parties not merging, then the proposed merger may raise substantive issues under Clayton Act Section 7.

²³ One exception may be integration planning activities, which are, with proper safeguards, appropriate among merging parties, whereas similar activities undertaken by non-merging parties could be per se illegal.

Information exchanges may also run afoul of Section 1, with the primary concern being that the exchange may facilitate coordinated interaction in the pre-closing period, or if the transaction fails to close, after abandonment.²⁴ In all but the most egregious circumstances, such as negotiations undertaken as a sham by one party to obtain confidential information or by both parties to coordinate market activities,²⁵ the rule of reason should apply.²⁶

STRATEGIC CONSIDERATIONS IN ASSESSING THE ANTITRUST RISKS OF PRE-CLOSING COORDINATION AND INFORMATION SHARING

When assessing risks associated with various activities relating to information exchange and premerger coordination, a number of factors particular to the premerger context must be considered. First, for most acquisitions time is of the essence. The buyer and seller are typically interested in closing as soon as practicable so as to eliminate uncertainty among customers and suppliers and in financial markets. In this context, a gun-jumping or information exchange investigation can be an extremely unwelcome side show, unnecessarily delaying the closing and diverting resources away from integration planning.

Second, and related, if a Second Request is issued under the HSR Act, premerger coordination and information exchanges may take place under a microscope. A typical Second Request will result in the production of many documents relating to integration planning. If any of those documents suggest inappropriate coordination or information sharing, that may lead to more targeted requests for further information, possibly including depositions of those involved. If the agency pursues a

²⁴ See, e.g., Complaint ¶¶ 9, 18, *Insilco Corp.*, 125 F.T.C. 293 (1998), available at <http://www.ftc.gov/os/1998/01/insilccomp.pdf> (alleging violation of Section 5, where seller provided buyer with customer-specific price information, current and future pricing plans, and competitive strategies which could have harmed competition if the transaction had been abandoned).

²⁵ See William Blumenthal, *The Scope of Permissible Coordination Between Merging Entities Prior to Consummation*, 63 ANTITRUST L.J. 1, 6–9 (1994) (discussing past views of agencies on sham negotiations); Morse, *supra* note 6, at 1479–80 (same).

²⁶ See, e.g., *United States v. Container Corp. of Am.*, 393 U.S. 333, 337 (1969) (ongoing exchange of current price information in concentrated industry had the effect of stabilizing prices, and was illegal under Section 1); *United States v. United States Gypsum*, 438 U.S. 422, 441 & n.16 (1978) (because information exchange can increase economic efficiency in certain circumstances, “the structure of the industry involved and the nature of the information exchanged are generally considered in divining the procompetitive or anticompetitive effects of this type of interseller coordination”).

separate investigation into these activities, it will divert company and agency resources away from the substantive investigation, thereby unnecessarily extending the HSR waiting period.²⁷

Third, when gun-jumping issues arise, the burden of proof inevitably rests with the merging parties, in fact if not in law, because they cannot afford the diversion of time or resources to defend premerger activities in court. For example, plaintiffs have the burden under Section 1 to show competitive harm, but if the merging parties want to bring a gun-jumping investigation to an end, they will likely make every effort to demonstrate the absence of competitive harm.

Fourth, assessments of illegal coordination or information sharing are highly fact intensive, and in any ensuing investigation the agency will have access to many of those facts. It is not enough to advance a well-thought-out justification for a particular activity, along with a description of all the safeguards that were followed. This position must also be supported by the facts. What will customers have to say about the related marketplace activities? Will a review of emails support the conclusion that the buyer has legitimate business justifications ancillary to the underlying transaction and that all appropriate safeguards were followed, or will they instead show that the parties have implemented an end-run around premerger safeguards?

Fifth, buyers and sellers have differing motivations which may affect their assessments of antitrust risks from premerger coordination and information sharing. Counsel must understand these differing motivations to be able to distinguish bona fide concerns relating to antitrust risk from other strategic business concerns. For example, in integration planning the flow of confidential information will likely be primarily from seller to buyer. The seller may rightfully be concerned that, should the transaction fail to close, the buyer will have received seller's confidential business information and may use it to its advantage. The basic question the seller will ask is: Will it regret sharing this information if the transaction fails to close? The answer may well convert the seller into a champion of the antitrust laws when discussing appropriate levels of disclosure. The seller may as a result overstate the level of legitimate antitrust concern.

