Premerger Planning and Coordination -- How to Avoid "Gun Jumping" Under U.S. Antitrust Law

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Overview of Gun Jumping

Companies engaged in negotiating a potential merger or acquisition have legitimate business reasons to exchange competitively sensitive information prior to closing. In addition, once a merger agreement has been signed, the merging companies need to ensure that their businesses can be effectively run as a merged entity as soon as they have consummated their transaction. These business realities create strong incentives for companies to begin to coordinate their business operations prior to closing. Despite these business justifications, however, the antitrust laws (particularly the U.S. laws discussed herein) limit the lawful exchange of competitive information and coordination of businesses between merging companies.

"Gun jumping" is the colloquial term applied by antitrust lawyers to describe the antitrust law violation in which businesses have gone beyond permissible limits -- either while negotiating their deal or while preparing their companies for post closing business. The premerger notification laws of the U.S. and other jurisdictions prohibit a merger or acquisition from being consummated prior to the time that the applicable government agencies have completed their antitrust review, and other antitrust laws limit coordinated conduct between companies that are competitors of one another. Antitrust and competition lawyers therefore carefully counsel their clients involved in mergers and acquisitions about how to steer clear of charges that they have engaged in illegal gun jumping.

In the United States, gun jumping charges typically involve allegations that companies have failed to observe the mandatory waiting periods imposed by the U.S. Hart-Scott-Rodino Act, either by exchanging competitively sensitive information or by ceding control of material decision-making to one party to the transaction. In addition, if companies are competitors in U.S. commerce, gun jumping may also include charges under Section 1 of the Sherman Act that the companies illegally combined their businesses prior to consummation when they were still required to be competitors.

Similar principles apply in Europe as well. Although U.S. enforcement agencies have thus far logged more gun jumping enforcement actions than have their counterparts in the EC, authorities in both the U.S. and the EC have made it clear that pre-consummation activities need to be carefully considered. In most instances, the prohibitions under U.S. law will affect the conduct of parties to international transactions, and therefore the U.S. enforcement actions are relevant to many, if not most, cross-border transactions.

This article discusses the legal underpinnings of gun jumping charges and also traces the major U.S. enforcement actions to date. Because both the U.S. and the EC ground their policy on similar principles, cases brought in the U.S. may be instructive elsewhere as well.

U.S. Legal Standards

The HSR Act

Permissible premerger activities are, in part, governed by Section 7A of the Clayton Act, which is the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"). This statute requires that firms provide specific information about certain planned transactions to the U.S. Federal Trade Commission ("FTC") and the Antitrust Division of the Department of Justice ("DOJ") before consummating their deal. The law further requires that the parties then must observe a statutory waiting period following making their HSR filings.

The waiting period is designed to give government authorities the ability to investigate possible competitive implications of the transaction and, where warranted, to challenge it before the assets of the two companies are scrambled. While most waiting periods are 30 days in duration, where a Request for Additional Information or "Second Request" has been issued, the waiting period is extended until 30 days after the parties have complied with the Second Request. Government authorities zealously guard the ability to require these waiting periods, and the parties' actions during them are watched carefully.

Gun jumping allegations under the HSR Act usually arise either: (1) where the parties have exchanged too much competitively sensitive information before expiration of the HSR waiting period; or (2) where one party has ceded to its partner control of material business functions prior to the end of the HSR waiting period. In either instance, the legal question according to the U.S. antitrust enforcement agencies is whether the companies may have taken steps that essentially transfer "beneficial ownership" of the to-be-acquired company before the applicable HSR waiting period has either expired or been terminated early by the government antitrust authorities.

Whether companies have prematurely transferred something akin to beneficial ownership will depend upon the industry and companies in question. For example, if a special confidential formula were a critical asset of the company being sold, the disclosure of that formula to the acquirer before expiration of the HSR waiting period may be illegal. Similarly, if the acquiring company is given the right to make significant business decisions on behalf of the company it is about to acquire -- prior to the conclusion of the U.S. agencies' antitrust review process -- those actions may also be illegal. Either of these types of conduct would likely be considered gun jumping by U.S. authorities, even though critical business needs may have justified the action.

