



PROSKAUER ROSE LLP

How to Avoid Jumping the Gun:

Interim Covenants, Transition Planning, and the HSR Act

Colin A. Underwood
Partner

Alicia J. Batts
Partner

Rhett R. Krulla
Senior Counsel

Proskauer Rose LLP

How to Avoid Jumping the Gun: Interim Covenants, Transition Planning, and the HSR Act

Presented by:

Colin A. Underwood
cunderwood@proskauer.com

Alicia J. Batts
abatts@proskauer.com

Rhett R. Krulla
rkrulla@proskauer.com

Introduction/Overview

- What is Gunjumping?
- Illustrative example – “Hell or High Water” provisions
- Recent cases and enforcement actions involving Gunjumping
- What factors are important to the antitrust enforcement agencies when evaluating a potential Gunjumping violation?
- Counseling Guidelines

What Is Gunjumping?

What Is Gunjumping?

- Gunjumping is any conduct that enables parties to a transaction to transfer beneficial ownership prior to the expiration of the HSR-mandated waiting period or prior to obtaining approval from an antitrust enforcement agency for the transaction.
- Gunjumping is a violation of the Hart-Scott-Rodino Act (HSR Act, Clayton Act Section 7A).

What Is Gunjumping?

- The HSR Act requires parties to remain separate economic actors and independent market participants
 - operations may not prematurely be joined
- It is well established that ceding or exercising control of a target prior to expiration of the HSR waiting period can amount to a *de facto* transfer of beneficial ownership.

What Is Gunjumping?

Merger Agreements

- A merger agreement may cause a gunjumping violation
- Agreement terms designed to:
 - maintain the benefit of the buyer's bargain
 - ensure that the business is operated in the ordinary course
 - ensure against material events
- Are permitted and routinely included in merger agreements

What is Gunjumping?

Conduct of the Parties

- Information exchanges:
 - Information exchanges are necessary and appropriate in the context of negotiations to evaluate a potential opportunity
 - Typically do not give rise to gunjumping violations

What is Gunjumping?

- Information exchanges (cont'd):
 - May run afoul of Sherman Act Section I which prohibits agreements in restraint of trade
 - Competitive effects (balance of procompetitive benefit v. anticompetitive harm) are generally central to the Section 1 analysis
 - To avoid potential antitrust liability, competitively sensitive information should be masked or aggregated to the extent feasible
 - Circulation should be limited to a need to know core group

What is Gunjumping?

- Information exchanges (cont'd):
 - Outside of the negotiation/due diligence context, information exchanges are harder to defend – *e.g.*, for transition planning
 - Antitrust enforcement agencies will balance potential adverse effects against the strength of the justification or need for the information

Illustrative Example: “Hell or High Water” Provisions

Illustrative Example: “Hell or High Water” Provisions

- Parties have in some cases attempted to insulate the Seller from antitrust transaction risk by including provisions requiring the Acquirer to pay even if HSR approval is not granted
 - If HSR approval is denied, so that Acquirer is prevented from taking title to the assets, a trustee would be required to sell the assets with the proceeds of the sale paid to the Acquirer
 - Seller is protected from any adverse change arising from announcement of transaction or during HSR review

Illustrative Example: “Hell or High Water” Provisions

- Example: Atlantic Richfield Co./Union Carbide (1991)
 - Agreement called for payment in full, nonrefundable even if ARCO was later blocked from taking title to the UC assets as a result of the HSR review
 - ARCO was required to cover environmental and other liabilities from continued operation of the assets from the date of the acquisition agreement
 - UC was required to operate the business in the ordinary course and in accordance with its existing business plan
 - Purchase price was adjusted at closing to take account of any positive or negative cash flow from operation of the assets prior to closing
- FTC and DOJ charged that these provisions amounted to a transfer of Beneficial Ownership from UC to ARCO upon execution of the acquisition agreement
- Substantial civil penalties imposed

Recent Cases and Enforcement Actions for Gunjumping

Recent Cases and Enforcement Actions for Gunjumping

- *Qualcomm Incorporated/Flarion Technologies, Inc.* (2006)
- *Gemstar/TV Guide* (2003)
- *Computer Associates International Inc./Platinum Technology International Inc.* (2002)
- *Input/Output, Inc./DigiCOURSE* (1999)
- *Hydro Polymers/INEOS Enterprises, Ltd.* (European Commission – 2007)

Qualcomm Incorporated/Flarion Technologies, Inc. (2006)

- Restrictive provisions of the Merger Agreement required Qualcomm's written consent prior to Flarion's:
 - entering into any agreement to license its intellectual property to a third party
 - entering into any agreement involving the obligation to pay, or the right to receive, \$75,000 or more per year or \$200,000 in the aggregate (the parties later increased these dollar amount to \$250,000 and \$1,000,000 respectively)
 - entering into agreements relating to the disposition or acquisition of most intellectual property rights

