Mergers and Acquisitions: Antitrust Limitations on Conduct Before Closing

By M. Howard Morse*

In recent years, the Federal Trade Commission (FTC) and Department of Justice (DOJ) have brought a number of antitrust enforcement actions challenging pre-closure conduct by firms proposing mergers, acquisitions, and joint ventures. Recent cases have attacked covenants restricting activities pending closing of proposed transactions as well as initial efforts to integrate operations and even exchanges of confidential information among parties proposing to merge. The government is proceeding on theories that such conduct is illegal “gun-jumping” and price-fixing. Federal officials have put the “fear of god” into merging entities through speeches raising the specter of even more aggressive enforcement actions. At the same time, there is tremendous pressure on business officials to make deals work by proceeding quickly to integrate operations and gain efficiencies from transactions.

This Article outlines the legal framework for analyzing pre-closing conduct by parties proposing to merge, under the Hart-Scott-Rodino Act,1 the Sherman Act,2 and the Federal Trade Commission Act.3 It also describes the conduct at issue in recent enforcement actions. The aim is to shed light on what is black, what is white, and what is gray in this confusing area of the law and to help firms to avoid becoming the next “poster child” for government enforcers. The Article concludes with practical guidelines for pre-consummation conduct.

THE HART-SCOTT-RODINO ACT

Corporate counselors should recognize that some pre-consummation coordination by merging firms may violate the Hart-Scott-Rodino Act and subject a firm and its officers and directors to civil penalties. The Act is procedural and applies whether or not a transaction raises substantive antitrust concerns.

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THE STATUTE—PREMERGER NOTIFICATION

The Hart-Scott-Rodino Antitrust Improvements Act of 1976, codified as section 7A of the Clayton Act and known as the HSR Act, established a premerger notification and waiting period procedure. The aim of the statute is to provide the FTC and the Antitrust Division of the DOJ, which share antitrust enforcement authority, information about planned transactions and a proscribed time period in which to analyze those acquisitions before they are consummated.

The statute provides that, if statutory thresholds for reportability are satisfied: “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...” Determining whether an HSR filing is required can be complex, with regulations issued under the statute filling more than fifty pages of the Code of Federal Regulations. Numerous formal interpretations and hundreds of informal interpretations have been issued over the last twenty-five years. Multi-volume treatises explain the details. Indeed, there are special rules for such situations as acquisitions of foreign assets or voting securities of a foreign issuer, limited liability companies, and secondary acquisitions. Specific rules govern such issues as how to value voting securities and assets to be acquired and the formation of joint ventures.

There are exemptions ranging from acquisitions of goods and really in the ordinary course of business, acquisitions of ten percent or less of an issuer’s voting securities solely for the purpose of investment, and intraperson transactions, to acquisitions by gift, intestate succession, or irrevocable trust. In general, however, as a result of amendments to the Act in late 2000, today transactions valued over $50 million must be reported. That threshold will be adjusted annually beginning in fiscal year 2005 for changes in the gross national product.

9. See 16 C.F.R. §§ 801.4, 801.31b, 802.40–50 (2002); Formal Interpretations, supra note 8, at No. 15.
10. See 16 C.F.R. §§ 801.4, 801.31b, 802.40–50 (2002); Formal Interpretations, supra note 8, at No. 15.
14. See id. Transactions valued up to $200 million are only reportable if a “size-of-person” test is also met. A transaction will generally satisfy that test if one of the parties has at least $100 million in total worldwide assets or annual net sales and the other party has at least $10 million in total worldwide assets or annual net sales (except that sales are ignored and the asset test must be met by target firms...
The government has explained that the purpose of the HSR Act is “to facilitate a prompt, thorough investigation of . . . acquisitions, and [to] assure[] the enforcement agencies an opportunity to seek a preliminary injunction before the parties to an acquisition are legally free to consummate it, reducing the problem of unscrambling the assets after the transaction has taken place.” 15 Before the Act was passed, antitrust enforcers were often unaware of proposed transactions before they were consummated, litigation challenging transactions dragged on for years, remedies were often ineffective, and businesses had no assurance that their transactions would not be challenged years later. 16

Today, when an acquisition is reportable, the HSR Act imposes an initial waiting period, which is typically thirty days, but is shorter for acquisitions in bankruptcy and for cash tender offers, and may be slightly longer when it would otherwise expire on a weekend or holiday. 17 The waiting period is often terminated early when a transaction does not raise serious antitrust issues. 18 On the other hand, transactions that may be anticompetitive may be delayed for months by issuance of a “request for additional information and documentary material,” known as a “Second Request.” 19 Such a request, typically a complex set of interrogatories and document requests, prevents consummation of the transaction until after the parties submit all of the information and documentary material required by such a request or a statement of reasons for noncompliance. 20

Failure to comply with the HSR Act may give rise to civil penalties of up to $11,000 per day “for each day” during which a person is in violation. 21 Those fines may be imposed on a firm and its individual officers or directors who fail to comply with the Act. 22

Because HSR violations are continuing violations, penalties assessed on a daily basis can quickly add up to substantial fines. Fines as high as $4 million have been imposed on a single company, 23 and fines as high as $5.6 million have been imposed in connection with a single transaction. 24 One individual officer was fined...
where the government found him personally culpable. On the other hand, the government generally has allowed “one bite of the apple” and has not sought civil penalties from companies that inadvertently fail to file and make a corrective filing as soon as the error is discovered, absent gross negligence by a sophisticated buyer that exercises a reckless disregard for its obligations under the Act.

In addition to civil penalties, if any person fails “substantially to comply” with the premerger requirements, a court may order compliance, extend the preacquisition waiting period until there has been “substantial compliance,” or grant “such other equitable relief as the court in its discretion determines necessary or appropriate.”

