



Threading the Needle—Avoiding Antitrust Violations During the M&A Pre-Closing Period

January 2, 2019

Merging parties need to share information and cooperate while negotiating a merger, conducting due diligence, and navigating integration processes. These needs, however, often dovetail with antitrust laws—specifically, the Sherman Act and the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act)—which strictly regulate conduct between parties prior to the closing of a merger or acquisition, and can impose personal and company liability. One liability arises when companies prematurely combine business operations, often referred to as “gun jumping.”¹

To avoid gun-jumping liability during the pre-closing period, merger partners should follow one simple principle: the parties are and must remain independent companies—and independent competitors—until they receive regulatory clearance; however, if the parties are competitors, they also need to remain independent until the deal is closed. To this end, prematurely sharing certain competitively sensitive information or exercising control over a merger partner before a transaction is closed can land companies in hot water.²

Competitively Sensitive Information

The antitrust laws are concerned with limiting the exchange of competitively sensitive information—in order to maintain robust competition—in the event that a merger is not ultimately consummated. In March, 2018, the Federal Trade Commission (FTC) issued updated guidance to help parties avoid gun-jumping and improper coordination issues during merger negotiations and due diligence.³ Although the FTC recognizes that merging parties “have legitimate need to access detailed information about the other party’s business” in order to negotiate or finalize a merger, parties must make special efforts to prevent the sharing of competitively sensitive information.

To be clear, merger partners are allowed to share competitively sensitive information—so long as the parties have a legitimate business purpose for doing so (e.g., integration planning or due diligence), and take precautions to limit the dissemination of the sensitive information in a manner that could lead to anticompetitive conduct.

Exercising Beneficial Ownership

Under the HSR Act, prior to closing, parties must maintain their separate and independent economic identities, meaning a buyer cannot exercise influence over the direction of the target’s business. There are two distinct restrictions upon the transfer or operational control of a target to a buyer: (1) the target from transferring “beneficial ownership” or indicial of “operational control” to the buying party; and (2) where the parties compete, they cannot lessen competition prior to closing.⁴ The HSR Act prevents parties from integration before receiving regulatory approval. Section 1 of the Sherman Act prevents merger parties from lessening competition prior to closing.⁵

The antitrust laws do allow, however, a buyer to place restrictions upon a target that prevent it from materially changing its business practices. Antitrust regulators recognize that a buyer is entitled to ensure that it gets what it paid for and protect the value of its acquisition through covenants in the parties’ merger agreement. Limiting a target’s ability to declare dividends, issue securities, amend by-laws, enter into material contracts, and undertake new large capital expenditures does not, generally, run afoul of the antitrust laws. However, restricting a company’s ability to offer discounts, make ordinary course sales or offer services, or control its procurement, or where a buyer effectively controls the target’s day-to-day operations, for instance, raise serious gun-jumping issues.

United States v. Qualcomm, Inc. and Flarion Techs illustrates the risk of overbroad restrictions in merger provisions.⁶ While the agreement allowed

¹ 15 U.S.C. § 18a (1994 & Supp. V 1999).

² Fed. Trade Comm’n, *Avoiding Antitrust Pitfalls During Pre-merger Negotiations and Due Diligence*, (March 20, 2018), <https://www.ftc.gov/news-events/blogs/competition-matters/2018/03/avoiding-antitrust-pitfalls-during-pre-merger>.

³ *Id.*

⁴ 43 Fed. Reg. 33,450 (1973).

⁵ The Sherman Act only applies in instances where merger partners are competitors, and prevents activities that would reduce competition (i) prior to closing; or (ii) in the event the merger is abandoned.

⁶ See Complaint at 8, *United States v. Qualcomm Inc. et al.* 1:06-cv-00672 (PLF) (D.D.C. Apr. 13, 2006).

Continued on page 2...

Threading the Needle—Avoiding Antitrust Violations . . .

Continued from page 1...

Flarion to “carry on its business . . . in the ordinary course in substantially the same manner as heretofore conducted,” it also prohibited certain actions without Qualcomm’s consent. Of particular concern to the U.S. Department of Justice (DOJ) were provisions requiring that Flarion obtain Qualcomm’s written consent before:

- entering into any agreement to license its intellectual property to a third party;
- entering into: (a) any agreement involving the obligation to pay, or right to receive, \$75,000 or more per year or \$200,000 or more in the aggregate, except purchase orders issued by Flarion to suppliers under obligations pre-dating the merger agreement; (b) agreements relating to the disposition or acquisition of intellectual property rights, except for “shrinkwrap” software licenses with purchase prices of less than \$10,000; or (c) any “material contract.” (The relevant dollar thresholds were later raised to \$250,000 per year and \$1,000,000 in the aggregate.);
- before Flarion could “hire any employee ... except in the ordinary course of business in accordance with its standard past practice.”; and
- before presenting business proposals to any customer or prospective customer. (Again, this was later amended to allow Flarion to present proposals “in the ordinary course of business in accordance with its standard past practice.”)

