Panel 5: Pre-Consummation Information Exchange and Integration Planning

(Slides & Presentations)

Federal Trade Commission
Understanding Mergers Roundtable
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Pre-Consummation Information Exchange and Integration Planning

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Critical Legal Distinctions

1. Gun Jumping v. Information Exchange

2. Hart-Scott-Rodino Act v. Sherman Act / FTC Act Limitations

See generally, H. Morse, *Mergers and Acquisitions: Antitrust Limitations on Conduct Before Closing*, 57 Business Lawyer 1463 (2002)

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Hart-Scott-Rodino Act

Premerger notification

- allows government to investigate before consummation
- avoids “unscrambling the eggs”

The Statute:

> “No person shall acquire, directly or indirectly, any voting securities or assets of any other person, unless both persons (or in the case of a tender offer the acquiring person) file notification ... and the waiting period has expired ...

Neither the statute nor HSR rules define the term “acquire”

HSR Rules / Beneficial Ownership

The Rules:

> “acquiring person” = person who will “hold” voting securities or assets
>
> “hold” = “beneficial ownership”

“Statement of Basis and Purpose”:

> “the existence of beneficial ownership is to be determined in the context of particular cases with reference to the person or persons that enjoy the indicia of beneficial ownership,” which include
>
> - right to obtain any increase in value
> - risk of loss,
> - right to vote
> - investment discretion

Beneficial Ownership / Operational Control

DOJ radio speeches

- "local marketing agreements" and "time brokerage agreements" "may prematurely transfer beneficial ownership"
- outside the context of an acquisition would not violate HSR

U.S. v. Titan Wheel International, Inc. (1996)

- agreement transferred "possession and operational control" of tire plant with the effect of "transferring beneficial ownership"

U.S. v. Input/Output (1999)

integrated personnel and operations + held out company as integrated to the public

- reorganization effective immediately
- personnel moved offices, new e-mail addresses, business cards
- phones answered under new name
- personnel traveled to resolve dispute for other company
- consulted on other possible transactions

U.S. v. Computer Associates Int'l, Inc. (2002)

Computer Associates "exercised unlawful control"

- installing employees to review contracts
- restricting discounts without approval
- restricting contract terms, fixed price contracts, services
- collecting + disseminating competitively sensitive information
- making day-to-day management decisions

- merging parties must remain "separate and independent economic entities"; acquiring person may not exercise "operational or management control"

- "customary provisions" restricting actions "reasonable and necessary" to protect value of transaction do not violate HSR

Fitting a Square Peg in a Round Hole?

"Signing the contract transfers some indicia of beneficial ownership. By itself, that transfer is entirely lawful.

But the transfer of additional indicia of ownership during the waiting period

– such as assuming control through management contracts, integrating operations, joint decision making or transferring confidential information for purposes other than due diligence inquiries –

are inconsistent with the purposes of the HSR Act and will constitute a violation."

Sherman Act / FTC Act

Sherman Act § 1:

"every contract, combination ... or conspiracy in restraint of trade" is illegal

FTC Act § 5:

prohibits "unfair methods of competition"

Naked price fixing, market division, customer allocation
= per se illegal

The Agencies' Position

DOJ:

"the pendency of a proposed merger does not excuse the parties of their obligations to compete independently"

FTC:

"between the time two competitors agree to merge and when they consummate their transaction, they are separate economic actors who are bound by the competition laws"

But see International Travel Arrangers v. NWA, Inc. (1993)

rejects view "only the formal consummation of a merger precludes application of section 1 of the the Sherman Act to an alleged conspiracy between the merging companies"

Government Enforcement

Torrington Co. (FTC 1991)

FTC § 5 violation to tell customer to purchase from merging party and refuse to quote to "speed up" the consolidation, per se illegal customer allocation

Commonwealth Land Title Ins. Co. (FTC 1998)

FTC § 5 violation to enter agreement setting prices, terms and conditions for services to be jointly provided "pending formation" of joint venture

U.S. v. Computer Associates Int'l, Inc. (2002)

Computer Associates' "conduct of business" covenants

- prohibiting discounts, fixed price contracts, specific services, requiring standard contract

"extraordinary and not reasonably ancillary to any legitimate goal"

Consent order allows

- agreements to operate in the "ordinary course" consistent with past practice
- restrictions on conduct that would cause a "material adverse change"
- reasonable and customary due diligence
- joint conduct lawful in the absence of the transaction

Premerger Information Exchange

Antitrust concerns:

1. Sham negotiations to collude
2. Predatory conduct by one firm to obtain information
3. Legitimate merger discussions may lead to coordinated interaction

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Supreme Court precedents (*Container Corp., U.S. Gypsum*) apply rule of reason to information exchanges considering:

- structure of industry
- nature of information exchanged

Legitimate business justifications:

- due diligence to determine and confirm value
- planning efficient integration

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Precautions and Safeguards

- restrict distribution and use
  - planning, non-operational staff, outside advisors
  - for use in evaluating transaction, planning integration, destroy or return
- aggregate customer specific, product specific data
- delay exchange of most sensitive data

Recent Enforcement Action

Insilco Corp. (FTC 1998)

- non-aggregated, customer-specific information, current and future pricing plans, formulas
- "transfer of such competitively-sensitive information in such highly concentrated markets violates Section 5"
- but analysis asserts exchange would "likely harm competition in any market"

Computer Associates

- information exchange among elements of control alleged

Can Mere Exchange of Information Violate HSR?