Another factor potentially affecting the motivations of buyers and sellers is the allocation of antitrust risk in the purchase agreement. Assume the buyer has taken on this risk by agreeing to pay a fee if antitrust clearance is not achieved by a date certain. The buyer may then have greater incentive to be risk averse in premerger activities, so as to minimize the risk that an investigation of these activities will further extend the HSR Act waiting period.

Many of the above factors serve to increase both parties' incentives to avoid risks associated with premerger coordination and information exchange. Why then does this not push most parties to undertake only the safest of premerger coordination and information exchange activities? The

²⁷ Even where the parties are able to certify substantial compliance with the Second Request despite the distraction of a separate gun-jumping investigation, the parties still may agree to extend the HSR waiting period so as to avoid a challenge to the underlying transaction.

answer, as discussed above, is that there are strong and legitimate forces pushing in the opposite direction, as parties attempt to value their transaction properly and plan for efficient integration.

ANTITRUST RISK ASSESSMENT FOR THE HARDER QUESTIONS—A REVIEW OF SOME COMMON SITUATIONS

On the most practical level, it is useful to review common examples of activities that raise some of the more difficult questions and explore some of the factors that should be considered in assessing the risk.²⁸ Two important caveats, noted above, are in order. First, there is no clear agency guidance on risk assessment for many of these harder questions. Nor are there any court decisions assessing and weighing the critical risk factors. The review is therefore to some degree a subjective assessment of what factors should be important based on past Section 1 and Section 7A enforcement actions. Second, any assessment of antitrust risks in premerger activities is inherently fact specific and the examples do not assess the many factual permutations that may arise.

Pre-Signing Due Diligence. With suitable protections, it is appropriate to share confidential business information of the target necessary for valuation. However, such exchanges can run afoul of Section 1 if the information is of competitive significance (e.g., current or future customer pricing or pricing strategies, other confidential customer contract terms, forward-looking strategic planning, etc.) and is not sufficiently protected. Antitrust risks are minimal unless the parties compete in a relevant antitrust market, as competitive harm from the exchange is otherwise unlikely. To continue, let's assume some level of competitive overlap.

Common advice relating to due diligence is that: (a) the parties exchange only that information relevant to the merger negotiation process, (b) its dissemination is protected by a non-disclosure agreement limiting its use only for the purpose of due diligence, and (c) access to any competitively sensitive information is limited to those individuals not involved in pricing, marketing, or sales. Further, certain categories of the most sensitive competitive information, such as current and future customer-specific pricing, detailed cost information, and forward-looking business plans, should be exchanged only under more restricted conditions.

Often, however, some of the highly sensitive competitive information listed above is critical to a proper valuation. This often applies to strategic planning documents because the buyer needs to gain some sense of where the target is heading and what key market forces are affecting its business growth. Detailed cost information may also be relevant to valuation, as may key customer contracts containing pricing and other commercial details. With respect to all of this sensitive information, the two critical starting questions are: (1) is it really necessary to the due diligence process; and (2) will the seller be comfortable with the level of exchange if the deal is not consummated? Assuming the answer to each is "yes" and proper safeguards are applied, the DOJ has found certain exchanges to

²⁸ For a further examination of these and many other antitrust issues frequently raised in the premerger process, see GUN JUMPING HANDBOOK, *supra* note 8, at 181–292.

be permitted conduct with appropriate certain safeguards on access.²⁹ The parties should consider what additional protections should be added as the level of sensitivity increases. For example, the number of individuals with access might be reduced further, excluding those with a close nexus to commercial decision making. With respect to cost and pricing data, possibly the business goals could be achieved using historic data or aggregated data.³⁰ If access to certain customer contracts is necessary, as may be the case, the parties should consider whether the business needs can still be fulfilled if specific pricing information is redacted.