The DOJ described these provisions and the parties’ actions as ceding to Qualcomm “control of much of its management and operations, including customer proposals, price discounts, licensing strategies, and personnel decisions.”⁷ The DOJ also alleged that Flarion deferred to Qualcomm on business decisions even when the merger agreement did not purport to oblige Flarion to do so. In doing so, the DOJ cited a senior Flarion executive, who stated that: “Bascially [*sic*] before we sign any new contracts, we seek Q[ualcomm’s] consent.” A senior executive at Qualcomm noted that Flarion was “being very careful seeking our approval on even very small operational level agreements.” The DOJ also noted that on multiple occasions, prior to marketing to specific customers, Flarion sought Qualcomm’s review and consent, including the submission of entire drafts of customer proposals for Qualcomm, requests for approval of price quotations, and a request to offer a discount to an existing customer. The DOJ alleged that this resulted in Flarion being discouraged from pursuing smaller accounts that were of little interest to Qualcomm, creating a policy on providing price information to mirror Qualcomm’s policy, and not pursuing a customer proposal that would have met Flarion’s margin targets.

While interim operating covenants are typical in merger transactions, parties should ensure that they are considered in the context of gun-jumping concerns, particularly where they require that a seller obtain consent before engaging in what the agencies may view as ordinary course of business conduct.

Practical Considerations and Pitfalls to Avoid

Due diligence and integration planning are key components of a merger or acquisition. To the extent that merger partners need to exchange competitively sensitive information as a part of assessing of planning a merger, each should take practical steps to limit their risk of violating the antitrust laws by:

- aggregating sensitive data;
- limiting dissemination to individuals with a legitimate need to know;
- preventing dissemination to sales or marketing personnel who could use it for anticompetitive purposes;
- ensuring a legitimate reasons for exchanging the information; and
- adhering to a confidentiality agreement crafted by antitrust counsel.

A practical and effective means to limit the risks of sharing competitively sensitive information is establishing a clean room, in which a limited set of individuals from each team will be able to review sensitive information.

Prior to closing, parties should remember to plan, but not to implement those plans.

No employee of either party should dictate or instruct the business activities of the other party in any way. Though it is permissible to include covenants that prevent material changes in a target company prior to closing, a buyer may not control a target’s ordinary course of business until after the transaction has closed and antitrust clearance is obtained.

⁷ Id. at []

Continued on page 3...

Threading the Needle—Avoiding Antitrust Violations . . .

Continued from page 2...

Taking these relatively simple steps and seeking the advice of antitrust counsel early in the M&A process may significantly limit the risks of violating the antitrust laws during the prickly pre-closing period of a merger.

Recent Gun-Jumping Settlements

Although gun-jumping cases are not frequent, the DOJ has brought several gun-jumping claims against merging parties over the last decade—levying hefty fines. Most recently, the DOJ alleged claims against Duke Energy Company in January 2017.

In August 2014, Duke Energy Company (Duke) entered into an agreement to purchase the Osprey Energy Company (Osprey) from Calpine Corporation. According to the DOJ's complaint, Duke took control of Osprey before filing required HSR notifications and waiting for the expiration of the mandatory waiting period for antitrust review.

At the same time Duke agreed to purchase Osprey, the companies entered into a tolling agreement, under which Duke gained control of Osprey's output of electricity and the right to receive Osprey's day-to-day profits and losses. Duke also assumed control over purchasing all of Osprey's fuel, arranging delivery of that fuel, and arranging for transmission of all energy generated by the Osprey plant.⁸

Tolling agreements are not uncommon in the energy industry. In this case, however, the DOJ alleged that the agreement served merely to facilitate the transaction between the parties by helping to obtain approval for the transaction from the Federal Energy Regulatory Commission. According to the DOJ, the parties ceased to be independent competitors the moment that the tolling agreement was entered, because it transferred beneficial ownership of Osprey's business to Duke in violation of the HSR Act. To settle the charges, Duke agreed to pay \$600,000 in civil penalties.

