Antitrust Update: FTC General Counsel Provides Informal Gun-Jumping Guidance

HSR Filing Thresholds Adjust Upward for 2006

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Two recent developments in the antitrust arena may be of interest to North Carolina business lawyers. The first is a major policy address given by the general counsel of the Federal Trade Commission last November on premature coordination among merging parties, or "gun jumping." The second is the announcement by the FTC of revised monetary thresholds for premerger notification filings under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a (the "HSR Act"), which took effect on Feb. 17, 2006.

A Primer on "Gun Jumping"

For years antitrust practitioners and their clients have wrestled with the question of how much due diligence, coordination and integration planning parties to a merger or acquisition may conduct before closing. Virtually every transaction requires some of these activities, and which ones are safe or dangerous has been the subject of extensive commentary. Articles, CLE manuscripts and speeches by government officials weave a confusing web of received wisdom that can be difficult to apply to new fact situations. A handful of high-profile cases brought by the FTC against merging parties in the last decade added a further layer of complexity. *See, e.g.,* **United States v. Gemstar-TV Guide Int'l, Inc.,** No. 03-0198, 2003 WL 21799949 (D.D.C. July 11, 2003); **United States v. Computer Assocs. Int'l, Inc.,** No. 01-02062, 2002 WL 31961456 (D.D.C. Nov. 20, 2002). Partly because consultants have counseled their clients conservatively, some merging parties have labored under heavy restrictions and incurred high transaction costs in efforts to avoid antitrust liability.

In his November 2005 speech, FTC General Counsel William Blumenthal brought a welcome dose of clarity to the antitrust rules that apply to coordinated pre-merger activities. *See* "The Rhetoric of Gun Jumping," Remarks Before the Association of Corporate Counsel (New York, Nov. 10, 2005), *http://www.ftc.gov/speeches/blumenthal.htm.* Blumenthal said the antitrust enforcement agencies understand that merging firms have a "legitimate interest in engaging in certain forms of coordination that would not be expected except in the merger context," that many forms of premerger coordination are "reasonable and even necessary," and that some merging parties may put unnecessarily strict limitations on due diligence and integration planning because of misperceptions about what the enforcement agencies will view as excessive coordination. Blumenthal acknowledged that the agencies' aggressive action against a few merging parties "may have been heard by some . . . to prohibit conduct beyond what [the agencies] intended." The agencies' enforcement actions, he said, were "easy cases that involved egregious conduct" by firms that "jumped the gun" on their mergers by "engaging in excessive coordination before closing." The cases were not intended, he suggested, to warn companies off of many forms of premerger coordination and transition planning that are reasonable and legitimate. (A summary of the agencies' enforcement actions can be found in the background materials accompanying Blumenthal's speech on the FTC's Web site.)

Antitrust Laws Affecting Gun Jumping

Premerger transition planning and coordination are analyzed independently under two federal statutes: Section 1 of the Sherman Act and the HSR Act.

Section 1 of the Sherman Act is a substantive antitrust law prohibiting collective action between independent entities that unreasonably restrains trade. Since merger partners are independent entities until the deal closes, Section 1 applies up until the deal is consummated (even if that happens long after HSR clearance has been obtained). Section 1 is primarily concerned with whether merger partners' pre-closing coordination activities have the effect of restraining trade by chilling competition.

The HSR Act is a procedural law requiring parties to a subset of transactions that satisfy certain jurisdictional thresholds (see the update below)

See **GUN-JUMPING** *page 6*

Proposed Legislation Update (Senate Bill 1377)