It is still an open question whether disgorgement—with even larger potential payments—is an appropriate remedy for violations of the HSR Act. The FTC has recently sought public comment on the use of disgorgement as a remedy for violations of the HSR Act, the FTC Act, and the Clayton Act. In doing so, the Commission said it was not re-examining the statutory authority to seek disgorgement in competition cases, but rather was soliciting comments on the factors the Commission should consider in applying this remedy and how disgorgement should be calculated, which suggests that the agency believes it has the authority to obtain disgorgement under the HSR Act. Nonetheless, while one district court decision has found that section 13(b) of the FTC Act vests the FTC with authority to seek disgorgement for violations of the FTC Act, no court has ever found that the HSR Act authorizes disgorgement. While the statute broadly authorizes “other equitable relief,” the fact that Congress expressly provided for a particular monetary remedy for a violation of the HSR Act may suggest that larger disgorgement payments should not be an available remedy.

Notably, the FTC recently settled one lawsuit, FTC v. The Hearst Trust, obtaining $19 million in disgorgement of allegedly unlawfully earned profits, after asserting a violation of the HSR Act and challenging an acquisition on the merits.

25. Blackstone Capital Partners, 1999-1 Trade Cas. (CCH) at 84,414 ($50,000).
27. 15 U.S.C. § 18a(g)(2) (2000). Only the DOJ, on behalf of the United States, may seek civil penalties, while either the FTC or the Assistant Attorney General for Antitrust may seek injunctive or other equitable relief. See id. § 18a(g)(1), (2).
29. Id.
30. See Krauss, supra note 26 (“An equitable remedy, such as disgorgement may remove the potential economic incentive that firms have to evade HSR compliance.”).
34. Civ. No. 01-00734 (D.D.C. Nov. 9, 2001) (final order and stipulated permanent injunction).
under section 13(b) of the FTC Act. The huge penalty should be a warning to potential violators of the HSR Act, but at the same time may not be too meaningful. The monetary recovery was to be distributed to injured customers as part of the settlement of a private class action suit alleging unlawful overcharges and may well have been available in the case even if there was no alleged HSR violation. At the same time, the government, in a suit filed by the DOJ, obtained $4 million in civil penalties for the HSR violation. The continuing controversy as to whether disgorgement should be obtained in this type of case is reflected in one FTC Commissioner’s dissent, arguing “a substantially higher civil penalty” could probably have been obtained and would not offset private damages as the disgorgement relief actually did.

Whether or not disgorgement will be available for HSR violations, potential civil penalties are substantial enough to encourage most companies to obey the law.

The Regulations—Focus on Beneficial Ownership

Neither the HSR statute nor regulations issued to implement it define the term “acquire” which triggers the Act. Its meaning, however, is not altogether obvious in all situations.

In fact, nearly identical language—“no person . . . shall acquire, directly or indirectly . . . .”—is in the substantive antitrust law. Section 7 of the Clayton Act provides that

*n*o person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.


Nonetheless, the two statutes are sometimes interpreted differently. Thus, entering into an exclusive license is considered an acquisition under both statutes.\(^{40}\) On the other hand, entering into a multi-year operating lease with an option to purchase has been considered an acquisition for purposes of section 7, but is not reportable under the HSR Act.\(^{41}\)

Regulations issued under the HSR Act impose filing obligations on “acquiring persons,” defined as “[a]ny person which, as a result of an acquisition, will hold voting securities or assets, either directly or indirectly, or through fiduciaries, agents, or other entities acting on behalf of such person . . . .”\(^{42}\) “Hold” in turn is defined to mean “beneficial ownership, whether direct, or indirect through fiduciaries, agents, controlled entities or other means.”\(^{43}\) Thus, any person that will be a beneficial owner as a result of an acquisition is an acquiring person. Reporting obligations under the statute are triggered by the planned transfer of beneficial ownership of voting securities or assets.

Although the regulations do not clarify the circumstances that give rise to beneficial ownership for HSR purposes, the government’s “Statement of Basis and Purpose” accompanying initial issuance of the HSR rules, points to attributes of ownership:

> 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 the right to obtain the benefit of any increase in value or dividends, the risk of loss of value, the right to vote the stock or to determine who may vote the stock, [and] the investment discretion (including the power to dispose of the stock).\(^{44}\)

The concept of beneficial ownership for HSR purposes overlaps with, but is not identical to, the definition promulgated by the Securities and Exchange Commission (SEC) for purposes of section 13(d) of the Securities Exchange Act.\(^{45}\)

Elsewhere, the “Statement of Basis and Purpose” makes clear reporting obligations may be triggered before a transaction is consummated: “The person or persons that have the benefits and risks of ownership of securities or assets ‘hold’


\(^{42}\) 16 C.F.R. § 801.2(a) (2002).

\(^{43}\) Id. § 801.1(c)(1) (emphasis added).


\(^{45}\) Id, see section 13(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m (2000). For instance, for purposes of determining beneficial ownership under the Exchange Act, a person holding or sharing the power to vote or direct the disposition of a security, or having a right to acquire a security within sixty days, is deemed to be a beneficial owner. Id. Thus a person holding an immediately exercisable option or warrant to acquire stock is a beneficial owner of the underlying stock for purposes of the Exchange Act, but not under the HSR rules. Similarly, an executor of an estate, a trustee of an irrevocable trust, or a person who in fact controls the beneficial owner of stock but does not have “control” within the meaning of the HSR rules, may hold stock for purposes of the Exchange Act but not the HSR rules.
those securities or assets, and persons that acquire beneficial ownership must report their ‘acquisition’ if the criteria of the act are satisfied.” On the other hand, the Act applies to acquisitions, not to offers or agreements to acquire. Thus the “Statement of Basis and Purpose” states that “the completion or consummation or ‘making’ of an acquisition refers to the closing date, or the date on which title is transferred, rather than to the date on which a contract, agreement in principle or letter of intent is signed.”

**ENFORCEMENT ACTIONS BASED ON PREMATURELY TRANSFERRING BENEFICIAL OWNERSHIP**

The FTC and DOJ have brought a number of cases and have obtained civil penalties on allegations that acquisitions were improperly “consummated” prior to notification and expiration of the required waiting period by transferring “beneficial ownership.”

