

DON'T JUMP THE MERGER GUN AS TEMPTING AS IT IS TO GET STARTED, BUSINESSES MUST WAIT OUT THE AGENCIES' REVIEW

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Companies tread a winding path from competitors to colleagues-the delicate courting, the thorny negotiations, the celebratory signing, and then what should be the last lobe toward a true merger of interests. Yet with disquieting regularity, a heedless stumble near the end excites the interest of antitrust authorities.

Federal law puts a hold on large mergers and acquisitions while the Federal Trade Commission or the Justice Department examine their competitive implications. Issues of improper coordination during this time-i.e., gun jumping-produce some of the hardest counseling questions and the most noteworthy cases.

While few gun-jumping investigations ultimately lead to a fine or litigation-about one case every two years-the time and money spent by the parties is significant. Even investigations that result in no action can be costly. Let's discuss how to avoid that last stumble.

NO HEAD STARTS

Under the Hart-Scott-Rodino Antitrust Improvements Act, parties to mergers and acquisitions that meet certain dollar thresholds must notify the federal antitrust agencies and observe a waiting period before closing the transaction. The waiting period gives regulators time to weigh the potential anti-competitive effects of the transaction. Gun jumping is any agreement or conduct by which the seller transfers beneficial ownership to the buyer during this period.

While it is almost unheard of to formally complete a transaction during the waiting period-a clear violation of the act-businesspeople have been known to exercise influence over the target that amounts to taking operational control. The line between legal due diligence or integration and illegal operational control is somewhat blurry. It may be crossed inadvertently by parties that lack adequate advice from antitrust counsel.

Gun jumping can be a problem in any transaction reportable under Hart-Scott-Rodino. The absence of substantive antitrust issues does not affect the analysis of whether gun jumping occurred, nor is it a defense-though it may impact regulators' decision to bring a case.

Gun jumping also raises potential liability under Section 1 of the Sherman Act, which outlaws contracts or combinations "in restraint of trade."

The period of highest risk comes when the parties begin to get comfortable with the idea that the transaction will proceed. Even as counsel repeatedly remind them that they must compete until the ink is dry on the closing documents, human nature makes it hard to wait. There are sound operational, financial, and emotional reasons to reap the benefits of the transaction as soon as possible. But "getting a head start" may put those very benefits at risk.

Much as businesspeople may chafe, the law on this is not without its own logic. While waiting until closing may delay the anticipated benefits of the transaction, allowing the parties to act as one prior to closing is potentially disruptive to both companies and the marketplace as a whole if, as sometimes happens, the transaction ultimately derails.

AGENCY ADVICE

In a 2003 presentation, Daniel Ducore of the FTC's Bureau of Competition identified the top five lines of thought that get pre-merger parties into trouble: (1) Let us run your company while we're waiting to close. (2) We'll take over handling your tricky customer issues and negotiating new contracts. (3) Let's start bringing your people onboard to work on some projects. (4) Let's both meet with your customers while we're waiting. (5) Show us all your confidential files.

Two years later, William Blumenthal, general counsel of the FTC, gave a speech designed to "reset the rhetoric" on gun jumping. He said that "some information exchanges and pre-consummation collaboration necessarily occur" in all mergers and posited that valuable pre-merger planning had been chilled by recent enforcement actions. He seemed to suggest the bar had been counseling too conservatively.

The enforcement record on gun jumping is limited to cases where parties very clearly crossed the line, so there is some merit to the idea that over-counseling could lead companies to scale back further than necessary during integration planning. Still, the large swath of gray between those actions that are definitely legitimate and those that will bring regulators' notice reasonably leads counsel to urge a conservative approach.

Blumenthal noted that some actions clearly cross the line. These include the buyer assuming control over the target's key decisions and trying to hire away top employees, woo important customers, appropriate proprietary know-how, or pre-empt attractive opportunities.

But more often, gun-jumping questions require more fact-sensitive analyses. Using the example of the deferral of a seller's project, Blumenthal suggested several questions to ask: Was the decision to defer reached unilaterally by the seller, mandated by the buyer, or something in between? How great are the efficiencies to be realized from deferral? How reversible is the deferral if the merger does not close? To what degree will the seller's competitiveness be harmed by the deferral if the merger does not close? To what degree will market competition be harmed if the seller's competitiveness is harmed? Does the project represent a material change in the seller's operation? Was that fact disclosed to or foreseeable by the buyer at the time of the merger agreement?