The North Carolina General Statutes Commission has recently introduced fast-track legislation drafted by the UCC Committee that is intended to remedy the problem described in Andrew Haile's article. It is hoped that the legislation will be addressed in the short session of the Legislature this spring. If adopted, this legislation will be effective as of June 30, 2006, and will give retroactive effect to continuation statements filed after Dec. 30, 2005. ■

to submit filings to the antitrust enforcement agencies and observe a 30-day waiting period before closing. The waiting period gives the enforcement agencies an opportunity to evaluate the transaction for antitrust implications. The key gun-jumping issue under the HSR Act is whether "beneficial ownership" of the to-be-acquired company or assets has been transferred to the buyer before the waiting period has expired or been terminated. Even though protecting competition is one of the antitrust laws' main public policy goals, since the HSR Act is not a substantive antitrust law, whether a transaction adversely affects competition does not matter for HSR purposes. An HSR Act violation can occur if pre-closing activities amount to a premature shifting of beneficial ownership even if the transaction raises no anticompetitive concerns. The penalty for violating the HSR Act is up to $11,000 for each day of noncompliance, and it can be applied to both the buyer and the seller.

Blumenthal Offers Reassurance for Vast Majority of Deals

Blumenthal suggested that some deal advisors, particularly accounting firms and investment banks, may have read the antitrust enforcement agencies' "interventions and statements over the past decade as implying a more absolutist approach than is actually the case" to gun-jumping problems. These advisors have sometimes led the business community to incur substantial transaction costs in an effort to structure due diligence and transition planning to avoid gun-jumping exposure.

Blumenthal's basic point is that the enforcement agencies recognize merging firms' "legitimate interest" in pre-closing due diligence and integration planning for implementing and attaining the efficiencies the deal is designed to produce. When these activities are undertaken to advance legitimate purposes, they will rarely violate the "rule of reason" that serves as a benchmark for Section 1 of the Sherman Act. Blumenthal stated that "[f]or the 95% of transactions that do not raise competition issues and that can be cleared without detailed examination, the reasonableness analysis should be simple, and the conduct will seldom present serious competitive questions." Blumenthal noted some practical effects of this observation:

- If the merger partners don't compete in any market, pre-closing due diligence and transition planning are unlikely to violate Section 1.
- In most (but not all) cases, obtaining HSR clearance (that is, expiration of the 30-day waiting period) suggests that the enforcement agencies think the transaction won't have anticompetitive effects.

Blumenthal noted that the analysis under HSR generally results in similar conclusions, even though it turns on the different question of whether beneficial ownership of the target company or assets has shifted. Because the HSR Act and related rules don't define the term "beneficial ownership," identifying when an acquiror has become a "beneficial owner" of a security or an asset rests on large number of factors. These include the right to gain in the value of the underlying asset, the risk of loss in value, the right to receive distributions, the right to vote stock or designate management, and discretion over investment decisions. Blumenthal observed that many commonplace provisions in acquisition agreements affect one or more of these factors, but stressed that problems typically occur only when other "pebbles" are placed on the buyer's side of the scale—such as access to the target's confidential information and control over key decisions. Qualcomm's April 2006 settlement with the Antitrust Division of the U.S. Department of Justice, discussed below, is revealing as a case study of how these factors can lead the enforcement agencies to pursue gun jumping violations directly under HSR, even where no substantive antitrust concerns are present.

What About the Other 5%?

In the "fraction of transactions in which the merging parties compete in a market with a limited number of rivals" [that is, deals likely to receive a request for additional information (a "Second Request") under the HSR Act] or in which their relationship presents complicated competitive issues, Blumenthal said that the reasonableness analysis under Section 1 of the Sherman Act is more problematic and can be highly fact-specific. Even in these cases, pre-closing activities that are reasonably necessary to protect the integrity of the transaction can take place if careful measures are taken. If a merger between competitors doesn't reduce competition, pre-closing activities aren't likely to violate Section 1. Because deciding what is acceptable in these cases is so fact intensive, merging companies will want to invest in the services of competent antitrust counsel.