In *United States v. Atlantic Richfield Co.*, 48 for instance, the government obtained a $290,000 civil penalty from ARCO and $150,000 from Sunseeds Genetics, Inc. in connection with an acquisition by Sunseeds of ARCO’s ARCO Seed subsidiary. ARCO had irrevocably granted the right to vote all of the subsidiary’s shares to Sunseeds, before filing under HSR, although fifty-one percent of the shares were placed with an escrow agent. Moreover, Sunseeds obtained the right to obtain interim earnings on the shares held by the escrow agent at the expiration of the HSR waiting period. The FTC alleged that Sunseeds had thereby acquired beneficial ownership of all of ARCO Seeds’ voting securities.

In another case involving ARCO, *United States v. Atlantic Richfield Co.*, 49 the government obtained a $1 million civil penalty from ARCO and $1 million from Union Carbide in connection with an ARCO acquisition of assets from Union Carbide. ARCO had paid the full “non-refundable” $220 million purchase price to Union Carbide on the day the acquisition agreement was executed. Union Carbide was “required to operate the business in the ordinary course and in accordance with its existing business plan” until consummation, and ARCO “was required to cover liabilities from the continued operation” of the assets and would benefit from any gains during the waiting period. 50 Under the terms of the acquisition agreement, if as a result of the HSR review, ARCO was prevented from acquiring the assets, a trustee would sell them with the proceeds paid to ARCO. The agencies rejected this apparent effort to shift antitrust risk to ARCO as a transfer of beneficial ownership, characterizing Union Carbide as only a “caretaker for ARCO,” and arguing the companies had “effectively consummated the acqui-
sition agreement by passing all benefits and risks of ownership to ARCO, thereby eliminating Union Carbide as an independent competitor."51

The agencies' position in these matters has been criticized. A leading American Bar Association (ABA) publication on the HSR Act, for instance, explains, "[w]hile the complaint [in ARCO/Union Carbide] sets forth a series of conditions which in the aggregate the agencies alleged to constitute a transfer of beneficial ownership, there is no indication, either in the complaint or in any other public statement, of which elements or combinations of elements alleged in the complaint were dispositive."52 The government continues to maintain that the transfer of beneficial ownership is to be determined in the context of particular cases, leaving uncertainty anytime some, but not all, of the various indicia of ownership are transferred.

**Enforcement Actions Based on Operational Control**

It now appears that additional considerations beyond traditional concepts of beneficial ownership are relevant to HSR enforcement decisions, even if the agencies invoke "beneficial ownership" language in their actions. Thus, a firm that takes "possession" or "control" or has "influence over the direction of the business" to be acquired in a transaction or holds itself out to customers and the public as having combined before the expiration of the applicable waiting period may be alleged to violate the HSR Act. Because there are no litigated decisions to date, the precise scope of allowable conduct, however, remains unclear.

If the power to set prices, select customers, or specify product lines—that is, control over key competitive variables—is transferred from one company to another, such transfer of operational or managerial control would likely increase HSR exposure. That is true even though those characteristics may not enter into a traditional determination of beneficial ownership. Moreover, even though partial economic integration through contract—such as distribution arrangements, subcontracting, joint bidding, and the like—has not historically been viewed as an

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52. Premerger Notification Practice Manual, supra note 8, at Interpretation 69; see also William Blumenthal, The Scope of Permissible Coordination Between Merging Entities Prior to Consummation, 63 Antitrust L.J. 1, 43 (1994).
acquisition of assets or voting securities within the meaning of the statute, such integration in connection with a merger before the expiration of the HSR waiting period may be viewed with suspicion and undergo close scrutiny.

The DOJ has specifically articulated the position that “local marketing agreements” (LMAs) or “time brokerage agreements,” by which radio station owners/licensees transfer the right to sell advertising and arrange programming, entered into in connection with an acquisition, “may prematurely transfer beneficial ownership” and require an HSR filing.53 The agencies recognize that LMAs “outside the context of an acquisition” are analogous to management contracts and would not violate the HSR Act.54 The agencies reason that when such an LMA expires, the station owner may operate the station himself or enter into an LMA with someone else. An LMA entered into in connection with an acquisition, however, “transfers operating control of the assets or business before expiration of the HSR waiting period.”55

The FTC and DOJ have, in recent years, challenged companies acquiring possession and operational control of assets covered by reportable transactions before expiration of the HSR waiting period as transferring beneficial ownership of those assets.

The first such case was United States v. Titan Wheel International, Inc.56 There, the government obtained a $130,000 civil penalty when Titan Wheel took control of assets before obtaining HSR clearance, despite the fact that the transaction posed no apparent antitrust issues and was cleared within days of filing. The asset purchase agreement at issue transferred control of one Pirelli Armstrong Tire Corporation agricultural tire plant, including inventory, machinery, equipment, and customer and supplier lists to Titan immediately. Alleging that the companies had transferred “possession and operational control,” with the effect of “transferring beneficial ownership,” the government insisted upon the maximum civil penalty in the case even though the transfer was subject to unwinding in the event the acquisition was not consummated.57

In 1998, in United States v. Input/Output,58 the buyer and seller each agreed to pay a $225,000 civil penalty to resolve charges that they failed to observe the HSR waiting period. The FTC alleged that the firms effectively jumped the gun, by allowing the acquiring firm to exercise operational control before the HSR waiting period had expired. The FTC alleged that the companies integrated their personnel and operations and held out the company as integrated to the public. Specific conduct identified in the government’s complaint included:

54. Id.
55. Id.
58. 1999-1 Trade Cas. (CCH) ¶ 72,528 (D.D.C. 1999).
The acquiring firm circulated an internal memorandum announcing a reorganization, effective immediately, which assigned personnel of the acquired firm to positions within the company.

Personnel of the acquired firm moved into the acquiring firm’s offices, received e-mail addresses and access to the acquiring firm’s internal reports, and were given business cards with titles in the acquiring firm which were distributed to customers.

Phones in the acquired firm’s offices were answered under the acquiring firm’s name.