Finally, the extent of information exchange that is allowable pre-signing during the due diligence process may be greater than that allowed in connection with post-signing integration planning. This point is often surprising to the merging parties, who believe anything that is in the due diligence data room should be available as the starting point for integration planning because the parties have by then shown a greater commitment to carrying out the transaction by signing the agreement. Viewed through the lens of a Section 1 rule of reason analysis, however, the assessment is different. Specifically, in due diligence the business justification for sharing competitively sensitive information is often greater than in connection with integration planning because such information is often critical to a proper valuation. And the likely anticompetitive harm is often less during due diligence because fewer individuals, often with less involvement in daily commercial activities, tend to be involved as compared to integration planning.

Operating Covenants. It is appropriate to impose restrictions on the seller's activities in the purchase agreement in order to protect the buyer's benefit of the bargain, so long as those restrictions, taken together, do not transfer operational control by restricting ordinary-course business activities or otherwise hinder the seller's ability to compete pre-closing or, in the event the deal fails to close, after abandonment.

Such restrictions were at issue in *Computer Associates*. The complaint alleged that operating covenants transferred operational control in violation of Section 7A and Section 1 where they limited the seller's ability to engage in ordinary-course competitive behaviors without the buyer's approval, such as granting price discounts of more than 20 percent and using fixed-price or non-standard

²⁹ See Proposed Final Judgment § V.D, *United States v. Gemstar-TV Guide Int'l, Inc.*, 2003-2 Trade Cas. (CCH) ¶ 74,082 (D.D.C. 2003) (No. 03-0198), available at <http://www.usdoj.gov/atr/cases/f200700/200731.htm> (allowing access to current and future price data and contract offers as necessary for diligence with safeguards); Proposed Final Judgment § V.D, *United States v. Computer Assocs. Int'l, Inc.*, 2002-2 Trade Cas. (CCH) ¶ 73,883 (D.D.C. 2002) (No. 01-02062), available at <http://www.usdoj.gov/atr/cases/f11000/11083.htm> (same).

³⁰ See, e.g., U.S. Dep't of Justice & Federal Trade Comm'n, *Statements of Antitrust Enforcement Policy in Health Care* § 5 (1996), available at <http://www.ftc.gov/reports/hlth3s.htm>.

customer contracts.³¹ The competitive impact statement recognized that customary operating covenants, such as restrictions on the seller's rights to issue new shares, assume debt, discharge liabilities outside the ordinary course, commence lawsuits, acquire businesses, or mortgage or sell assets, are justified as a means of protecting the value of the transaction.³² More recently, the Qualcomm complaint alleged that operating covenants requiring buyer approval for ordinary course licensing agreements, personnel decisions and customer proposals, along with other activities ceding control to the buyer, transferred operational control in violation of Section 7A.³³

Prior to Computer Associates, operating covenants restricting the seller's pre-closing conduct did not receive a lot of attention. Some may have believed that if the parties negotiated arms-length operating covenants as part of a legitimate negotiation process, then they should be exempt from scrutiny. As Computer Associates makes clear, if it is illegal for competitors to coordinate pricing, placing such an agreement in an operating covenant may at best move the parties from a per se to rule of reason analysis, but in the end such an agreement is likely to violate Section 1.

One approach to reducing the risk from specific covenants is to rely on general provisions requiring that the seller operate the business in the ordinary course, or not undertake actions which result in a material adverse effect. However, such general provisions are likely to create uncertainty for the buyer and seller, result in potentially inappropriate pre-closing discussions of what is or is not ordinary course, and ultimately lead to disputes that are difficult to resolve.³⁴ More specific covenants avoid these problems, and a key to avoiding undue antitrust risk with such covenants is to ask the following questions: (1) are they reasonably necessary to preserve value, and (2) will they allow—and be perceived by the agencies as allowing—the seller to compete in the ordinary course pre-closing or, should the deal fail, after abandonment?