U.S. antitrust regulators bring relatively few gun-jumping cases (just more than 10 in the last two decades, and none between 1976 and the late 1980s). Merger partners, however, should remain cognizant of conduct that could cause the DOJ or FTC to ask questions about their pre-closing conduct. Gun-jumping fines are often expensive, and additional scrutiny of merger partners can put parties and—more importantly—transactions at risk unnecessarily.

The appendix that follows identifies more recent gun-jumping cases. For more information regarding the DOJ complaint or information related to pre-closing antitrust issues, please contact a member of the WSGR antitrust practice.

⁸ Complaint at 2, *United States v. Duke Energy Corp.*, 1:17-cv-00116 (D.D.C. Jan. 18, 2017).

Continued on page 4...

Threading the Needle—Avoiding Antitrust Violations . . .

Continued from page 3...

Case	Fine	Description	Case Files
<i>United States v. Duke Energy Corp.</i> (D.D.C. 2017).	\$600,000	The DOJ alleged that Duke Energy acquired beneficial ownership over Osprey Energy Center prior to the expiration of the HSR waiting period. When Duke agreed to purchase Osprey, the parties entered into a tolling agreement, under which Duke would control: i) the output of electricity produced by Osprey; ii) Osprey's fuel purchases; iii) the transportation of energy generated by Osprey; and iv) Osprey's profits or losses.	https://www.justice.gov/atr/case/us-v-duke-energy-corporation
<i>United States v. Flakeboard America</i> (D.D.C. 2014).	\$3.8 million in civil penalties (HSR violation); \$1.15 million is disgorged profits (Sherman §1 violation)	The DOJ's complaint alleged that Flakeboard exercised operational control and therefore beneficial ownership over SierraPine when the two companies coordinated to close a SierraPine sawmill and move SierraPine customers to Flakeboard before the parties' received clearance under the HSR Act.	https://www.justice.gov/atr/case/us-v-flakeboard-america-limited-et-al
<i>United States v. Smithfield Foods</i> , (D.D.C. 2010).	\$900,000	The DOJ's complaint alleged that Smithfield exercised operation control over Premium Standard Farms' purchasing decisions during the HSR waiting period when Premium sought Smithfield's consent to enter ordinary course procurement contracts. Premium provided Smithfield with contract terms, pricing information, and other competitively sensitive information during this process.	https://www.justice.gov/atr/case/us-v-smithfield-foods-inc-and-premium-standard-farms-llc
<i>United States v. Qualcomm, Inc. and Flarion Techs</i> (D.D.C. 2006).	\$1.8 million	The DOJ's complaint alleged that under the parties' merger agreement, Flarion must seek Qualcomm's consent to enter into agreements involving payment or receipt of more than a certain amount, to enter into agreements relating to the sale or purchase of intellectual property rights, or to present business proposals to current or prospective customers. In sum, the merger agreement ceded control of management and operations, customer proposals, pricing, licensing, and personnel to Qualcomm during the HSR waiting period. In practice, however, Flarion sought Qualcomm's consent on business decisions, even when the parties' agreement did not require Flarion to do so.	https://www.justice.gov/atr/case/us-v-qualcomm-inc-and-flarion-technologies-inc
<i>United States v. Gemstar-TV Guide Int'l</i> , (D.D.C. 2003).	\$5.68 million	The DOJ's complaint alleged that prior to expiration of the HSR waiting period, the parties began to conduct business jointly. Significantly, the parties "slow rolled" pending negotiations with customers, allocated markets and customers, and transferred control of assets, such as TV Guide's marketing and advertising operations. In addition to gun-jumping charges, the DOJ alleged that these activities constituted unlawful agreement between competitors in violation of Section 1 of the Sherman Act.	https://www.justice.gov/atr/case/us-v-gemstar-tv-guide-international-inc-and-tv-guide-inc
<i>United States v. Computer Associates, Int'l</i> (D.D.C. 2002)	\$1.28 million	The DOJ's complaint alleged that Computer Associates installed an employee at Platinum during the HSR waiting period that approved customer contracts and undertook other management activities. In addition, under the merger agreement, Platinum agreed to limit discounts and other competitive terms to its customers.	https://www.justice.gov/atr/case/united-states-v-computer-associates-international-inc-and-platinum-technology-international-0
<i>United States v. Input/Output, Inc.</i> (D.D.C. 1999)	\$450,000	The DOJ's complaint alleged that prior to the end of the HSR waiting period, Input/Output began exercising operational control over DigiCOURSE. Specifically, Input/Output installed DigiCOURSE officers to positions within Input/Output (issuing each new titles, moving their offices, and giving them business cards) and subsequently deployed a DigiCourse executive overseas to negotiate an Input/Output contract dispute.	https://www.justice.gov/atr/case/us-v-inputoutput-inc-and-laitram-corp

Continued on page 5..