The Sherman Act

Section 1 of the Sherman Act prohibits concerted activity between competitors that unreasonably restrain trade. When potential merger partners are competitors, exchanging too much information required for valuation of assets and due diligence or entering into contractual terms to preserve the assets until closing, may cross legal boundaries under the Sherman Act. In appropriate circumstances, the government could allege that the companies had engaged in a conspiracy or combination that was illegal because it was between competitors. If the merging competitors go further and begin to coordinate their business operations before the transaction has been legally consummated, the risk of antitrust liability under Section 1 is greater.

As explained by the General Counsel of the Federal Trade Commission, William Blumenthal, in a speech called "The Rhetoric of Gun-Jumping" given on November 10, 2005, to the Association of Corporate Counsel Annual (Greater New York Chapter): "[M]erging firms are separate entities and . . . must continue to reflect those separate identities [until closing]. Under Section 1 merging firms are not permitted to engage in collective actions that adversely affect competition." Where the companies' collective actions are legitimately necessary to protect the merger, they may be permissible, but he cautioned that certain types of coordination, such as coordinating prices or allocating accounts, would "almost never be reasonably necessary to protect the merger." Moreover, just the exchange of competitive information that is material to the business can adversely affect competition to the extent that it would support charges of facilitating collusion.

Thus, even though two companies have signed a merger agreement and are planning a closing on a certain date, during the weeks and days leading up to that closing, their actions must remain independent from one another. They are, and must remain, competitors until they have finally consummated their transaction.

It is also worth emphasising in this context that the limitations on parties' conduct under the HSR Act end once the applicable waiting period has ended. In contrast, the constraints on coordinating business conduct imposed by Section 1 of the Sherman Act remain in place until the date of consummation. Moreover, even where HSR filings are not required for a particular transaction, where for example the value of the transaction is below reporting thresholds, Section 1 of the Sherman Act will still constrain parties' pre-consummation conduct.

How To Advise Clients

General Advice Guidelines

Giving generalised advice to clients about how to avoid charges of gun jumping can be quite difficult for several reasons. First, each transaction involves different competitors and industries, and as with almost all antitrust issues, the factual background is critical to determining what will run afoul of the antitrust laws. Second, the standards for permissible premerger conduct will differ based upon timing, with more permissive instructions being suitable as the time for consummation nears. Third, because gun-jumping advice is not based upon litigated precedent, but rather on governmental policy as reflected in consent settlements entered into with the U.S. authorities (as well as occasional public remarks by U.S. officials), the legal standards are somewhat unclear.

Antitrust counsel usually provide specific and fairly stringent guidelines to their clients at the outset of a deal. During negotiations, the deal team can be briefed orally about the limits on their discussions. After signing of a transaction agreement, however, it is usually best to provide a short memorandum that in-house counsel can distribute widely within the company. At that point in time, many more company officials are involved in the transaction planning. In addition, those employees who are interacting with customers will need to be able to answer questions about the impact of the transaction on their accounts and those employees working toward the day of transition to a merged company will need guidance about what can be done before consummation and what will need to be delayed until afterwards.

An important adjunct to the antitrust lawyer's advice is to invite managers and executives to come back and discuss any specific instances where the guidelines may be creating difficulties for the business to obtain needed information or to plan for an orderly transition. In many instances, "work-arounds" may be implemented to accomplish legitimate business purposes and at the same time to protect the client from overstepping boundaries.

Generally speaking, clients should understand that their discussions with a merger partner should not include competitively sensitive information -- information that, in the hands of a competitor, could be used to harm the company or to compete more effectively against it. With most business people, therefore, it is effective to have them consider a scenario where they engage in discussions with a potential transaction partner only to have the efforts prove unsuccessful. They will need to return to their normal market and, in that instance, would not want to have disclosed material information to the other company.