The president of the acquired firm traveled on behalf of the acquiring firm to resolve a commercial dispute with a customer, and was consulted and asked to review and comment upon the possible acquisition by the acquiring firm of another company.59

Explaining the case at the time, the FTC Bureau of Competition Director said:

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 business information for purposes other than due diligence inquiries—are inconsistent with the purposes of the HSR Act and will constitute a violation.60

It is now clear that it is the government’s position, at least, that merging firms shifting control through management contracts and integrating operations before the expiration of the HSR waiting period, when an acquisition is contemplated, will be considered an HSR violation. The suggestion that transferring confidential business information by itself may violate the HSR Act seems to be on particularly shaky ground, and no enforcement action has been based on exchange of confidential information without much more questionable conduct.

Most recently, in September 2001, in United States v. Computer Associates International, Inc.,61 the DOJ alleged violations of both the Hart-Scott-Rodino Act for “gun-jumping” and the Sherman Act for price fixing based upon covenants in a merger agreement between Computer Associates International, Inc. (CA) and Platinum technology International, inc. (Platinum) and conduct by the companies before closing.62

The DOJ specifically alleged the merger agreement “prevented Platinum from undertaking certain competitive activities during the HSR waiting period without

Mergers and Acquisitions: Antitrust Limitations on Conduct Before Closing

CA's approval, including determining the prices and terms it would offer to its customers. The HSR gun jumping count alleged that CA "exercised unlawful control" over Platinum by:

- installing CA employees at Platinum headquarters to review and approve contracts;
- restricting Platinum's rights to grant discounts without approval;
- limiting Platinum's rights to negotiate contract terms without approval;
- limiting Platinum's rights to enter into fixed-price contracts;
- limiting rights to offer certain services without approval;
- collecting and disseminating competitively sensitive information; and
- making day-to-day management decisions, including decisions relating to recognition of revenue and participation at industry trade shows.

The actions challenged in this matter, unlike the previous enforcement actions, arguably did not involve steps aimed at taking control over the business to be acquired, but rather were actions aimed at preserving the value of the business to be acquired. Nonetheless, the actions gave CA substantial control over key competitive aspects of Platinum's business.

CA issued a press release in response to the DOJ complaint, arguing its actions were "consistent with the law" and were "essential in order to protect the assets" of Platinum. CA also noted that the provisions were virtually identical to provisions used in previous acquisitions. Nonetheless, in April 2002, CA agreed to pay $638,000, approximately half of the maximum civil penalty, to resolve the alleged HSR violation. In a "Competitive Impact Statement," the DOJ explained its view that merging parties must remain "separate and independent economic entities" and "an acquiring person may not, after signing a merger agreement, exercise operational or management control of the to-be-acquired person's business." The DOJ further clarified that "ordinary course" covenants requiring companies to operate businesses in the ordinary course do not violate the HSR Act. Indeed DOJ advised that "customary provisions" restricting business actions "reasonable and necessary" to protect the value of a transaction, such as limits on declaring dividends, issuing securities, amending organizational documents, making acquisitions, mortgaging property, making tax elections, discharging liabilities outside the ordinary course, and commencing lawsuits other than routine collection of bills, were not considered HSR violations. Restrictions on "new large capital expenditures" were also considered customary.

In light of this enforcement action, businesses should be advised that antitrust counsel ought to review covenants in merger and acquisition agreements restrict-

64. Id. at 13.
66. Id.
68. Id.
ing conduct pending closing if those covenants go beyond general restrictions limiting the acquired firm to operating its business “in the ordinary course of business.” One possible course of action may be to turn restrictive covenants into conditions precedent to closing that give a buyer the right to “walk” rather than consummate the transaction, but which do not restrict the conduct of the business pending closing. Such an approach leaves the decision whether to abide by such restrictions in the seller’s hands, and thus should avoid any HSR violation while still allowing the buyer the right not to consummate the transaction, and perhaps to obtain a break-up fee or liquidated damages, if it determines that the value of the business has deteriorated as a result.

**INFORMATION EXCHANGE**

One of the gray areas in the law is whether the mere exchange of information for purposes of planning integration may violate the HSR Act. FTC officials have suggested that exchanging confidential information before the expiration of the HSR waiting period may violate the HSR Act as an exercise of control.

One Director of the FTC Bureau of Competition took the controversial position in a 1998 speech that:

> When to-be-acquired firms release information that goes beyond due diligence because they are told to do so by their future bosses, they and their bosses are jumping the starting gun that is supposed to be triggered by the expiration of the waiting period . . . . 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 . . . . Absent special circumstances, we consider that the release of information violates the HSR Act even when the acquired firm maintains its release is voluntary, unless the acquired firm can show that it would have provided such information to a firm other than the acquiring firm.70

The government has expressed concern that release of confidential business information to the buyer can prejudice antitrust relief, even when a consent order requires divestiture of only a single product. The government is also concerned that information that is exchanged for the purpose of planning can also increase interim competitive harm. Officials have suggested, for example, that the existence of a corporate integration plan can induce critical employees to leave during the waiting period, and thereby lessen competition. This argument, however, ignores the fact that uncertainty from the absence of an integration plan can also cause critical employees to find other jobs. According to FTC officials, the agency has at times even obtained agreements from parties to cease exchanging information and to return all documents containing confidential business information that

was not being used either for due diligence or for negotiating a consent order with the Commission.71

Notably, information exchange allegations were among the elements of control alleged in Input/Output and Computer Associates, discussed above. It seems doubtful that exchange of information by itself for purposes of planning integration, if undertaken subject to confidentiality restrictions, would support an action for civil penalties under the Act.72 Indeed, in its “Competitive Impact Statement” in Computer Associates, DOJ noted CA obtained Platinum’s competitively sensitive information, emphasizing it did so “without any restrictions as to its use or its dissemination within CA.”73 Nonetheless, until repudiated, the government speeches will continue to create uncertainty in this field.

A final note of caution with respect to the HSR Act bears repeating. That Act is procedural and applies to premerger consolidation even when merging parties are not competitors or a transaction does not raise substantive concerns. Where a transaction does raise substantive concerns, pre-consummation activities that are regarded as inappropriate are likely to complicate efforts to obtain agency clearance to complete the transaction.