Blumenthal identified three coordination issues that merging competitors frequently encounter:

1. Spillover Effects from Ordinary Due Diligence and Transition Planning. Blumenthal explained that the term "spillover effects" refers to situations where competitors are engaging in pre-closing due diligence and transition planning activities for legitimate purposes, but the conduct cannot be strictly contained and spills over into competitive activities. These communications may have adverse effects if the merger is blocked or abandoned. Blumenthal identified four possible solutions:

- Provide aggregated or time-lagged information.
- When identifying personnel to conduct a sensitive planning activity on a sensitive issue, select those who are not involved in the business operations that are the source of the spillover concern and wall them off from employees who are directly involved (for example, keep post-merger pricing discussions away from the sales and marketing department). Retired personnel or third party consultants may be good choices.
- When deciding who will conduct the planning, consider outsourcing to consulting and accounting firms. Although costly, this solution can allow for detailed planning without material spillover risk.
- If the planning can be deferred until after closing, wait.

2. Planning for Post-Closing Matters Requiring Preliminary Premerger Implementation. Merging partners, even those who aren't significant competitors, should be cautious about undertaking pre-closing coordination that may be difficult to undo if the transaction fails to close—for example, whether to proceed with a significant capital project or a plant closing. (In most cases there is plenty of private incentive here, since sellers are hesitant to put irreversible measures in place before closing.) Although no bright-line test can be devised in these situations, Blumenthal stated that the enforcement agencies conduct a fact-intensive review revolving around such questions as whether the decision not to proceed was reached unilaterally or jointly and how great the efficiencies are that would be realized from deferral of the project.

3. Joint Marketing. Blumenthal reaffirmed the enforcement agencies' longtime opposition to pre-closing coordination between merging competitors on prices to be charged or allocation of customer accounts. Blumenthal distinguished this from joint marketing efforts that simply announce or support the merger itself. Blumenthal also explained that the agencies do not prohibit joint courtesy calls paid on "important customers and suppliers" to explain the benefits of the merger or address concerns. Such communications, Blumenthal warned, should limit the scope of the discussion when both competitors are present and should not intrude into ordinary-course selling communications.

Speech "Resets the Rhetoric"

Blumenthal said the purpose of his speech was to "reset the rhetoric" and clarify the balance the enforcement agencies try to strike in gun-jumping matters. Although he drew few bright lines and gun jumping will remain a concern, Blumenthal sent a clear signal that the enforcement agencies' views are rarely doctrinaire and that in the majority of transactions, the parties' legitimate needs for reasonable and necessary premerger coordination activities can be accomplished by careful planning. Balancing the buyer's interest in maintaining the viability of the acquired business and integrating operations against the prohibitions of the antitrust laws will involve a fact-intensive assessment of all the circumstances of the deal. Incurring transaction costs to avoid gun jumping may be unavoidable or advisable in some cases, but the business community should incur them, according to Blumenthal, "on a considered basis and not out of ignorance or fear." A careful, early evaluation of whether the merger partners compete in one or more markets can hold an important key to deciding whether gun jumping is likely to be a serious risk. Training integration planners on permitted and impermissible activities and engaging experienced antitrust counsel to help navigate these areas can pay real dividends.[1]

Recent Case Study: Qualcomm's Control Over Merger Target Leads to Settlement of HSR Gun Jumping Complaint

A recent gun jumping case sheds further light on the issues Blumenthal was seeking to address.

On April 13, 2006, Qualcomm agreed to pay a penalty of $1.8 million to settle allegations of gun jumping under the HSR Act in connection with its acquisition of a competitor, Flarion Technologies, Inc. *See http://usdoj.gov/atr/cases/qual.htm.* Qualcomm and Flarion signed a merger agreement in July 2005 and then filed for HSR clearance. The Antitrust Division of the U.S. Department of Justice[2] issued a Second Request, extending the HSR waiting period until December 2005. The Antitrust Division took no further action on the transaction, which closed in January 2006.