Gun-jumping advice typically would include prohibitions on providing the following information to the company's putative merger partner:

- information regarding current product-specific or customer-specific prices, costs, discounts or profits -- although appropriately aggregated or historical information in these categories may be permissibly exchanged;
- research and development plans;
- strategic plans;
- marketing plans;
- individual customer lists;
- information about nonpublic contract terms; and
- certain information about suppliers, where it could provide a competitive advantage.

This list is by no means exhaustive, because that will depend upon the particular company, but it does provide many of the basic categories that should be carefully guarded.

Where business needs require some disclosures of information in these categories, employees should be advised to discuss those areas specifically with their antitrust counselor. In many instances, alternative means of exchanging the information or meeting the business' needs may be possible. And, as discussed more fully below, there may be a somewhat sliding scale applied by enforcement authorities, who recognise that as the time of consummation nears, more coordination may be permissible than in earlier stages of a transaction.

Advice During Early Stages Of Negotiations

Most gun-jumping issues that arise in the initial stages of a deal will involve questions of whether certain information can be shared between the companies. Executives considering a transaction need to determine the likely "fit" of the businesses together and to evaluate the potential value of the assets possibly being acquired. Whether the sought information should be turned over, however, depends upon a number of factors, such as the level of detail requested, whether it is historical or for the future, and whether the other party is a competitor.

A short-cut may be used to identify most potentially problematic information exchanges. Ask the client whether the information they are considering exchanging could be used to harm the company if the deal does not proceed to consummation. If the company which receives the information may later be able to make use the information to obtain a competitive advantage, it is most likely "competitively sensitive information" that should not be exchanged between competitors. Such information is typically guarded very carefully by companies. Often it involves information about future prices or product innovation or detailed information about customers. Most businesses would not consider disclosing competitively sensitive information outside the special context of a possible transaction. Particularly if the transaction partner is also a competitor, such information should not be exchanged.

Executives conducting negotiations may be lulled into a false sense of security because they have entered into a Confidentiality Agreement that governs the use to which any recipient may make of the information received by it during negotiations. The existence of such a Confidentiality Agreement, however, does not provide a shield from antitrust enforcement.

Advice While Negotiating A Purchase Agreement

As negotiations move from exploring whether the two companies should enter into an agreement to negotiating the merger agreement itself, questions often arise about what terms may legitimately be included in the purchase agreement. The acquiring company has business incentives to ensure that the assets of the company being acquired will continue to remain as valuable as possible. Both parties need to ensure that business and legal risks are properly allocated and that the agreement provides appropriately for business contingencies. During this time, detailed due diligence to identify the strengths and weaknesses of the assets being purchased will be necessary.

Antitrust advisors must evaluate the proposed terms carefully with an eye to ensuring that the purchase agreement does not transfer beneficial control prematurely to the other party to the transaction. The FTC's implementing statements for the HSR Act noted several "indicia" of beneficial control that would be considered on the issue of whether beneficial control had been transferred. These were "(1) the right to obtain the benefit of any increase in value or dividends, (2) the risk of loss of value, (3) the right to vote the stock or to determine who may vote the stock, and (4) the investment discretion (including the power to dispose of the stock)." (Statement of Basis and Purpose Implementing Title II of the Hart-Scott-Rodino Antitrust Improvements Act of 1976.) The critical question is at what point quantitatively and qualitatively the parties have transferred beneficial ownership of the voting securities or assets.

Advice During Transition Planning

The types of gun-jumping issues that arise after the parties have signed a merger agreement are often much thornier than those that arise during negotiations. The merger partners must not, in the words of FTC General Counsel Blumenthal "prematurely combine significant aspects of their day-to-day operations and manage themselves as one." Both the buyer and seller must remember at all times that their companies are required to remain independent until consummation despite the need to plan for an orderly transition.

Moreover, if the companies are competitors, they must remain competitively active against each other throughout this interim period. They may not coordinate business operations or collaborate with respect to their relationships with any vendor or customer in a way not otherwise permissible under U.S. antitrust laws.