THE SHERMAN ACT AND FTC ACTS

Pre-consummation conduct must also be examined under the lens of the Sherman Act and FTC Act as they bring different limitations into play. Section 1 of the Sherman Act makes illegal every “contract, combination . . . or conspiracy in restraint of trade,”74 and the Federal Trade Commission Act prohibits “unfair methods of competition.”75

The limitations under these statutes apply whether or not an acquisition is reportable under the HSR Act, and even after expiration of the HSR waiting period, until the transaction is consummated.

PREMERGER COORDINATION

The DOJ has plainly taken the position that “the pendency of a proposed merger does not excuse the merging parties of their obligations to compete independently.”76 Thus, the DOJ asserts, activities by one party to control or affect decisions of another with regard to price, output or other competitive variable may violate the Sherman Act.77 FTC Bureau of Competition officials have similarly

71. Id.
72. See also John M. Sipple, Jr., Gun Jumping and Exchanges of Competitively Sensitive Information, ABA CORP. COUNSELING REP. (Corporate Counseling Committee, ABA Section of Antitrust Law), Winter 2000, at 6 (“[I]t is difficult to conceive of a case that would rise to the level of transferring sufficient indicia of beneficial ownership to constitute a violation of the HSR Act.”).
73. 67 Fed. Reg. at 41,479.
75. Id. § 45.
77. Id.
asserted that "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." Thus, until consummation, naked price fixing agreements, agreements to limit output, allocate customers, divide markets, and similar agreements between competitors or potential competitors are—in the government’s view—per se illegal.

The case law is a bit less clear. In *International Travel Arrangers v. NWA, Inc.*, the U.S. Court of Appeals for the Eighth Circuit upheld a jury instruction that merging parties are incapable of a Sherman Act conspiracy if the jury decided the merging parties “lacked [the] independent economic consciousness after they had decided to merge and before the merger was completed.” The court rejected the view that “only the formal consummation of a merger precludes the application of section 1 of the Sherman Act to an alleged conspiracy between the merging companies.” The court reasoned that while the firms' interests were previously divergent, “that situation completely changed once the merger was agreed upon.”

Under Supreme Court precedent, the only clear role is that a firm cannot be found to conspire with its wholly-owned subsidiary. The Court's reasoning only protects firms that have a “complete unity of interest.” The Court's reasoning is that because a parent may assert full control at any moment if its subsidiary fails to act in its best interest, a parent and its wholly-owned subsidiary always have the unity of purpose or common design that underlies a section 1 agreement, and the idea of an agreement in Sherman Act terms therefore lacks meaning. That reasoning is arguably not applicable before consummation.

The FTC has brought two enforcement actions to date on the theory that companies must continue to compete up until closing, both of which were settled. In 1991, in *In re Torrington Co.*, the FTC accepted a consent order, resolving charges challenging premerger coordination between Torrington and Universal Bearings, Inc. during the pendency of an HSR investigation. Torrington and Universal abandoned their proposed merger after the Commission voted to challenge it. In the interim, however, the president of Universal, knowing that Torrington planned to consolidate production of axle shafts in a Torrington plant after consummation of the proposed merger, told customers that they should purchase product from Torrington and refused to quote to them.

79. Id.
81. Id. at 1397.
82. Id. at 1398.
83. Id.
85. Id. at 771.
86. Id. at 771-72.
Universal believed that sending customers to Torrington would “speed up” the consolidation and “keep the business in the family.”

The FTC charged that Torrington and Universal engaged in per se illegal customer allocation. The FTC Consent Order was narrowly tailored to limit activity in connection with future acquisitions in the same market, prohibiting “directing, implementing or otherwise providing for any consolidation of the business or assets . . . to be acquired and the acquiring person prior to the consummation of the proposed acquisition.”

The FTC followed the Torrington case in 1998, when it charged a title company with violating section 5 of the FTC Act by entering agreements with customers setting prices, terms, and conditions for title services to be “jointly provided” by the title company and a prospective joint venture partner, “pending formation of a joint title plant entity.” The FTC alleged that the effect of that conduct was to increase prices and restrict output in the market, and that the conduct constituted a “combination, agreement, or understanding between competitors to raise, fix, and maintain the price, terms and conditions of compensation paid for title plant services.”

Most recently, in the Computer Associates matter discussed above, the DOJ alleged a violation of the Sherman Act as well as the Hart-Scott-Rodino Act. The Sherman Act price fixing count was based primarily on allegations that CA and Platinum agreed that Platinum would not offer its customers discounts greater than twenty percent off list price unless CA agreed in writing to a larger discount.

The central focus of the DOJ’s complaint was “conduct of business” covenants that the DOJ maintained are not normally found in merger agreements and severely restricted Platinum’s ability to engage in business as a competitive entity independent of CA’s control. The DOJ did not object to a merger covenant that required Platinum to carry on its business “in the ordinary course in substantially the same manner as heretofore conducted.” But the DOJ did object to merger agreement provisions that prohibited discounts, limited customer contracts to an agreed-upon “standard” contract, prohibited long-term service contracts at fixed prices, and barred Platinum from offering certain specific services, without CA’s permission.

The DOJ alleged that Platinum modified its ordinary discounting and contracting practices and CA installed one of its vice presidents at Platinum’s headquarters to review and approve customer contracts. The DOJ also alleged that CA made day-to-day management decisions for Platinum, including how the company rec-

88. Id. at 284.
89. Id. at 286, 287.
91. See id. at 24,340.
92. See supra note 61.
93. Id.
95. Id. at 41,476-78.
ognized revenue, and "reviewed competitively sensitive information about Platinum's customers and business strategy." The DOJ reasoned that the limitation on Platinum's right to set price and the actions to effectuate that agreement were "extraordinary and not reasonably ancillary to any legitimate goal."

