KIRKLAND & ELLIS LLP Alert

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AVOIDING ANTITRUST RISK DURING COMPETITOR TRANSACTIONS

Antitrust law requires that parties to a merger or acquisition act like competitors until their deal closes. This presents business challenges beyond those that may be raised during the Hart-Scott-Rodino Act ("HSR") review process. How can companies price the deal, conduct intensive due diligence, and hold cross-company planning meetings in preparation for an immediate post-closing integration, while avoiding even an appearance of acting in concert before the deal closes? ***When does pre-closing information exchange and integration planning cross the line to become improper "gun-jumping"?***

Sensitivity to this issue is warranted. Gun-jumping has been a priority for the U.S. Department of Justice ("DOJ") for several years and the Federal Trade Commission ("FTC") has held informal hearings on the issue.[1] Regulators can raise gun-jumping concerns in deals that otherwise merit HSR clearance -- and even after substantive regulatory clearance is granted -- although the issue is heightened where the deal raises substantive antitrust issues.[2]

The good news is that merging parties ***can*** meet the business demands of preparing for integration ***and*** minimize antitrust risk, even if they are direct competitors. Part I provides an overview of gun-jumping, discusses the aggressive enforcement actions taken against alleged gun-jumpers and the actual facts of these cases, and tries to place regulators' policy pronouncements in perspective to help your company avoid antitrust jeopardy during the pre-closing period. Part II sets forth guidelines and ***"do's and don'ts"*** that will help your company accomplish pre-closing business goals while minimizing antitrust risk.

1. What Is Gun-Jumping?

Pre-closing exchanges of competitively sensitive information and coordinated actions can raise gun-jumping concerns, as can deal terms that transfer operational control or provide highly favorable interim terms to the buyer.

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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 A gun-jumping investigation also can tag-along with a substantive antitrust case. A line of inquiry during the FTC's administrative trial seeking to break up Chicago Bridge & (Continued…)

Iron Co.'s consummated acquisition of Pitt-Des Moines Inc. probed 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 government fined the parties for gun-jumping, but allowed the HSR period to expire without requesting additional information, demonstrating its lack of concern about the merger's competitive effects. The parties halted the arrangement and were fined for three weeks of gun-jumping. *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.

Horizontal transactions require particular attention during the pre-closing period, although the pre-closing actions of any merging parties are susceptible to government attack.

The U.S. antitrust authorities have two means of targeting alleged gun-jumping: They can pursue the matter as a technical violation of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, if an acquiring company obtains "beneficial ownership" of a target company before the deal closes, and impose penalties of $11,000 per day for the entire period of the claimed gun-jumping. Or, they can bring a Sherman Act "restraint of trade" claim, which exposes the company to civil treble damage claims. Or, the U.S. antitrust authorities can do both.

In foreign jurisdictions -- including the EU, France, Germany, Mexico, Taiwan, and the United Kingdom -- regulators target gun-jumping with their respective antitrust laws, which are often based on the U.S. Sherman Act and HSR Act, and may impose fines for improper pre-closing conduct.

Although the business desires and needs for a quick and effective integration are understandable, the price of gun-jumping ***probably*** exceeds the benefits of a premature coordination of business operations. As noted, in the U.S., each merging party can be fined $11,000 per day for a HSR Act violation. The meter can start running during due diligence -- before the companies even file their HSR notification -- and continue until the deal's closing. Regulators can seek equitable relief under the HSR Act (including disgorgement) and private claims can be brought under the Sherman Act.[3] In the EU, gun-jumping fines, which generally have been imposed when the parties failed even to notify the transaction, are based on the nature, seriousness, and duration of the violation.

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.

These two examples of coordinated actions by competitors simply are ***not*** close call "gun-jumping," as they are clear *per se* violations of the Sherman Act's prohibitions of price-fixing. That said, the facts of those cases underscore the importance of strict adherence to standard antitrust compliance program guidelines against communications with competitors regarding prices or customers, and the need to treat an acquisition partner as a competitor until ***all*** required antitrust clearances and approvals are received and the deal closes. In any jurisdiction, concerns about improper conduct also can distract regulators from your company's transaction, complicating sensitive negotiations and even delaying clearance.

2. What Is Permissible Pre-Closing Conduct?

The DOJ and FTC have ***not*** issued guidelines on what they consider improper gun-jumping, nor do they appear likely to do so any time soon. The guidelines we set forth below -- which are based on our experience counseling clients during the pre-closing period, as well as on speeches and discussions by DOJ and FTC personnel and practitioners -- are designed to provide merging companies with a path to effective and legal pre-closing integration planning. The bottom line is that competitors – even if they have agreed to a deal – cannot even appear to

[3] *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. In the six years since that comment was made, both the use of disgorgement by the FTC and the attention paid to gun-jumping have markedly increased. These trends should be noted by all companies anxious to move forward with pre-closing integration.

be coordinating any ongoing business activities until all antitrust approvals are received and the deal is closed. Therefore, even as parties are planning for the integration and efficient operation of the merged entity, they must act like independent and vigorous competitors.

In virtually all deals, a "Transition Team" (even if only several individuals comprise the "team") should be designated and then insulated from your company's and your deal partner's operating managers. Transition Team members should be from the strategic, not the operating side, of the business. The entire Transition Team, as well as any other company personnel involved with the transaction, should be familiar with the guidelines below.

