The Do’s and Don’ts of Premerger Coordination
By Peter J. Levitas and Ross Wolland

I. Introduction

On November 7, 2014, DOJ announced a settlement with two parties, Flakeboard America Limited and SierraPine, to resolve claims that they illegally coordinated their businesses while Flakeboard’s acquisition of SierraPine’s assets was under Hart-Scott-Rodino (HSR) Act review.\(^1\) Flakeboard and SierraPine each agreed to pay $1.9 million dollars for “gun-jumping” violations under the HSR Act and Flakeboard agreed to pay an additional $1.15 million for illegal agreements with SierraPine under Section 1 of the Sherman Act.\(^2\) Finally, both parties agreed to 10-year behavioral restrictions, including development of antitrust compliance programs, designating antitrust compliance officers, and submitting annual compliance reports to DOJ.\(^3\)

This case serves as another reminder that the antitrust laws continue to apply in full force during all phases of the premerger process, from consideration of a transaction all the way through the final phases of agency review. Transacting parties must remain independent and continue to treat each other as competitors prior to closing.

But how do merging competitors, who must coordinate and share information in order to facilitate the transaction, do so without suffering the same fate as Flakeboard and SierraPine? Below is a general framework for approaching these issues and a list of “Do’s and Don’ts” which provide some initial guidance to limit the chances that your company will face enforcement action or private litigation as a result of pre-closing activity.

II. The Risks Inherent in Premerger Coordination

Pre-merger coordination creates two distinct categories of potential liability: (1) premature control (or “gun jumping”), in violation of Section 7A of the HSR Act, and (2) illegal restraint of trade under Section 1 of the Sherman Act. Only competitors are at risk of Section 1 liability, but all companies, even those acquiring non-competing assets, may be at risk under Section 7A.

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(A) Premature Control or “Gun Jumping”

Under the HSR Act, parties may not consummate a reportable transaction without making an HSR filing and observing the statutory waiting period. Moreover, a party need not actually close the transaction to run afoul of the HSR Act. By its terms, the HSR Act prohibits acquiring parties from gaining “beneficial ownership” of the target company prior to expiration or termination of the applicable waiting period. While the HSR Act and its implementing regulations do not provide a definition of beneficial ownership, enforcement actions focus on actions that tend to provide the acquiring party with premature “operational control” of the target’s business. Thus, to limit risk the parties should continue to compete as separate companies, to the same extent they did in the ordinary course of business prior to deal discussions; interactions should be limited to those necessary for due diligence, post-transaction planning, and navigating the regulatory process. In particular, if the acquiring party gains control or influence over the target’s decision-making in competitively significant areas such as pricing, R&D, investment, or marketing strategies, it may be deemed to have gained operational control and be at risk for gun-jumping liability.

(B) Restraint of Trade

The exchange of commercially sensitive, non-public information between competitors creates risk under Section 1 of the Sherman Act. Of course, parties must

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4 Any person, officer or director that does not comply with the mandatory HSR waiting period is subject to a daily fine of $16,000 for the duration of the violation. 15 U.S.C. § 18a(g)(1); 28 U.S.C. § 2461; 16 C.F.R. § 1.98. Moreover, if discovered during the HSR waiting period, gun jumping violations are likely to prolong and complicate the HSR investigation.


7 In addition to liability under the HSR Act, premature control/gun jumping as to pricing and other competitively sensitive areas may also constitute unreasonable restraints of trade under the Sherman Act. See, e.g., Competitive Impact Statement, United States v. Computer Assocs. Int’l Inc., Case No. 01-02062 (GK) (D.D.C. April 23, 2002), available at //www.justice.gov/atr/cases/f11000/11082.htm (merger agreement violated Section 1 of the Sherman Act where it prohibited seller, which competed with the acquirer, from offering customer discounts greater than 20% without buyer’s approval). Where premerger coordination between competitors is “reasonably necessary to protect the core transaction,” it will be analyzed under the rule of reason. William Blumenthal, Gen. Counsel, FTC, The Rhetoric of Gun-Jumping, at 8 (Nov. 10, 2005), available at https://www.ftc.gov/public-statements/2005/11/rhetoric-gun-jumping. However, coordination that goes far beyond that, such as price fixing and customer allocation, will remain subject to the per se rule. Id.

8 15 U.S.C. § 1. Potential consequences for violating the Sherman Act include civil and criminal fines, treble damages liability, injunctions, and even imprisonment, though the latter is uncommon in the context of an acquisition. See also, e.g., Blumenthal, The Rhetoric of Gun-Jumping.
exchange certain information when they are considering a transaction, and antitrust agencies recognize that such exchanges are a legitimate part of that process. However, increased care should be taken as the competitive sensitivity of the information increases. While it is difficult to state a general rule for assessing competitive sensitivity, it is useful to ask as a starting point: if the transaction is not completed, would it change the competitive dynamics in the marketplace for the other party to have this information? Is the information such that one would be uncomfortable with the other party having that information absent the transaction?