Threading the Needle—Avoiding Antitrust Violations . . .

Continued from page 4...

Case	Fine	Description	Case Files
<i>In re Commonwealth Land Title Inc. Co.</i> , 126 F.T.C. 680 (1998)	Consent requiring re-establishment of independent operation	The FTC's complaint alleged that Commonwealth had violated Section 5 of the FTC Act by entering into agreements with customers that set price, terms, and condition for title services to be "jointly provided" by the title company and prospective joint venture partner (First American Title Insurance Company), pending formation of a joint title plant entity. According to the FTC, the conduct raised prices and restricted output in the market for title services.	https://www.ftc.gov/enforcement/cases-proceedings/9810127/common-wealth-land-title-insurance-company-matter
<i>In re Insilco Corp.</i> , 125 F.T.C. 293 (1998)	Consent requiring divestiture of certain acquired assets to FTC-approved buyers	The FTC's complaint alleged that the exchange of competitively sensitive information about customers, prices, and costs, during pre-closing integration planning was likely to lessen competition in the highly concentrated market for aluminum tube manufacturing in violation of the FTC Act. This transaction was not HRS reportable. Nonetheless, according to the FTC, the parties prematurely exchanged competitively sensitive information, including non-aggregated, customer specific pricing, costs, and strategic plans.	https://www.ftc.gov/enforcement/cases-proceedings/9610106/insilco-corporation-matter
<i>United States v. Titan Wheel Int'l.</i> (D.D.C. 1996)	\$130,000	The DOJ's complaint alleged that Titan Wheel took control of Armstrong Tire Corporation when the two companies entered into an asset purchase agreement giving Titan control of \$15 million of assets, including inventory, machinery, equipment, and customer and supplier lists before the companies complied with requirements under the HSR Act. Although the purchase agreement was subsequently amended, and the parties did comply with the HSR Act, the DOJ argued that the parties had been in violation of the act for a period of 13 days. Titan was made to pay the maximum allowable fine for its violation.	https://www.justice.gov/atr/case/us-v-titan-wheel-international-inc
<i>United States v. Atlantic Richfield Co. (ARCO)</i> (D.D.C. 1992)	ARCO: \$290,000 U.F.G.: \$150,000	The DOJ's complaint alleged that U.F. Genetics took premature control of ARCO's seed business before expiration of the HSR waiting period. ARCO and U.F. Genetic entered into a transaction to sell ARCO seed for \$19 million. On the same day, U.F. Genetics paid over \$9 million into escrow and almost \$9 million in cash and notes to ARCO. In exchange, U.F. Genetics received 49 percent of ARCO seed voting securities and the right to vote the remaining 51 percent held in escrow. The parties settled the dispute and agreed to pay civil penalties for violating the waiting period of the HSR Act.	https://www.justice.gov/atr/case/united-states-v-atlantic-richfield-company-inc-and-uf-genetics-inc-aka-sunseeds-genetics
<i>United States v. Atlantic Richfield Co. (ARCO)</i> (D.D.C. 1991)	\$1 million each	The DOJ's complaint alleged that prior to filing an HSR notification, Union Carbide transferred the assets and operations of two chemical manufacturing processes to ARCO. Although Union Carbide continued to run those assets and operations, it did so only as a "caretaker" for ARCO (which assumed the risk and benefits of the undertaking). According to the DOJ, beneficial ownership transferred between the parties because the transaction eliminated Union Carbide as an independent competitor before expiration of the HSR waiting period.	https://www.justice.gov/atr/case/us-v-atlantic-richfield-company-et-al



This WSGR Alert was sent to our clients and interested parties via email on October 29, 2018.

To receive future WSGR Alerts and newsletters via email, please contact Marketing at wsgr_resource@wsgr.com and ask to be added to our mailing list.

This communication is provided as a service to our clients and friends and is for informational purposes only. It is not intended to create an attorney-client relationship or constitute an advertisement, a solicitation, or professional advice as to any particular situation.

650 Page Mill Road | Palo Alto, CA 94304-1050 | Tel: (650) 493-9300 | Fax: (650) 493-6811 | email: wsgr_resource@wsgr.com | www.wsgr.com

© 2019 Wilson Sonsini Goodrich & Rosati, Professional Corporation
All rights reserved.