In April 2002, CA agreed to resolve the DOJ Sherman Act charges by entering into a consent order. That order will prohibit CA in future acquisitions from agreeing on prices, approving customer contracts, and misusing competitively sensitive bid information. The order will, however, allow CA to:

- agree with firms to be acquired to continue to operate in the ordinary course of business consistent with past practice;
- condition transactions on a requirement that the to-be-acquired firm not engage in conduct that would cause a material adverse change;
- conduct reasonable and customary due diligence; and
- agree on price in buyer/seller transactions and to submit joint bids where such agreements would be lawful in the absence of the proposed transaction.

The consent order is quite explicit that in conducting due diligence, pending bid information may only be obtained from a competitor: (1) to the extent bids are material to understanding future earnings and prospects, and (2) pursuant to a non-disclosure agreement that limits use of the information, and (3) prohibits disclosure to employees directly involved in the marketing, pricing or sales of the competing business. With respect to non-material bids, DOJ suggests firms must use an independent agent to collect information and present it in an aggregated or other form that shields customer specific and other competitively-sensitive information.

The DOJ order curiously is limited to restricting conduct between signing of an acquisition agreement and the earlier of (1) expiration or termination of the HSR waiting period or (2) closing of the transaction. Since the Sherman Act restrictions are independent of the HSR Act, firms should nonetheless be advised not to fix prices even after termination of the HSR waiting period.

While CA might have defended the DOJ suit on the grounds that (1) merging firms are not independent actors, and (2) the agreement should be analyzed under the rule of reason because it was intended to preserve the business to be bought, was ancillary to the acquisition agreement, and was not a naked agreement to limit price competition, the government's position makes entering into similar agreements risky. Ad hoc agreements, such as that in Torrington, face even greater risk because it is difficult to characterize them as ancillary to the acquisition agreement.

97. 67 Fed. Reg. at 41,478
98. Id. at 41,474, 41,476, 41,479-80.
99. Id. at 41,474, 41,479-80.
100. Id. at 41,479.
101. Id. at 41,474.
In light of the Computer Associates enforcement action, as noted above, covenants in merger agreements beyond general restrictions limiting the acquired firm to business in the ordinary course or prohibiting material changes in operations should be scrutinized by antitrust counsel. In particular, counsel should be aware that price fixing charges may be brought based on covenants that restrict the acquired firm’s ability to discount prices or require the acquiring firm to approve agreements by the acquired firm with respect to products or services where the firms compete.

**Premerger Exchanges of Information**

Antitrust officials have articulated several concerns arising from exchange of information among firms during merger and acquisition negotiations, due diligence, and integration planning. Those concerns can be put into three broad categories: (1) sham merger negotiations may be used to exchange confidential commercial information or otherwise coordinate activities anti-competitively; (2) one firm may enter into negotiations to obtain confidential information for predatory purposes even if the other firm enters negotiations in good faith; and (3) exchange of information during the course of legitimate merger discussions may lead to coordinated interaction, or lead a firm that obtains information to raise prices, knowing for example that it did not need to price so low to win business. These concerns may arise during the pre-consummation period or afterwards if the transaction is abandoned or blocked, or a business is divested.

It is not difficult to understand the reasoning of the first case, involving sham merger negotiations designed to cover an illicit information exchange. Proving such a case, however, is likely to be difficult in practice. Similarly the second case, where one firm uses sham negotiations to obtain confidential information of a competitor, may be predatory, at least if that firm has monopoly power. It is the third case, which raises the most common concern and requires balancing of legitimate business justifications and potential anticompetitive effects under the rule of reason, that is most challenging.

**The Enforcement Debate**

FTC officials in the early 1990s gave a number of speeches suggesting information exchanges during the course of merger negotiations should be limited for
the reasons discussed above. The position was widely criticized. Assistant Attorney General James Rill, for instance, said he would be very concerned about overreaching in that area . . . [unless] we had proof that the whole deal was a sham . . . . But again, because of the downside risk of overreaching, we would have to be quite convinced that there was evidence that the activity was other than honestly industrial before we would take an interest in it.

It has also been argued that enforcement against legitimate information exchanges may chill the market for corporate control, which must operate efficiently to restructure and keep U.S. industries competitive.

The Case Law

Supreme Court precedents recognize that information exchanges can be used by firms as a facilitating practice, which makes coordinated interaction more likely. Under these precedents, exchanges of information must be judged under the rule of reason. An information exchange will be allowed where there is a legitimate business justification and neither its purpose nor effect is to stabilize prices.

In United States v. Container Corp. of America, the Court held that continuous and ongoing exchanges of recent sales prices among manufacturers of corrugated containers was unlawful. The Court reasoned that the industry was highly concentrated and the exchange had the effect of stabilizing prices and “chilling the vigor of price competition.” Subsequently, in United States v. United States Gypsum Co., the Supreme Court reasoned that the “exchange of price data and other information among competitors does not invariably have anticompetitive effects; indeed such practices can in certain circumstances increase economic efficiency and render markets more, rather than less, competitive.” The Court held that “the structure of the industry involved and the nature of the information exchanged are generally considered in divining the procompetitive or anticompetitive effects of this type of interseller communication.”
Considerations Under the Rule of Reason

There are two legitimate business justifications for exchange of information among firms contemplating a merger or acquisition that must be taken into account under the “rule of reason”: (1) legitimate due diligence, i.e. evaluating the seller’s business in order to determine a purchase price and confirm that valuation, and (2) planning efficient integration of the firms after consummation. Some have argued that information exchanges should be allowed where “reasonably necessary” to value the transaction or to effect an orderly transition, as long as appropriate security and confidentiality is afforded the information. The problem for corporate counsel is that there are few bright lines under the rule of reason, only a balance of procompetitive justification and anticompetitive risks.

The structure of the industry has to be a key factor in a rule of reason analysis. Coordinated interaction is likely to be a greater concern in highly concentrated markets with high entry barriers, otherwise susceptible to collusion. These factors are similar to those analyzed in determining whether the proposed transaction is itself anticompetitive, and therefore information exchanges should not present serious concerns where the underlying transaction is approved. Logic therefore suggests that information exchanges should present the greatest concern when undertaken with respect to aspects of transactions ultimately challenged as likely to lessen competition or when merger negotiations break down and proposed transactions are abandoned.