(a) ***General Pre-Closing Guidelines***

- Buyer ***must not limit*** the ability of Seller to take actions that are ***within*** its usual course of business, and Buyer ***must not require*** Seller to take actions ***outside*** of its usual course of business. For example, Buyer ***must not*** become involved in Seller's day-to-day operation and management by dictating prices and terms of trade, purchasing decisions, sales or marketing strategies, output decisions, geographic expansion, research and development, advertising, or business development.

- Buyer and Seller ***must handle customer dealings independently and may not hold themselves out to customers or suppliers as a combined entity.*** Each company must continue to separately solicit customers, develop market strategies, and set prices and terms of trade. Prices, sales terms, customers, and sales territories ***must not be agreed on*** prior to closing. Counsel should be involved in determining whether the parties should initiate any joint meetings with customers and what the parameters of such meetings should be.

- Buyer and Seller ***must not coordinate*** their production or distribution policies and practices. For example, Buyer must not restrain Seller's production, processing, distribution, commercialization of goods, or its rendering of services.

- Buyer and Seller ***must not attend*** each other's internal meetings. Buyer can observe Seller's internal plant operations and review information during due diligence, but efforts must be made to guard against the disclosure of trade secrets and other proprietary information. The same rule applies for reviewing personnel files and interviewing employees.

- Buyer ***can*** make unilateral and independent decisions regarding the future of the combined businesses and do what is necessary to carry out those decisions.

- Buyer ***can*** limit Seller from taking actions outside of the ordinary course of business, in order to ensure that it obtains the agreed-upon assets. However, the Buyer must be careful not to cross the line into managing the day-to-day operations of the Seller.

Unofficial statements by DOJ and FTC representatives indicate that the following specific scenarios could attract gun-jumping scrutiny, so caution in navigating these areas is advisable pending further guidance from the regulators:

- Joint advertising efforts by two companies (*e.g.*, radio stations) that would be permitted absent the deal but, in the context of a deal, are improper because they would combine the companies marketing operations prior to closing the deal; and

- Day-to-day management of Seller by a vertically-related Buyer (*e.g.*, management of a hospital by a hospital management service) when an acquisition is pending.

(b) ***Guidelines Concerning Pre-Closing Information Exchanges.***

The Buyer will want data from the Seller to assist in planning for the integration of the business. Although information exchanges, like coordinated conduct, can lead to gun-jumping charges, deal partners can exchange a substantial amount of information without raising gun-jumping concerns.

Merging companies may share the following:

- Balance sheet and other financial data, including current and projected sales, revenues, costs, and profits by broad product categories, and tax returns;

- Aggregate customer information;

- Lists and descriptions of current products, manufacturing and distribution assets, distribution, and general business activities;

- Projected revenues and profits of merged operations for general, not specific, product lines;

- Information regarding data processing, information and risk management, accounting, and computer systems;

- General information regarding existing joint ventures or similar relationships with third parties (giving due consideration to confidentiality obligations to third parties);

- Information regarding operations, management, personnel, and human resources;

- Information regarding pending legal claims against the company;

- Information regarding environmental risks; and

- Information in the public domain or of a type that is regularly or usually 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. What constitutes "competitively sensitive" varies by industry. As a rule of thumb, 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. As in any situation that could result in an investigation, 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 deal-related purpose.

Merging companies must not share the following:

- Current or planned pricing, marketing, business, production, strategic plans, or bidding strategies;

- Customer lists, contracts, detailed sales figures by customer, information about pending bids, or other customer-specific information including rebates, discounts, or other terms of sale (customer sales data can be provided in the form "customer A, customer B, etc.," if there are more than 15 customers on the list);

- Executed, current, and proposed customer and supplier contracts or terms of trade (form contracts can be obtained, and contracts with pricing/deal terms redacted may be permissible on a case-by-case basis);

- Current or projected cost or profit information by individual product or SKU; and

- Details about ongoing R&D efforts, including new products in the pipeline (unless already disclosed to the public).

One legitimate purpose for the exchange of competitively sensitive information is joint preparation of an efficiency study. These studies are an integral part of the pre-closing period and, in some instances, an essential part of the companies' clearance case before regulators. Nevertheless, regulators have (unofficially) expressed concern that efficiency studies could promote improper information exchanges. To play it safe, the Buyer's Law Department should document the need for any competitively sensitive information. And, the information should flow from Seller to Buyer and be accessible only to the due diligence or Transition Team or to outside consultants. Whenever competitively sensitive information is going to be exchanged, companies are advised to sign a non-disclosure agreement detailing the information to be exchanged and the identity of those who will have access to it.

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Regulators are on alert for gun-jumping violations. No bright line between proper and improper pre-closing conduct has been drawn, nor does formal guidance from either the DOJ or the FTC appear forthcoming. Even so, the guidelines above leave ample room for your company to begin lawfully planning integration efforts as soon as a deal is signed up, ***so long as you do not implement the plans before closing***.

The Kirkland & Ellis Antitrust and Competition Group is available to advise whether, before a deal closes, certain actions can be coordinated or particular information shared. With careful planning, deal partners can jump start integration without jumping the gun.