Few general rules are available for determining whether a specific covenant restricts the ability of the seller to compete in the ordinary course. This assessment hinges on marketplace facts. For example, the buyer may wish to prevent the seller from tying up significant shares of capacity in large long-term customer contracts. However, if competitors in this market frequently compete on

³¹ Computer Associates Complaint, *supra* note 9, ¶¶ 15–24.

³² Competitive Impact Statement §§ II.B.2, II.C.2, *United States v. Computer Assocs. Int'l, Inc.*, 2002-2 Trade Cas. (CCH) ¶ 73,883 (D.D.C. 2002) (No. 01-02062), available at <http://www.usdoj.gov/atr/cases/f11000/11082.htm>.

³³ Qualcomm Complaint, *supra* note 16, ¶¶ 15–21, 31–32. Although the agreement was amended before closing to allow ordinary-course personnel decisions and customer proposals without buyer consent, the seller allegedly continued to seek buyer approval for these and other ordinary-course decisions, including pricing decisions.

³⁴ See, e.g., Bonanto Remarks, *supra* note 4, at 315–16.

large, lumpy contracts, such a restriction may pose a problem. Similarly, the buyer may wish to restrict the seller from undertaking large capital investments or signing large supply agreements for any number of reasons related to enhancing post-closing efficiencies. In each case, the question must be asked: Will this restriction unduly limit the ability of the seller to compete pre-closing or after abandonment should the transaction fail to close? One means of approaching this question is to ask whether the restriction will limit activities commonly undertaken in recent years or contemplated in recent business plans.³⁵ If the answer is yes, it may raise antitrust risks.

Restrictions on customer pricing should be avoided, even if they restrict pricing outside the ordinary course. Such restrictions are likely to invite an investigation, especially if they set a particular price.³⁶ A safer course may be to rely on general ordinary course and material adverse condition clauses to deal with any out-of-the-ordinary pricing concerns. Restrictions on customer proposals also should be avoided, and restrictions on customer contracts without buyer approval should be limited to large long-term contracts that are substantially larger than the seller's recent past ordinary course contracts and that may negatively impact the buyer's benefit of the bargain. The same approach may be applied to capital investments—restrictions on large investments beyond the ordinary course likely will not be challenged.

Where buyer approval is required, such as for large customer contracts or capital investments, the approval process should minimize discussions between the parties.³⁷ For example, the seller could submit a written proposal, and the buyer could respond with a simple veto or not. Detailed discussions surrounding the approval of a contract or investment could be viewed by the agencies as evidence of illegal coordination or a transfer of operational control.³⁸ In addition, the buyer should not submit the seller's proposal to a wide internal group for assessment and most certainly should not submit it to those running the daily commercial business for an assessment of its impact on the buyer's current business.

³⁵ See, e.g., GUN JUMPING HANDBOOK, *supra* note 8, at 234–35.

³⁶ See Mark D. Whitener, Antitrust Counsel, General Electric Corp., Remarks at a Roundtable Sponsored by the Bureau of Economics, Understanding Mergers: Strategy and Planning, Implementation and Outcomes 329 (Dec. 10, 2002), available at <http://www.ftc.gov/be/rt/xscriptpanel5.pdf> (discussing restrictions on prices outside the ordinary course); GUN JUMPING HANDBOOK, *supra* note 8, at 246–47 (same).

³⁷ See *infra* notes 44–46 and accompanying text (discussing joint decision making regarding investments not covered by operating covenants).

³⁸ See Qualcomm Complaint, *supra* note 16, ¶ 25 (buyer and seller entered into detailed discussions of customer proposals).

Premerger Coordination Activities. It is generally appropriate to plan for the integration of operations, subject to protections on the flow of competitively sensitive information.³⁹ Although certain planning activities can fall into the grey area, the following general guidelines point in the direction of the safe zone. First, planning activities relating to the “back end” or cost side of the business, such as integration of IT, employee benefits, human resources department, etc., are safer than planning relating to “front end” or customer-facing aspects of the business, such as sales and marketing or product development. Second, to the extent that front-end integration planning is deemed to be critical, care should be taken to avoid the flow of confidential information to members of the integration teams who have front-line business responsibilities for pricing, sales, or marketing. Often, comfort can be achieved by bringing in third-party consultants to analyze competitively sensitive information. Third, actual integration is generally prohibited and cannot be justified as part of integration planning. Examples of prohibited integration include pre-closing coordination on product development, control of the other party’s business decisions, and joint marketing or sales calls.