Similarly, the type of information exchanged should be an important consideration in the analysis. Current and future information is more likely to be problematic than historical information. Customer specific pricing, cost, and margin information are often the most sensitive, though what information is competitively significant often varies by industry. Customer identity, product development plans, and trade secrets may be sensitive in some industries, while in others price information may be widely known and will not be sensitive. Wherever sensitive information is exchanged, there should be a demonstrable need for the information.

Precautions or safeguards adopted to prevent unlawful collusion should also be relevant to the rule of reason analysis. The recent Computer Associates consent offers guidance with respect to the most sensitive information, pending bid information. As the DOJ explained in its “Competitive Impact Statement,” antitrust

112. See Loftis & Forch, supra note 105, at 11; Graphics Prods. Distsribs. v. Itek Corp., 717 F.2d 1560, 1573 (11th Cir. 1983). But see Kevin J. Arquit, FTC Bureau Director Clarifies Premerger Exchanges of Information, ANTITRUST, Fall/Winter 1990, at 48 (“The existence of a valid efficiency rationale (e.g., the need to value a transaction) is only one component of the full rule of reason evaluation.”).


115. Id. at 503 n.86, 509.
exposure can be limited by operating under a confidentiality agreement restricting distribution and use of information.\textsuperscript{116} Access to sensitive confidential information might be provided only to planning staff or executives involved in negotiating or approving the transaction, non-operational people, and outside advisers, restricting operational personnel in competing businesses from access to sensitive information. Limiting the most sensitive information only to outside consultants, accountants or attorneys, who aggregate customer specific and product specific data before providing it to company officials, may be the safest approach. Limiting exchanges of the most sensitive information until late in the due diligence process when a transaction is more certain may also at times be a reasonable accommodation of competitive concerns and legitimate needs for information.\textsuperscript{117}

Any confidentiality agreement should provide that confidential information should not be used for any purpose other than in relation to the transaction itself,\textsuperscript{118} and should also provide that documents should be returned or destroyed if the merger is not consummated. Confidentiality agreements may create a “firewall” between individuals authorized to review information and others that have operational responsibility in the event that the transaction is not consummated or the subject business is divested.

In most transactions, due diligence information should flow from seller to buyer, but not from buyer to seller. Mutual exchanges of information warrant more scrutiny than one-way provisions of information. Unless the transaction is structured so that part of the consideration is stock of the acquiring company or as a merger in which shareholders of both companies will obtain an interest in the combined company, the flow of information should be one-way. Similarly, repeated exchanges of information are more likely to be questioned than one-time exchanges.\textsuperscript{119}

After a deal is valued and agreed to in principle, there is likely less justification for the exchange of due diligence information, though some exchange may still be reasonably necessary to assure that assets are not wasted and the target is continuing to operate in the normal course. Antitrust risk, however, can be minimized by considering these issues in advance, and establishing procedures for revaluing the transaction, using independent consultants to monitor events during the intervening period.\textsuperscript{120}

Integration planning may provide a valid rationale for continuing exchanges of confidential information, especially regarding such topics as information technology or accounting systems and human resources, which are essential to integration and raise little competitive concern. Despite pressures on business officials

\textsuperscript{116} 67 Fed. Reg. at 41,479.
\textsuperscript{117} See Steptoe, Remarks Before the ABA, supra note 78, at 49,032-33; Steptoe, Remarks Before the ABA, supra note 102, at 12; Arquit, Remarks Before the ABA, supra note 102, at 13.
\textsuperscript{119} See Steptoe, Remarks Before the ABA, supra note 102, at 11-12; Arquit, Remarks Before the ABA, supra note 101, at 11-13.
\textsuperscript{120} See Loftis & Forch, supra note 105, at 12.
to speed up the consolidation, integration planning is less likely to be as convincing a rationale for exchanging competitively sensitive information as due diligence, particularly if the integration can be delayed at minimal cost. While unilateral integration planning should be uninhibited, exchange of information with respect to how manufacturing facilities will be rationalized, which products may be dropped or repositioned, and how products will be priced is likely to be most sensitive. Nonetheless, with precautions restricting use and access to information, integration planning should be permissible.\footnote{121}

In sum, standards for allowable information exchange are not black and white, but rather vary according to market conditions, the sensitivity of the information to be exchanged, safeguards adopted, and the need for the information.

**Recent Enforcement Action**

After talking about information exchange issues for years, in 1998, in *In re Insilco Corp.*,\footnote{122} the FTC charged that the transfer of competitively sensitive information about customers, prices and costs, between firms proposing to merge, in advance of the purchase, was likely to lessen competition in the highly concentrated markets at issue and violated the FTC Act. Notably, the underlying transaction at issue was not reportable under the HSR Act and the FTC required a post-consummation divestiture. At the same time, the FTC alleged that:

[p]rior to the consummation . . . , Insilco requested and received . . . Non-Aggregated, Customer-Specific Information all of which is the type of information that would likely have been detrimental to competition in the relevant markets if the Acquisition had not been consummated . . . [including] descriptions of prior customer negotiations; detailed customer-by-customer price quotes; current pricing policies and strategies; and detailed, customer-by-customer future pricing strategies.\footnote{123}

The FTC alleged that, but for the acquisition, such information exchange “may have detrimentally affected competition . . . “\footnote{124}

The FTC “Analysis of Proposed Consent Order to Aid Public Comment” in *Insilco* reveals that the information exchanged in that matter included “current and future pricing plans” and “price formulas.”\footnote{125} Significantly, there was no indication that the information was exchanged pursuant to a confidentiality agreement. Moreover, the Commission took the position that the information transfer was “particularly harmful” because the affected markets were duopolies, emphasizing that “the transfer of such competitively-sensitive information in such highly concentrated markets violates Section 5.”\footnote{126}

\footnote{121. See Blumenthal, supra note 52, at 56-57; Steptoe, supra note 78, at 49,032.}
\footnote{122. 125 F.T.C. 293 (1998).}
\footnote{123. *In re Insilco Corp.*, Complaint, 125 F.T.C. 293, 294-95 (1998).}
\footnote{124. Id.}
\footnote{126. Id.}

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\textit{Mergers and Acquisitions: Antitrust Limitations on Conduct Before Closing} 1483
Proposed Consent Order to Aid Public Comment” surprisingly asserts that the exchange of such information would “likely harm competition in any market.”