That said, as companies work toward an orderly transition, from two entities to a single functioning whole, they will need to learn each others' systems and products. Sales forces that were once competing for customers will need to be prepared to coordinate their efforts. They have legitimate needs to understand how each others' companies are organised and function.

To some degree at least, U.S. authorities recognise that as consummation day draws near, the information exchanges between the two companies may need to be more extensive. Otherwise, customers could be adversely affected by the transaction and the merged company may lose its competitive edge and suffer significantly. Allowing the companies to tie become quite close in the last days before closing, however, does entail risks, which need to be weighed in the totality of the circumstances presented by that particular transaction. For example, if the antitrust agencies have issued a second request and there is a possibility that the agency staff may recommend taking legal action to block the transaction, wise antitrust counselors will advise their clients to hold back on coordination efforts. On the other hand, where HSR waiting periods have all expired and no antitrust investigation looms in the background, companies may be somewhat less guarded about at least some of the categories of competitively sensitive information. Still, however, the parties must recognise that there remain real limits to their legal collaboration before actual consummation.

Employee Instructions During Transition Planning

Once plans for a transaction become publicly known, or when news of a pending acquisition is disclosed to customers, it may be appropriate to advise clients to give specific instructions to their employees, reminding them that they are to conduct their business as usual and to compete with their acquisition partner during the time pending closing of the transaction.

Employees with customer contact may need to be given a script to use for answering customer questions. Those responsible for products or services that, absent the transaction, are in competition with one another, should be given instructions about how to answer customers' questions about a pending transaction. When discussing the transaction, they should use the terms that have been publicly announced by the companies. Generally it is safe for employees also to explain to customers that they look forward to the transaction being completed; that if it is completed, they expect a smooth transition; and that the companies are working to make the acquisition as seamless as possible from the customers' viewpoint. In the context of any discussion with customers, company personnel should be careful to say that until the acquisition has been completed, the customers will see business as usual on the part of both companies.

In any communication or negotiation, all representatives of the companies must be absolutely clear that, even though a purchase agreement has been signed, the transaction remains conditional at this time. Though the companies may be optimistic that it will be completed in the near future, at this time it has not yet been made final and it is possible that it may never be finalised.

Specifically, while this is by no means an exhaustive list, employees must understand that the two companies may take no action before the transaction has been consummated that:

- establishes any price or discount for any product or service of the other party;
- grants to one party to the transaction the right to negotiate,

approve or reject any bid or customer contract for any product or service of the other party;

- requires a party to provide bid information to the other party for any product or service;
- discloses to each other competitively sensitive business information; or
- influences the management of the other party to undertake a particular course of action.

The buyer does not yet own and cannot exercise control over the assets of the seller, and must not hold itself out to anyone as owning the assets, products or services which are part of such proposed transaction.

Companies face significant obstacles as they endeavor to engage in appropriate transition planning and avoid gun-jumping charges at the same time. Antitrust counselors will need to work closely with their clients, often on a daily basis providing detailed guidance.

In many instances involving competitors, the parties to transactions employ a “clean team” where particularly significant competitively sensitive information needs to be exchanged. “Clean teams” are usually consulting or accounting firms that provide market evaluation, integration and planning services for acquisition partners. They may be asked to evaluate detailed competitive information for purposes of valuation. They may also provide important transition planning so that the newly merged business can function efficiently as soon as the transaction has been consummated.

Work-Arounds

Despite the constraints imposed by the gun-jumping principles, several methods have been developed to provide companies the means by which to obtain much of the information they may need. In some instances involving competitors, the parties to such transactions employ a clean team where particularly significant competitively sensitive information needs to be exchanged. “Clean teams” are usually consulting or accounting firms that provide market evaluation, integration and planning services for acquisition partners.