Qualcomm Incorporated/Flarion Technologies, Inc. (2006)

- Restrictive provisions of the Merger Agreement required Qualcomm's written consent prior to Flarion's (con't):
 - entering into any material contract
 - hiring any employees outside the ordinary course of business, and
 - presenting business proposals to any customer or prospective customer (the parties later amended this provision to permit Flarion to present proposals in the ordinary course of business)
- Restrictions deemed to have transferred beneficial ownership; \$1.8 million civil penalty

Gemstar/TV Guide (2003)

- DOJ alleged that the parties agreed to:
 - Slow roll/stall customers pending closing
 - Stop competing in certain markets
 - Standardize terms offered to customers
- Parties found to have ceased acting as separate economic entities; \$5.67 million civil penalty

Computer Associates International Inc./Platinum Technology International Inc. (2002)

- Agreement restricted Platinum's ability to offer discounts to customers during the merger waiting period
- Prevented Computer Associates from agreeing on prices, approving or rejecting proposed customer contracts, and exchanging prospective bid information with all future merger partners
- Parties ceased acting as separate economic entities; \$638,000 in civil penalty

Input/Output, Inc./DigiCOURSE (1999)

- Assigned target employees to positions within acquirer company
 - provided them with new offices and business cards
- President of acquirer negotiated settlement of commercial dispute between target and one of its customers
- Target sought acquirer's comments on a contemplated acquisition by target
- Additional indicia were transferred when Input/Output began to exercise operational control
- Parties had ceased to function as separate business entities; \$225,000 civil penalty for *each party*

Hydro Polymers/INEOS Enterprises, Ltd. (European Commission – 2007)

- Unconsummated \$900mm transaction between UK and Norway based companies
- Presently under investigation by the EC as to whether the transaction would raise substantive antitrust issues
- EC also now investigating whether inappropriate information exchanges have taken place between the parties during the main investigation
- Lesson: This is not just an issue in the US!

What Factors Do the Antitrust Enforcement Agencies Look At?

What factors do the antitrust enforcement agencies look at?

- FTC GC Blumenthal Speech (2005)
 - Possible indicators that the line has been crossed
 - “access to confidential information and control over key decisions”
 - “attempts to hire away key employees, woo important customers, appropriate proprietary know-how, or preempt attractive opportunities”
- Blumenthal acknowledged that “some information exchanges and pre-consummation collaboration necessarily occur in all mergers”

What factors do the antitrust agencies look at?

- Questions to ask with respect to key decisions made by the target prior to closing (*e.g.*, deferral of significant project):
 - “Was the decision not to proceed reached unilaterally by the seller, mandated by the buyer, or something in between?”
 - “What is the magnitude of the efficiencies that would be realized from deferral of the project?”

What factors do the antitrust enforcement agencies look at?

- Questions to ask with respect to key decisions made by the target prior to closing (*e.g.*, deferral of significant project):
 - “How reversible is the decision not to proceed if the merger ultimately does not close?”
 - “To what degree would the seller’s competitiveness be harmed by the deferral (or abandonment) of the project, if the merger ultimately does not close?”

What factors do the antitrust enforcement agencies look at?

- Questions to ask with respect to key decisions made by the target prior to closing (*e.g.*, deferral of significant project):
 - “To what degree would the overall level of market competition be harmed if the seller’s competitiveness were harmed?”
 - “To what extent would the project represent a material change in the operation of the seller? If substantial, was it disclosed to the buyer or reasonably foreseeable by the buyer at the time of the merger agreement?”

Counseling Guidelines

Counseling Guidelines

- Competing concerns
 - Smooth transition = successful merger
 - Legal limits – can't do everything that might make business or economic sense

Counseling Guidelines

- DO
 - Conduct reasonable and customary due diligence
 - Operate as separate businesses at arm's length
 - Make independent decisions
 - Continue to compete

Counseling Guidelines

- DON'T
 - Initiate contact with target's customers
 - Seek to control target's business behavior prior to closing
 - Discuss competitively sensitive issues
 - pricing
 - discounts
 - market strategy
 - Share competitively sensitive business information

Counseling Guidelines

- “Hell or High Water”: A transaction can be structured so that
 - Seller gets paid on agreed dates regardless of the antitrust outcome
 - Risk of divestiture passes to Acquirer
- Any such transaction will be closely scrutinized to confirm that Beneficial Ownership does not pass from Seller to Acquirer prior to the expiration of the HSR waiting period
 - Control provisions should be clean
 - Disposition of the assets should not be automatic, but determined instead through negotiation between Acquirer and FTC/DOJ



PROSKAUER ROSE LLP

How to Avoid Jumping the Gun:

Interim Covenants, Transition Planning, and the HSR Act

Colin A. Underwood
Partner

Alicia J. Batts
Partner

Rhett R. Krulla
Senior Counsel

Proskauer Rose LLP