"While parties have argued that their intent was merely to plan integration rather than to implement it, we do not think this distinction meets the requirements of the Act ...

When to-be-acquired firms release information that goes beyond due diligence ... they ... are jumping the starting gun that is supposed to be triggered by the expiration of the waiting period ...

we consider the release of information violates the HSR Act ... unless the acquired firm can show it would have provided such information to a firm other than the acquiring firm."

Gun Jumping

- HSR - Preserving the integrity of the regulatory process
  - may not implement the transaction until the waiting period has expired
  - absence of competitive concerns is irrelevant
- Preclosing activities between the parties when competitive issues exist
  - exchange of information in connection with the merger
  - covenants and provisions in the agreement of sale
  - preparation for start-up (closing) and integration

Business Needs

- Once announced, the deal should go through
  - usually this is even more important to the seller than to the buyer
- Value must be maintained and captured
- Start up must be smooth (effective)

Due Diligence and Integration

- The process of due diligence (value confirmation) and integration (value capture) is one continuous process
- Due diligence
  - confirms value
  - identifies what needs to be done for successful start up and integration
- Due diligence continues until closing but emphasis shifts from value confirmation to value capture
- Buyers need for information continues until closing

Exchange of Information

- Traditional rule of reason analysis
- Practitioners are comfortable and experienced in dealing with these issues
- Further guidance not needed
- Must recognize that need for information continues until closing

Covenants and Provisions in the Agreement of Sale

- Seller needs certainty that deal will go through
- Important to regulatory agencies that approved deals close
- "Ordinary course of business" covenant is not enough
- Conditions of closing are not a substitute
- Lack of specific covenants may cause less competitive vigor
- In evaluating covenants Gov't should consider the underlying business reality
- Covenants are typically arms length and carefully negotiated

Preparation for Start Up

- Activities prior to closing to facilitate an effective start up should be allowed unless they raise anti-competitive issues.
- Typical case -- information systems
- The business may never recover from a bad start up

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Merging Parties' Pre-Closing Conduct

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Overview

- Current business environment makes it especially important that acquisitions be well-planned and well-executed
- Business needs for thorough due diligence and rapid deal integration are legitimate, and should inform the antitrust analysis of pre-closing activities
- Planning for rapid post-closing integration is not about "closing early" but is about ensuring that the integration succeeds at all
- Well-counseled companies can operate in the current legal environment – but some efficient conduct may be impeded at the margin by overly-restrictive guidance
- The agencies can help by sticking to the fundamentals of the (distinct) Sherman Act Section 1 and HSR Act Section 7A analyses
- Practitioners can help by giving practical guidance based on those fundamentals and by avoiding cookbook solutions

Legitimate Pre-Closing Needs

- Due diligence
  - Good information is vital for deal selection and valuation
  - Distinguishing "necessary" vs. "unnecessary" information is elusive – more is usually better
  - But keeping competitively sensitive information out of competing personnel's hands can readily be done with some fairly simple steps
  - Proper legal focus here is Section 1 – not 7A
  - Section 1 analysis should usually require rule of reason approach, given presence of legitimate rationales

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Legitimate Pre-Closing Needs

- Integration Planning
  - Integration success or failure and ability to capture planned efficiencies can turn on fast post-closing integration of acquired business
  - Distinction between planning and implementation is important and is usually manageable in practice, with good guidance
  - Difficult questions often relate to information flow – buyer needs thorough understanding of target business, and may in some areas require involvement of buyer's business people who understand the issues
  - Business imperatives must be tempered by legitimate 7A concerns – and by concerns about agency distraction from substantive deal review/clearance

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Legitimate Pre-Closing Needs

- Ordinary Course Conduct
  - Buyer (and seller) have legitimate interest in fixing deal terms and preserving target's value pending closing
  - Sellers and their employees may have incentives (unrelated to competition on the merits) to deviate from the ordinary course and undermine value of the deal
  - Appropriate contractual restrictions on such non-ordinary-course activities should not be condemned simply because they relate to competitive activities – need to examine the facts and justifications
  - Question: What if the discounting in Computer Associates had clearly been outside the seller's ordinary course?

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Current Guidance

- From the Agencies
  - Several cases/consents, many reasonable on their face
  - Agency "gloss" has been more aggressive than the consents
  - Some tendency to blur Section 1 and 7A analyses
  - Potential for overly regulatory approach - is burden on the parties to justify any deviations from "no-deal" status quo? Or on the agencies to show the elements of a specific violation?

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Current Guidance

- From Practitioners
  - Unavoidable focus on agencies' consents, speeches in giving guidance
  - Clients' desire for simple do's and don'ts can lead to rigid advice
  - More fact-intensive case-by-case guidance is more useful, but costly and time-consuming
  - Antitrust counsel will appropriately focus on the big picture – the need to clear the deal – but this can result in an overly restrictive approach in order to avoid a gun-jumping sideshow

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Going Forward

- No crisis here – some complexity and need for judgment calls is probably inevitable
- Not a call for "more guidance" – but for adherence to a defined legal framework
- Agencies and practitioners should focus on fundamentals of distinct Section 1/Section 7A analyses:
  - Is there a per se Section 1 violation? Rare, given usual presence of justifications
  - Is there a rule of reason violation for improper information exchange? Real competitive analysis needed
  - Is there a transfer of beneficial ownership – giving rise to a 7A violation? Focus on HSR Act Statement of Basis and Purpose

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