Although the merger did not give rise to any substantive antitrust concerns, the Antitrust Division's complaint alleged that Qualcomm had violated the HSR Act by acquiring "beneficial ownership" of Flarion before the HSR waiting period had expired. Based on the "totality of the[parties'] conduct" between signing and closing, the Antitrust Division alleged that Qualcomm had obtained operational control of Flarion's business by restricting Flarion's discretion to conduct its affairs during the period between the signing of the merger agreement and the closing. The objectionable conduct involved Flarion's "ced[ing[] . . . control of much of its management and operations, including customer proposals, price discounts, licensing strategies and personnel decisions" to Qualcomm. Several specific post-signing covenants in the merger agreement affected the ceding of control, including covenants requiring Flarion to seek Qualcomm's consent before:

- Entering into intellectual property licensing agreements with third parties;
- Entering into certain agreements involving the obligation to pay or receive $75,000 or more per year or $200,000 or more in the aggregate;
- Entering into certain agreements relating to the disposition or acquisition of intellectual property rights; and
- Presenting business proposals to customers or prospective customers.

The first three of these covenants appear to be the type of "commonplace provisions" that Blumenthal suggested are not inherently problematic. The fourth item—requiring Qualcomm's consent for Flarion to make sales proposals—is more unusual and may have been one of the "pebbles" that, in the Antitrust Division's view, tipped the scale to the buyer's side in light of other facts suggesting that Qualcomm was exercising control over Flarion's business during the HSR waiting period:

- Flarion sought Qualcomm's review and consent for "routine things" such as hiring, despite a specific provision in the merger agreement that permitted Flarion to hire new employees "in the ordinary course of business in accordance with its standard past practice"; and
- Flarion sought Qualcomm's review and consent before marketing products and services to customers, including requests for approvals of price quotations and customer discounts. Qualcomm discouraged Flarion from pursuing smaller customer accounts that were of little interest to Qualcomm.

The Qualcomm settlement underscores Blumenthal's suggestion that post-signing covenants in merger agreements can reflect an unlawful transfer of beneficial ownership in violation of the HSR Act where there is already competitive overlap between the parties and other facts indicate that the buyer has acquired control over the seller's basic business decisions.

Revised HSR Filing Thresholds

In another recent development, the monetary size-of-person and size-of-transaction jurisdictional thresholds for filing premerger notification and report forms under the HSR Act increased on Feb. 17, 2006. The increases are the result of the annual indexing of filing thresholds required by amendments to the Act that were adopted in 2000. The 2006 increases are the second time the thresholds have been indexed (the first was on Mar. 2, 2005). The indexing is based on changes in the gross national product. The dollar amounts used to determine whether certain exemptions to HSR filing requirements apply have also been adjusted to reflect the new thresholds.

The critical size-of-transaction thresholds used to determine whether a transaction is reportable have increased as follows: from $53.1 million to $56.7 million (the basic threshold); from $106.2 to $113.4 million; from $212.3 to $226.8 million; from $530.7 to 567.0 million; and from $1,061.3 to $1,134.0 million.

Under the indexed thresholds, transactions valued at more than $56.7 million but less than $226.8 million are not reportable unless the parties also satisfy the size-of-person jurisdictional thresholds. As revised, the size-of-person thresholds are now satisfied if one merger party has annual net sales or total assets of $113.4 million and the other has annual net sales or total assets of at least $11.3 million. Acquisitions valued at more than $226.8 million are reportable without regard to the sales or assets of the parties.

The filing fees for reportable transactions have not changed, but the size-of-transaction thresholds that trigger the fees are subject to indexing. As of Feb. 17, 2006, the filing fee schedule is:

Size of Transaction	Filing Fee
More than $56.7 million but less than $113.4 million	$45,000
More than $113.4 million but less than $567 million	$125,000
$567 million or more	$280,000

As a yearly feature of life under the HSR Act from now on, indexing can raise problems relating to timing of transactions and impacts on HSR waiting periods. Helpful guidance on these issues can be found in Malcolm R. Pfunder's "Indexing Comes to the HSR Act," The Antitrust Source 1 (ABA Section of Antitrust Law, Jan. 2005), available at *www.antitrustsource.com.* ■

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