In other circumstances, it may be appropriate to have an in-house “clean team” where those individuals are appropriately screened from any marketing activities and can remain so even if the transaction is never consummated. For obvious reasons, the in-house clean team concept brings greater risk. At a minimum, the in-house clean team must be set up so that its information cannot be used in the conduct of the competitor’s everyday business decisions with regard to the competing products. Typically, that team is a closely controlled handful of people be given access to the information and its members are “walled off” from those running the company’s everyday business activities.

In many instances, companies’ needs to exchange information may be satisfied by having the parties’ aggregate information so that the recipient cannot determine individual details in a competitively significant form. Alternatively, historical data is often available that can, in part, satisfy needs of the requesting company.

Enforcement Actions

Although the U.S. case law does not include any litigated cases, settlement decrees provide important background as to enforcement intentions. Several such enforcement actions are discussed below, however it is important to note that the agencies’ reactions are often more informally learned by experienced practitioners in connection with investigations that do not culminate in a settlement agreement (or litigation). Nonetheless, the complaints issued with consent decrees, the consent orders themselves, and the publicly filed analyses of the antitrust agencies enforcement actions provide at least some of the factual background for each and give counselors important perspectives for use in advising their clients.

Gemstar/TV Guide

In *United States v. Gemstar-TV Guide International, Inc.*, 2003-2 Trade Cas. (CCH) 74,082, at 96,764 (D.D.C. 2003), the government alleged that Gemstar and TV Guide, which had once been competitors providing interactive programme guides and technology used by subscription and satellite television service providers and manufacturers of consumer electronics, had signed a merger agreement and consummated their transaction prematurely. The complaint contained one count alleging that Gemstar and TV Guide acquired operational control over each others’ assets prior to the end of the HSR waiting period. The complaint also included three counts under Section 1 of the Sherman Act involving alleged pre-consummation agreements (1) to suspend competing for business from Cox Communications, Inc., and Charter Communications, Inc., (2) to allocate certain markets between Gemstar and TV Guide, and (3) to charge certain prices and include certain agreed-upon standard terms in some customers’ contracts.

The companies allegedly shared price information and advertising capabilities as well as met jointly with consultants to develop pricing and marketing strategies. The complaint alleges also that Gemstar and TV Guide disclosed substantial amounts of confidential information, shut down Gemstar’s competitive marketing operations and shared business opportunities with one another.

The Department’s complaint stated that the agreements between the companies were not necessary to promote a legitimate business interest relating to their merger agreement. The Department specifically rejected the notion that the agreements were necessary to prevent a material change in the value of the businesses being merged. Further, the Department alleged that Gemstar and TV Guide had effectively acquired each other’s assets by “enter[ing] into and implement[ing] an agreement to eliminate competition between their two firms.”

Computer Associates

“Extraordinary” provisions in a 1999 merger agreement between Platinum Technology and Computer Associates were the primary issue in connection with a settlement reached by the parties with the Department of Justice in 2002. (2002-2 Trade Cas. (CCH) 73,883, at 95,249 (D.D.C. 2002.) The Department’s complaint singled out merger agreement provisions that required Platinum to obtain Computer Associates’ prior written approval before entering into certain agreements for services.

Effectively, according to the Department’s complaint, the companies transferred operational control of Platinum to Computer Associates just after execution of the merger agreement and before observing the HSR waiting period requirements. In addition, through the process for submitting contracts for approval, Computer Associates obtained significant competitively sensitive information that allegedly was made use of by Computer Associates’ employees involved in competitive bids. The parties agreed to a civil penalty of $638,000 to settle the HSR charges and required Computer Associates to agree to certain conduct restrictions for a period of ten years.

For advising companies on gun-jumping issues, the Department’s settlement provides specific provisions that are instructive.

Specifically, "prohibited conduct" includes any agreement with an acquiring or to-be-acquired person that, during the pre-consummation period:

(A) establishes any price or discount for any product or service of the other party to be purchased, used or re-sold in the United States;

(B) grants to one party to the transaction the right to negotiate, approve or reject any bid or customer contract for any product or service of the other party to be purchased, used or re-sold in the United States; and

(C) requires a party to provide bid information to the other party for any product or service to be purchased, used or re-sold in the United States.