Information such as customer-specific pricing, current sales figures or input costs, pricing or marketing plans, competitive strategy and plans to bid is routinely treated as highly sensitive. Such highly sensitive information should only be exchanged if it is reasonably related to assessment and/or valuation of the transaction, including synergy projections or planning for post-consummation integration. Moreover, such information should be limited to historical data and shared in aggregated form whenever feasible.

Further, for highly sensitive information it is essential that the parties put in place protections to ensure that the information will not be used for anticompetitive purposes. Parties should limit the access to information to those that have a legitimate use for it, and ensure that those with access to the information use it only for proper purposes. Most often this is accomplished via Non-Disclosure/confidentiality agreements, along with the use of a “clean team.” Clean teams are generally comprised of outside consultants and/or internal personnel who are precluded from engaging in competitive decision-making regarding the sensitive competitor information to which they have access. The clean team will use the competitively sensitive information only for purposes of evaluating and planning the transaction, not for commercial purposes.

Thus, parties to a transaction must balance the legitimate need for due diligence and integration planning against the continuing legal obligation to compete prior to closing. Information sharing will be scrutinized with an eye towards the nature of the information being exchanged, the need for sharing that particular information, and

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10 Blumenthal, The Rhetoric of Gun-Jumping, at 7 (“The agencies' overriding enforcement message has been, and remains, that merging firms are separate entities and that they must continue to reflect those separate identities until the applicable legal standards allow them to do otherwise.”).

11 See, e.g., In the Matter of Insilco Corporation, 125 F.T.C. 293, 294-95, 1998 WL 34077349 (Jan. 27, 1998) (“Non-Aggregated, Customer Specific information … is the type of information that would (….continued)
whether the parties have implemented measures sufficient to ensure that the information is used only for legitimate purposes.

III. The Do’s and Don’ts

Whether pre-consummation conduct rises to the level of gun-jumping, or whether information is being shared appropriately under Section 1, is highly fact-specific. However, there are some practical guideposts that can help companies limit the risk of liability.

LIMITING THE RISK OF GUN JUMPING AND ILLEGAL RESTRAINT OF TRADE PRIOR TO CONSUMMATION

DO

• DO allow target full control of its own fundamental business operations
• DO allow each party to make business decisions it would have otherwise made prior to consideration of the proposed transaction
• DO establish merger provisions that are reasonably necessary to protect buyer’s legitimate interest without impairing the target’s independence
  o For example, you may negotiate reasonable restrictions on target’s ability to declare dividends, encumber assets or stock, acquire other businesses, amend organizational documents, make large capital expenditures, discharge claims outside the ordinary course of business, or take any action that would have a material adverse effect on the target’s assets
• DO exchange, as needed, less sensitive information, including: publicly available information, ordinary course financials, aggregated budgets, organizational charts, insurance policies, asset and depreciation schedules, information regarding locations, facilities, and services offered, pending legal claims, environmental risks, compliance programs and IT systems
• DO exchange only information that is reasonably necessary to evaluate and plan for implementation of the transaction
• DO exchange information only on a “need to know basis”
• DO share information in an aggregated or anonymous format, whenever possible
• DO share historical, rather than current information, whenever possible
• DO establish a Non-Disclosure Agreement (NDA) expressly limiting the scope and use of exchanged information
• DO label, segregate and track all information under the NDA
• DO establish a “clean team” for receiving highly sensitive information
• DO agree to terms on the destruction or return of information in the event that the transaction does not proceed

(continued….)
DON’T

- DON’T condition target’s ordinary course business contracts on buyer’s approval
- DON’T condition target’s marketing plans on buyer’s approval
- DON’T condition target’s pricing or discounts on buyer’s approval
- DON’T condition target’s personnel decisions on buyer’s approval
- DON’T have buyer offer positions to or terminate target employees
- DON’T place target data on buyer’s servers, or vice versa
- DON’T allow employees with direct sales, pricing or marketing responsibility to see competitively sensitive information, such as current, non-aggregated information regarding prices, discounts, bidding, costs, margins, product innovation/development, supply terms, competitive strategies or marketing plans
- DON’T allow non-clean team personnel access to customer-specific, non-aggregated information such as notes on customer contracts and negotiations, customer quotes, or current/future pricing strategies
- DON’T reach agreements/make plans for post-transaction competitive strategies regarding, e.g., pricing, output, bids, marketing or R&D

IV. Conclusion

Merging parties must take special care when coordinating with each other or sharing information prior to closing. By carefully limiting information exchanges, using confidentiality agreements and clean teams, and ensuring the market independence of both parties prior to closing, merging parties can limit the risks associated with transaction diligence and implementation.

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