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Department of Justice Imposes $1.8 Million Fine for Hart-Scott-Rodino Act Violations — Premerger Coordination Cited as "Gun-Jumping"

QUALCOMM Incorporated ("QUALCOMM") has agreed to pay a $1.8 million civil penalty to resolve Department of Justice Antitrust Division ("DOJ") allegations that the company illegally acquired operational control over Flarion Technologies Inc. ("Flarion") prior to obtaining antitrust clearance to proceed with the acquisition, through certain provisions of the parties' merger agreement and by other actions through which QUALCOMM controlled many of Flarion's business decisions during the statutory waiting period imposed on many mergers. There are two notable aspects of the DOJ's lawsuit: one, the complaint adds important information to the record of what actions the DOJ will challenge as unlawful premerger coordination; and two, the DOJ did not impose a consent decree regulating QUALCOMM's future conduct in other acquisitions, which it typically obtains from parties in these circumstances, probably because these parties voluntarily reported the conduct to the agency and changed some of their conduct during the waiting period.

The Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, (the "HSR Act" or the "Act") requires parties to mergers and acquisitions that meet certain thresholds to notify the federal antitrust enforcement agencies (the "Agencies") of their transaction and observe a waiting period before completing the transaction. The waiting period provides the Agencies with an opportunity to address potential anticompetitive effects that the transaction may pose. While it is almost unheard of for parties to complete a transaction while the waiting period is pending – a clear violation of the Act – exercising influence over the target that amounts to taking operational control during the pendency of the waiting period (commonly referred to as "gun-jumping") is a less clearly drawn line, and is sometimes crossed either inadvertently or because parties do not adequately seek the advice of antitrust counsel in drafting their merger agreements or in dealing with each other prior to closing.

The DOJ Alleged that Certain Merger Provisions Restricting Flarion's Business Decisions Amounted to Unlawful Acquisition of Control of the Business

QUALCOMM and Flarion entered into an Agreement and Plan of Reorganization (the "Merger Agreement") on July 25, 2005. Pursuant to the Merger Agreement, QUALCOMM agreed to acquire Flarion for cash and stock valued in excess of the HSR Act's notification threshold. The parties submitted the required notification under the Act to the Agencies, and, following compliance with the DOJ's request for additional information, the statutory waiting period expired on December 23, 2005. The DOJ alleged that prior to the expiration of the waiting period, however, QUALCOMM exercised operational control over Flarion to the extent that it acquired beneficial ownership of the company in violation of the HSR Act.

According to the DOJ's complaint, the Merger Agreement contained provisions that prevented Flarion from engaging in certain routine business activities without QUALCOMM's consent. Most merger agreements include legitimate provisions restricting the target from taking steps outside the ordinary course of business that diminish the value of the business to be acquired. However, the DOJ alleged that the Merger Agreement in this case went too far in restricting what the target could do.

The DOJ alleged that QUALCOMM insisted on certain provisions in the Merger Agreement because QUALCOMM did not intend to commercialize a particular Flarion product and sought to limit Flarion from entering into agreements inconsistent with QUALCOMM's own business plans. The provisions of the Merger Agreement that the DOJ identified as too restrictive required Flarion to obtain QUALCOMM's written consent prior to:

- 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 amounts to $250,000 and $1,000,000 respectively),
- entering into agreements relating to 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 or prospective customer (the parties later amended this provision to permit Flarion to present proposals in the ordinary course of business).

Another provision permitted Flarion to support the deployment of its technology but only to the extent provided in an attached schedule to the Merger Agreement.

The DOJ Alleged that QUALCOMM Exercised Control over Flarion's Business in Many Instances that Were Not Required by the Merger Agreement

In its complaint, the DOJ alleged not only that certain provisions in the Merger Agreement restricting Flarion's business conduct amounted to gun-jumping, but also that the parties' conduct exceeded even what the Merger Agreement provided. Although the agreement required Flarion only to seek approval for hiring outside the ordinary course of business, in fact Flarion regularly sought approval for routine hiring. Other examples cited in the complaint, which appear to result from the agreement's provision requiring Flarion to seek QUALCOMM's consent prior to marketing products and services to customers, include:

- the submission of draft proposals to QUALCOMM for review and approval,
- creation of a new policy that restricted Flarion's ability to disclose pricing even to prospective customers,
- requests for QUALCOMM to approve Flarion's pricing and discounts, which on at least one occasion was denied by QUALCOMM after an exacting review, and
- discouraging Flarion from pursuing certain business opportunities, particularly those deemed to be too small or liable to interfere with QUALCOMM's ability to sell its own technology to a customer.

After announcing the settlement, Assistant Attorney General for the Antitrust Division Thomas O. Barnett said "Merging parties must continue to operate independently until the end of the premerger waiting period," and "The Antitrust Division will vigorously enforce this requirement against any company that assumes operational control of a business that it is acquiring." The DOJ explicitly stated that the $1.8 million fine imposed was less than the statutory maximum of $11,000 per day because the parties came forward and voluntarily reported the violation.

Merger Agreements and Pre-Closing Conduct Must Be in Compliance with Antitrust Laws

Restrictions in an acquisition agreement aimed at preserving the benefit for which the buyer bargained by generally limiting the target's activities that occur outside the ordinary course of business are typically both necessary and legitimate. However, restrictions such as those agreed to by QUALCOMM and Flarion, aimed more narrowly at specific business functions and at actions that are in the ordinary course of business, are inherently more suspect and will likely trigger an investigation of whether gun-jumping has occurred. Provisions that require the acquiring party's consent will also attract the Agencies' attention. Merging parties should consider using a general provision prohibiting the acquired party from acting outside the ordinary course of business, coupled with specific provisions that address corporate actions such as payment of unusual dividends, issuance of additional shares or debt instruments, *etc.* and appropriate covenants by the acquired party to preserve the business from material changes in value.

The complaint does not make clear whether the DOJ takes the view that the provision prohibiting the target from hiring employees outside the ordinary course of business is unlawful by itself. Prior statements by DOJ officials suggest that the agency would not take this view, and it is difficult to see how it could constitute a violation. However, the complaint's inclusion of this restriction in the list of problematic provisions causes concern, and merging parties should obtain counsel's advice on any such provision.

Integration planning is a critical part of the merger process. It should be approached with due caution and should be informed not only by the technical requirements of the HSR Act and other applicable antitrust laws, but also by the enforcement trends at the Agencies. Antitrust counsel should thus generally have an the opportunity to review merger agreements before they are executed to ensure that they comply with the antitrust laws, and should be consulted by the parties and by counsel negotiating the transaction with respect to the parties' integration activities prior to closing.

In most cases, the agency will also charge that contract provisions and conduct such as are alleged here, including the disclosures of highly specific, competitively sensitive information described in the complaint, separately violate Section 1 of the Sherman Act, which prohibits agreements that unreasonably restrain trade. It is likely that the DOJ did not allege a Section 1 violation here for the reason previously mentioned, *i.e.*, the parties' voluntary reporting of their conduct.

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