Under the FTC consent order, Insilco is prohibited from obtaining or providing, without specific safeguards:

• customer-specific price and cost information;
• current or future pricing plans; or
• current or future strategies or policies relating to competition; and
• analyses or formulas used to determine costs or prices absent aggregation, for twenty years in connection with acquisitions of firms competing in the relevant markets, and for ten years in connection with acquisitions of firms competing in any markets in which Insilco competes. The order specifically allows the exchange of information to an “independent agent” not regularly employed by the company that does not have responsibility for pricing, who can then provide aggregated information to the company.

The DOJ allegations in Computer Associates, discussed above, include claims CA reviewed competitively sensitive information about Platinum’s customers and business strategy though it appears those allegations support the price fixing charges and not an independent claim that the exchange of information was unlawful.

Certainly, what is permissible in terms of information exchange remains a large gray area, requiring counsel to balance due diligence and integration planning justifications against potential anticompetitive concerns on a case-by-case basis.

**PRACTICAL GUIDELINES FOR PRE-CONSUMMATION CONDUCT**

The following general guidelines for pre-consummation conduct identify both prohibited and permissible conduct. The guidelines, which leave a large gray zone, is based upon both the recent case law and agency pronouncements discussed above.

The general rule is that companies must remain separate and independent until closing. Integration planning is permitted, subject to limits on exchange of information. Transition teams may collaborate on developing plans for post-closing integration of operations. Actual integration, coordination of business operations,

127. Id. (emphasis added).

128. See Insilco Corp., Complaint, supra note 123, at 306-07 (Order ¶V). Other FTC cases reflect a similar concern about access to information, in different contexts. See, e.g., In re General Elec. Co., 99 F.T.C. 422, 428-29 (1982) (requiring return or destruction of documents and prohibiting use of information learned while GE had a partial ownership interest in firm required to be divested); see also In re PacifiCorp (FTC File No. 971-0091, consent accepted for public comment Feb. 18, 1998) (limiting access to proprietary information to resolve vertical concerns); In re Boeing Co., 123 F.T.C. 812 (1997) (limiting access to proprietary information to resolve vertical concerns); In re Raytheon Co., 122 F.T.C. 94 (1996) (limiting access to proprietary information to resolve vertical concerns); In re Martin Marietta Corp., 117 F.T.C. 1039 (1994) (limiting access to proprietary information to resolve vertical concerns).

129. See supra note 61.
and direction of, oversight over, or involvement in the other firm’s business affairs, however, is prohibited.

**PROHIBITED CONDUCT**

1. Do not coordinate pre-consummation activities. Do not direct or participate in day-to-day decision-making about the other firm’s business affairs. Do not take possession or control of any assets or businesses of the other firm.

2. Do not hold out employees of one firm as being with the other to customers or the public. Do not use new business cards, answer telephones by reference to other company, or use one company’s logo with the other company’s products or literature. Do not relocate employees, give employees of one firm office space in other’s facilities, or have employees of one firm report to employees of the other.

3. Do not accept or provide information that is not reasonably necessary for legitimate due diligence or integration planning purposes. Shield or aggregate competitively sensitive information.

4. Merging firms should not:
   - discuss or exchange information regarding customers, distributors, pricing policies, pricing formulas, prices or other terms of sale, business or marketing plans, bidding or other sales solicitation activities, costs or cost structures, profit margins, profitability targets, proprietary technologies, pending or planned research and development (R&D) or product development efforts, except as provided below.
   - agree on, coordinate, or otherwise discuss past, present or planned competition between them, outstanding or prospective competitive bids, pricing, discounts or other terms under which either company might offer its products or services in competition against the other company.
   - agree on, coordinate, or otherwise discuss current product development efforts.

5. Examples of the above rule include: no agreement that only one company will compete for business when both normally might do so; no agreement on the price or other terms either company may offer customers; no agreement or discussion regarding either company’s withdrawal or change in any outstanding bid; no agreement or discussion regarding either company’s changing the manner it is now servicing or dealing with any existing customer; and no agreement or discussion regarding current product development efforts.

6. Personnel should not disclose to personnel of the other company proprietary information that would not ordinarily be disclosed to the public or to the other company (e.g., pricing and other commercial terms, costs, development plans, customer lists, marketing intentions, and business plans), except through designated due diligence and transition teams subject to confidentiality strictures.

7. Even after all regulatory clearances are obtained, there should be no agreement or understanding with regard to price or customers to be served, until after closing.
PERMISSIBLE CONDUCT

1. Due diligence and transition teams may exchange information required for legitimate purposes subject to confidentiality strictures, using of independent consultants to aggregate competitively sensitive information or a “clean team.”

2. Transition teams may collaborate on developing plans for post-closing integration of operations. This may include collection of otherwise prohibited information for the purpose of making decisions about immediate post-closing plans, including:
   - evaluation of employees for purpose of making decisions regarding post-closing personnel assignments, combined staffing needs and related matters, and communications about post-merger employment prospects, staffing arrangements, and related matters;
   - evaluation of facilities, equipment, information and other operational systems, distribution arrangements, and products for purposes of planning post-merger consolidation;
   - evaluation of environmental and other existing liabilities, employee benefits, tax and other financial or related aspects of the business for purposes of planning post-merger corporate organization, and related matters.

3. Personnel may jointly or separately meet with customers for purposes of (a) introduction; (b) generally explaining the contemplated transaction; (c) discussing post-closing plans; and (d) otherwise explaining how the transaction may benefit customers. On the other hand, it is not okay to make joint calls on customers to sell products or services.

4. More flexibility and broader areas of information exchange for purposes of integration planning may be permissible with regard to parts of the business as to which there is no existing or prospective competition between the firms or no impact on consumers in the United States.