There are various circumstances where merging parties have a legitimate desire to go beyond integration planning in the pre-closing period, whether to more fully capture efficiencies or avoid undue waste in the merging process. These activities, which require some level of pre-closing implementation, may be allowable in certain circumstances.

1. Announcement of Human Resource Plans.

Employees often comprise a critical component of the value of a transaction. It can be important to take some steps beyond confidential integration planning to establish or preserve the post-closing team. Antitrust concerns relating to these activities are two-fold. First, the buyer should not take (or fail to take) steps if doing so may lead to an exit of competitively critical employees, thus harming the competitive viability of the seller (or buyer) pre-closing, or, should the transaction fail, after abandonment.⁴⁰ Often, but not always, this antitrust concern is aligned with the business interests of both parties. In some transactions, where the buyer is planning significant cost synergies, the buyer may be less concerned with employee exit, as long as the “right” employees remain. Second, employees of each party must continue to compete and act for their employer. Steps should not be taken which may tend to blur these allegiances.

Missteps in this area may lead to allegations of Section 7A (illegal transfer of operational control) and Section 1 (illegal coordination) violations. That said, there appears to be much that the parties

³⁹ See, e.g., Blumenthal Speech, *supra* note 5, at 10–12 (discussing appropriate integration planning safeguards); GUN JUMPING HANDBOOK, *supra* note 8, at 259–61 (same).

⁴⁰ See, e.g., William J. Baer, Director, FTC Bureau of Competition, Report from the Bureau of Competition Before the ABA Antitrust Section Spring Meeting nn.25–26 and accompanying text (Apr. 2, 1998), available at <http://www.ftc.gov/speeches/other/baeraba98.htm>.

can safely do in this area. Assuming no market power in the relevant labor markets, it would be appropriate in most instances to share compensation and other information necessary to:

- formulate and make post-closing offers to the senior team, and (upon acceptance) announce the post-closing senior team;
- compare information relating to benefits and salaries and make related post-closing decisions; and
- interview employees below the senior level and establish likely job candidates from the two companies.

On the last point, more caution may be required below the senior level so as to strike the right balance between eliminating uncertainty (to reduce exit) and creating too much certainty (which may lead to the exit of employees who become certain that they will not long have a job). In addition, the danger that employees begin to act for the merged entity increases as the extent of these decisions widens, and in particular as these decisions begin to be made with respect to the sales and marketing forces.

Employees should not be relocated from one company to the other or hired by the other company, as this can raise issues of both operational control and illegal coordination. It is possible in limited circumstances that one or both firms may make unilateral termination/hiring decisions resulting in an employee transfer, but the record should support the unilateral nature of the decisions, and the transferred employee may need to be walled off to some extent so as to avoid sharing or acting on confidential information from the prior employee.

2. Negotiation of Supplier or Customer Contracts to Take Effect Post-Closing.

If negotiations relate to a contract that will become effective only if the transaction closes, Section 7A concerns of transfer of beneficial ownership should be minimal even if both parties are involved in the negotiations. Section 1 concerns should arise only if the combined entity has market power in the relevant market in which the contract is being negotiated. Assume, for example, that the combined entity has no market power in a particular input market. Then, the sharing of confidential information (e.g., current contracts) and the negotiation of a new contract should not raise Section 1 issues unless the input comprises a significant share of the cost of an output on which the parties compete. On the other hand, assume that the combined entity has market power in a particular output market. In this situation, joint negotiation of a post-closing customer contract could lead to Section 1 problems. First, the parties likely would need to share sensitive pricing data, and second, those individuals best suited to be involved in the negotiations would be those most likely to benefit from the competitively sensitive information in their other business dealings. The safe advice would seem to be: don't do it.