Blumenthal's 2005 speech has helped counsel facing difficult questions from eager merging parties. Still, the agencies' career staff may not entirely agree that an excess of self-restraint is a major Hart-Scott-Rodino problem, and a new administration may be more aggressive. The enforcement record is where we learn what the agencies will absolutely not tolerate.

REAL PENALTIES

The following cases brought by the Justice Department, for itself or the FTC, illustrate the problems that companies get into when they jump the gun.

Qualcomm/Flarion Technologies (2006): The merger agreement required Qualcomm's written consent prior to Flarion licensing its intellectual property to a third party, agreeing on the disposition or acquisition of most intellectual property rights, entering into any material contract, hiring any employees outside the ordinary course of business, and presenting business proposals to any customer. (The last provision was later amended to permit Flarion to present proposals in the ordinary course of business.) The parties compounded their problem when Flarion sought Qualcomm's approval for routine decisions even where their agreement did not require it. These restrictions and the parties' conduct were deemed to have transferred beneficial ownership during the waiting period, and Qualcomm settled for a \$1.8 million civil penalty.

Gemstar/TV Guide (2003): The Justice Department alleged that the parties agreed to slow or stall contract negotiations with new customers, stop competing in certain markets, and standardize terms

offered to customers. Gemstar and TV Guide were found to have ceased acting as separate economic entities and were assessed a \$5.67 million civil penalty.

Computer Associates International/Platinum Technology International (2002): The merger agreement required Computer Associates' written approval before Platinum provided certain discounts during the waiting period. A Computer Associates employee was sent to Platinum's headquarters to approve customer contracts and participate in day-to-day management. Computer Associates personnel also reviewed competitively sensitive information about Platinum's business, including prices and discounts, and cancelled Platinum's participation at a trade show where it would have sought business. The parties were found to have ceased acting as separate economic entities and assessed \$638,000 in civil penalties.

Input/Output/DigiCourse (1999): During the waiting period, the president of DigiCourse managed the combined business of the two companies and negotiated settlement of a commercial dispute for Input/Output. Other key DigiCourse employees were assigned to positions within Input/Output, provided offices there, and issued Input/Output business cards. DigiCourse's phones were answered under Input/Output's name. A \$225,000 civil penalty was imposed on each party.

While these are all U.S. cases, other authorities are starting to worry about gun jumping too. Last year the European Commission conducted a raid to investigate whether Ineos and Hydro Polymers had improperly exchanged information. Allegations of early implementation were ultimately found to be unjustified, but only after an investigation that no doubt diverted valuable resources.

Counsel need to be ready: None of these warnings will change the fact that merging companies want to do all that is possible, as soon as possible, to make their transition glitch-free. Lawyers must work with clients to understand not only what they want to accomplish, but why. Understanding the reason can lead to solutions that fit business needs within the legal framework.

Some pre-closing activity is not at all questionable. Conducting reasonable and customary due diligence raises no gun-jumping issues. But initiating joint contact with the target's customers; seeking to control the target's business behavior; discussing competitively sensitive issues such as pricing, discounts, and market strategy; and sharing competitively sensitive data usually do.

Most gun-jumping questions fall somewhere in between. Competitors-turning-colleagues may still find a way to achieve their goals with careful advice from antitrust counsel.

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---- INDEX REFERENCES ---

COMPANY: QUALCOMM INC; PLATINUM; CONCORD TECHNOLOGIES INC; FU MAO XING YE GU FEN YOU XIAN GONG SI; COMPUTER ASSOCIATES PTY LTD; FU LAI XI BO TAI GE JIN SHU BO WEN GUAN YOU XIAN GONG SI; FEELING TECH; QUALCOMM INDIA PVT LTD; PLATINUM TECHNOLOGY INTERNATIONAL INC; JUSTICE DEPARTMENT; INPUT; CA INC; MIRAMAR SYSTEMS INC; PLATINUM COMMUNICATIONS INC; FU ER TE KE JI GU FEN YOU XIAN GONG SI; INPUT INC; COMPUTER ASSOCIATES

OTHER INDEXING: (BUREAU OF COMPETITION; COMPUTER ASSOCIATES; COMPUTER ASSOCIATES INTL; DIGICOURSE; EUROPEAN COMMISSION; FLARION; FLARION TECHNOLOGIES; FTC; HART SCOTT RODINO; HART SCOTT RODINO ANTITRUST; INEOS; INPUT; JUSTICE DEPARTMENT; PLATINUM; PLATINUM TECHNOLOGY INTL; QUALCOMM; TV) (Alicia J. Batts; Blumenthal; Daniel Ducore; Gemstar; Hydro Polymers; John R. Ingrassia; Lawyers; Rhett R. Krulla; William Blumenthal)