Permitted Conduct includes:

(A) agreeing that the to-be-acquired person during the pre-consummation period shall continue to operate in the ordinary course of business consistent with past practices;

(B) conditioning the transaction on a requirement that the to-be-acquired person during the pre-consummation period not engage in conduct that would cause a material adverse change in the business;

(C) agreeing that the to-be-acquired person during the pre-consummation period shall not offer or enter into any contract that grants any person enhanced rights or refunds upon the change of control of the to-be-acquired person;

(D) agreeing that either party may conduct reasonable and customary due diligence prior to closing the transaction, and conducting such due diligence. However, if CA and the other party are competitors for any service or product that is the subject of any pending bids, a party may obtain pending bid information of the other party for purposes of due diligence only to the extent that bids are material to the understanding of the future earnings and prospects of the other party and only pursuant to a non-disclosure agreement. This non-disclosure agreement must limit use of the information to conducting due diligence and must also prohibit disclosure of any such information to any employee of the party receiving the information who is directly involved in the marketing, pricing or sales of any product or service that is the subject of the pending bids;

(E) submitting a joint bid to a customer where the joint bid would be lawful in the absence of the planned acquisition; and

(F) entering into an agreement where CA and the other party to the transaction are or would be in a buyer/seller relationship and the agreement would be lawful in the absence of the planned acquisition.

Input/Output

In *Input/Output*, 1999-1 Trade Cas. (CCH) 75,528 (D.D.C. 1999), the Department of Justice alleged in its complaint that Input/Output and DigiCOURSE, after an acquisition agreement had been signed but prior to consummation, had engaged in a pattern of conduct that allowed Input/Output to take operational control of its merger partner. Managers of Input/Output managed all operations of DigiCOURSE and DigiCOURSE was held out as being a part of Input/Output during this time. Settlement terms required Input/Output to pay $225,000 in civil penalties for violations of Section 7A of the HSR Act.

In re Insilco

Through a series of acquisitions, Insilco acquired aluminum tube manufacturing facilities from its competitor Helima-Helvetion in transactions that may not have required HSR filings. *Insilco*, 125 F.T.C. 293 (1998) In the context of an FTC consent decree alleging that the transactions violated Section 7 of the Clayton Act, and whereby Insilco agreed to divest certain assets, the FTC also alleged that Insilco and Helima had illegally exchanged nonpublic customer data prior to completion of the acquisitions. The information exchange challenged by the agency included "descriptions of prior customer negotiations; detailed customer-by-customer price quotes; current pricing policies and strategies; and detailed, customer-by-customer future pricing strategies."

Conclusion

Antitrust rules of gun jumping are far from clear, and without litigated precedent, they will remain so in the near term. Antitrust counselors can nonetheless provide important guidance for companies engaged in mergers and acquisitions based upon enforcement agency settlements and public statements of officials. The advice needs to be tailored to fit the competitive circumstances in the industry involved, and adjusted over the life of the transaction. With care, most legitimate business needs can be met even though the gun-jumping prohibitions seem broad. Each transaction, however, will require fact-based advice from an experienced antitrust lawyer, and preferably one with breadth of exposure to the varied factual circumstances that may arise as well as to the enforcement agencies' informal reactions.

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Kaye Scholer's Antitrust/Competition Practice Group litigates cases in civil and criminal actions, represents clients before federal and state enforcement authorities in pre-merger and other investigations, and counsels clients with respect to the development and execution of business strategies. Our practice comprises antitrust and competition lawyers fluent in multiple languages, and who are familiar with European and Asian business and legal environments. With more than 40 antitrust/competition lawyers in the US and Europe, including a number of former US Department of Justice and Federal Trade Commission officials, we have successfully represented multi-billion dollar acquisitions before both US enforcement agencies and have litigated many major competition cases in federal, state, and appellate courts.

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