Suppose, however, that a customer of the seller insists on renegotiating a post-closing contract now or else it will move to another supplier. This would not be an unreasonable request, particularly if the contract contains a change-of-control provision. In this situation, the safest course may be for the buyer unilaterally to renegotiate the contract contingent on closing, without the benefit of the seller's input. This may not be a problem in a horizontal setting, presuming that the buyer has an adequate

understanding of the business without the seller's input. However, there may be strong business reasons why the buyer's negotiating team would want access to the seller's current contract. Antitrust risk from such access should be reduced if the customer provides (or agrees that the seller may provide) the contract to the buyer or if the buyer's negotiating team is limited to individuals who are not in a position to benefit in the market from gaining access to the contract information. Alternatively, the buyer may consider preventing this customer's flight by agreeing to a few attractive contract terms (e.g., extended contract length, a most favored nation clause, etc.) that are contingent on closing, with the negotiation of the full contract to await closing.

3. Pre-Closing Joint Ventures Between the Buyer and Seller.

If the parties to a merger enter a joint venture, cross-licensing, or other collaboration to become effective pre-closing, there is some risk that the agencies will have gun-jumping concerns. The primary Section 7A concerns are that the buyer may be using the joint venture to take operational control of the seller or that the joint venture serves as a vehicle to combine operations prematurely. The primary Section 1 concern is that the parties are using the joint venture as a means of coordinating pre-closing market activities.

A key factor mitigating the Section 7A concern would be that the parties each unilaterally decided to enter the arrangement. Relevant to this determination is evidence that the parties intend to continue the joint venture even if the larger transaction fails, which might support the contention that each party unilaterally determined that the arrangement made sense for it. The fact that such arrangements are common between these parties will also support a contention of unilateral interest and may serve to reduce concerns that the joint activity is an effort prematurely to combine entities or take control.⁴¹ If the arrangements are not common between the parties, as a second best it is helpful if they are common in the industry. In addition, the record must support the existence of an arm's-length negotiation process between the parties. The importance of an arm's-length negotiation, the result of which is unilaterally supported by each party, is critical, given that the threshold for a Section 7A violation may be fairly low. If the joint venture is found to transfer additional indicia of ownership or control on the basis that it is not in the seller's unilateral interest, a violation may well be alleged.

Turning to Section 1, the parties should first ensure that the joint venture would pass scrutiny standing alone under Section 1.⁴² Some would say this should be both the starting and ending point

⁴¹ See, e.g., GUN JUMPING HANDBOOK, *supra* note 8, at 240–41.

⁴² See Collaboration Guidelines, *supra* note 21, at 11–12 (collaborations which raise possible competitive concerns are not illegal under the rule of reason if the "agreement is reasonably necessary to achieve procompetitive benefits that likely would offset anticompetitive harms").

because if it is allowable without the merger agreement it should be allowable with it.⁴³ That may well be valid in theory, but joint ventures that may be appropriate outside the merger context may be suspect when undertaken by merging parties, for two reasons. First, the merging parties may not negotiate the collaboration at arm's length, and may not undertake the collaboration with the same level of independence and the same sensitivity to protecting competitively sensitive information as parties not planning to merge, and this may increase the risk of anticompetitive effects. Second, the agencies are likely to be suspicious of pre-closing joint ventures and may question whether the business justifications are a pretext for gun-jumping.

Mitigating Section 1 factors will include those referenced above in the Section 7A context, which support a contention that each party unilaterally assessed and agreed to enter the venture. In addition, it will be helpful to show that the joint venture is ancillary to the core transaction, in that it will help increase post-closing efficiencies or minimize post-closing waste (such as duplicative investments). This showing will support an argument that the collaboration is not an end-run around restrictions on premerger activities and will also allow the parties to factor these transaction efficiencies into the rule of reason balancing.

Although the assessment of joint ventures under the rule of reason is highly fact intensive, it is safe to say that supply-side collaborations are generally safest, particularly for buyer markets in which the parties have little or no market power. Production-related joint ventures, including cross-license agreements and R&D collaborations, raise more risk both because the underlying antitrust risk is greater and because the agencies will view such arrangements as accomplishing more significant pre-closing operational integration. However, such collaborations should not automatically be out of the question, particularly where the collaboration relates to a limited and discrete portion of the production process and the collaboration will improve efficiencies or reduce waste post-closing. Finally, the parties should avoid joint marketing and selling collaborations, as these raise the most serious antitrust concerns, both because they go directly to Section 1 pricing issues, and because the agencies would be more likely to view this as a merger of operations and products in violation of Section 7A.

4. Joint Decision Making Regarding Buyer or Seller Investments in the Pre-Closing Period.

Often it will become apparent after signing that certain planned investments by the buyer or seller will be redundant, or at the least inefficient, in light of the pending combination. What can the parties do? This raises both Section 7A and Section 1 issues. If the buyer directs the seller to stop the investment, this may contribute to a transfer of operational control in violation of Section 7A or illegal coordination under Section 1. If a decision to delay an investment harms the ability of the

⁴³ See, e.g., Final Judgment § V.E, *United States v. Computer Assocs. Int'l, Inc.*, 2002-2 Trade Cas. (CCH) ¶ 73,883 (D.D.C. 2002) (No. 01-02062), ("submitting a joint bid to a customer [is permitted] where the joint bid would be lawful in the absence of the planned acquisition").

seller to compete—either now or later if the transaction fails to close— this may contribute to or constitute a violation of Section 1.

If a buyer investment is at issue, the buyer is free to take unilateral action to delay or slow the timing of the investment. If a seller project is at issue, the buyer may be able to veto it if it is covered by an operating covenant (and is also outside the ordinary course), or the seller may unilaterally decide that it makes sense to delay the project. Absent that, as acknowledged by Blumenthal,⁴⁴ any involvement by the buyer in the seller's decision may trigger a fact-intensive review by the agencies. If the buyer mandates the decision, that raises both Section 7A (control) and Section 1 (coordination) issues. Concerns will be lessened, although not eliminated, if the seller acts unilaterally after consultation with the buyer.⁴⁵ Decisions are more likely to be perceived as unilateral if the record supporting the decision (committee minutes, etc.) adequately addresses the seller's interests, and if correspondence from the buyer advocating (or worse, mandating) the decision is limited. Other relevant factors, according to Blumenthal, are the magnitude of the efficiencies from delay; the reversibility of the decision, and the harm to both the seller's competitiveness and market competition if the transaction fails to close; and, if material, whether the investment was disclosed to the buyer in due diligence.⁴⁶

5. Joint Marketing in the Pre-Closing Period.

The common advice is that joint sales calls are generally not appropriate, but the parties may jointly sell the transaction. The problem with the former activity is that the parties will both present themselves and in fact act as one in the marketplace, in violation of both Section 7A and Section 1. The danger with the latter activity is that meetings to sell the transaction can quickly turn into (or be misperceived as) meetings to sell products jointly. Thus, any such meetings should be few in number, reserved for key customers, particularly where there is a risk of lost business as a result of the transaction, and limited to participation by high-level executives—not sales representatives—of the two companies. Further, these executives should be advised to follow a carefully prepared set of talking points.

⁴⁴ Blumenthal Speech, *supra* note 5, at 12–13.

⁴⁵ See *id.* at 12 n.29.

⁴⁶ *Id.* at 13.

CONCLUSION

Counseling questions relating to premerger coordination and information exchange are not readily resolved by looking to bright lines and clear guidance. In part, this is due to the limited number of consent orders, all of which deal with conduct that is fairly easy to categorize as problematic. In part, it is also due to the inherently fact-intensive nature of the assessment. Instead, general Section 1 and Section 7A standards for assessing the more difficult questions are in some ways more useful than long lists of do's and don'ts. The latter can never cover the myriad issues that may arise in the pre-closing period, whereas the former can provide the tools for a consistent assessment. No doubt, the agencies have undertaken any number of assessments of premerger activities over the years which did not result in enforcement actions. Merging parties would benefit from any additional guidance the agencies could provide as to the factors they have considered relevant to these Section 1 and Section 7A assessments.