or are required, to provide liquidity to their affiliates holding equity securities will need to file registration statements to register the resale of such securities. Issuers may also agree to file resale registration statements for the benefit of non-affiliated holders of restricted securities that hedge such securities.

11. Institutional investors that have hedged the issuer's securities would be unable to sell their shares for up to one year under the new Rule 144, rather than six months, and as a result may still require that the issuer file a resale registration statement to provide the investor with greater liquidity.


13. The proposed changes will make it slightly easier for stockholders of private companies to resell their equity securities under Rule 144 (as long as the “current public information” requirement is satisfied) because the requirement that the shares be sold in brokers’ transactions would be eliminated. However, the changes will primarily benefit public companies, not private companies, which want to use stock as an acquisition currency because the rule changes are unlikely to lessen the liquidity discount applied when valuing securities for which there is no public market.

## Antitrust Angle

### Gun Jumping—Real Hazard or Just Hype?

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Merging parties must exchange information and coordinate with one another during the transaction planning process, beginning with the due diligence stage and continuing through the integration planning period to closing. At the same time, the
antitrust laws obligate parties to continue to act as independent competitors until their transaction closes, place seemingly ill-defined limits on the permissible scope of pre-merger coordination, and allow the U.S. federal antitrust enforcement agencies to impose significant fines upon the parties if they prematurely combine their operations. As a result, merging parties sometimes view themselves as situated between a proverbial rock and a hard place, and view the transaction planning process as a minefield fraught with antitrust risk.

These concerns are overstated. Even though there are few bright line rules, parties to a transaction can engage in legitimate due diligence and integration planning activities without incurring any material risk of engaging in “jumping the gun” by adhering to a few basic principles and implementing several safeguards. Moreover, while the federal antitrust agencies have consistently prosecuted gun jumping, a review of the agencies’ enforcement records suggests that most of these cases have involved extreme examples of an acquirer asserting control over the acquisition prior to closing. As discussed below, some basic points to keep in mind regarding gun jumping are:

• An acquiring company may restrict the seller from engaging in activities that would result in a material adverse change to the value of the target company, but should not attempt to restrict the seller from engaging in ordinary course of business conduct that is consistent with the seller’s past business practices; and
• Exchanging competitively sensitive information (e.g., bid data, customer information) during the merger process in and of itself may not result in a finding of antitrust liability, but could trigger a protracted government investigation that could delay regulatory clearance of the transaction. In addition, as a practical matter it may be difficult to prove that neither firm used this information to alter its competitive response in the marketplace.

Pre-merger activities are subject to scrutiny under Section 7A of the Clayton Act, also known as the Hart-Scott-Rodino Act1 (“HSR Act”); Section 1 of the Sherman Act;2 and Section 5 of the Federal Trade Commission (“FTC”) Act.3

The HSR Act requires that parties to any significant transaction4 observe a mandatory 30-day waiting period,5 during which time the acquiring party must not acquire “beneficial ownership” 6 of the other party to the transaction. A violation of the HSR Act is subject to penalties of up to $11,000 per day and may be enforced by either the U.S Department of Justice (DOJ) or the FTC. The purpose of the waiting period is to give the antitrust agencies an opportunity to evaluate the likely competitive effects of a proposed transaction before consummation. The waiting period prohibits any premature transfer of “beneficial ownership” that might impair future competition between the parties if the transaction does not go forward. Without a mandatory waiting period, the government would be confronted with the difficulty of “unscrambling the eggs” if the transaction is ultimately adjudged illegal under the antitrust laws.

Neither the HSR Act nor its implementing regulations define “beneficial ownership,” nor is there any case law that provides any definitive guidance. The only source of guidance is a litany of fact-specific consent orders over the past 30 years that reflect the government’s views of its meaning. Nonetheless, as discussed below, one can divine from these decrees a few general principles that help define the boundaries of permissible conduct.

Section 1 of the Sherman Act prohibits any coordination or agreement that unreasonably restrains competition, and Section 5 of the FTC Act prevents unfair methods of competition. Parties may violate Section 1 or Section 5 if they engage in coordinated conduct that unreasonably restrains competition while the transaction is still pending or would unreasonably harm competition if the transaction does not close.6 While potential liability for gun jumping under the HSR Act concludes once the HSR waiting period expires, Section 1 continues to apply until a transaction has been consummated.

Pre-merger coordination and information sharing can give rise to antitrust risk with respect to several aspects of transaction planning: (1) the due diligence phase; (2) the express terms of the transaction agreement that limit the seller’s pre-closing activities; and (3) the integration planning activities that occur during the period between the signing of the transaction agreement and closing.
In general, parties negotiating a proposed transaction should not engage in integration planning activities prior to executing a transaction agreement. Taking steps to integrate two companies before the parties have agreed to a definitive transaction would be difficult to justify to the antitrust authorities, who are tasked with enforcing antitrust laws that discourage parties from “living together” before they get “married.”

**Allowable Information Exchanges**

However, just as a prospective couple should engage in some information gathering about one another before deciding whether to enter into a long-term commitment, merging parties have a legitimate need to exchange information in order to conduct due diligence and reach agreement on deal valuation. Such information exchanges are unlikely to raise concerns if 1) the information in question is reasonably related to a party’s legitimate need to evaluate future earnings and prospects; 2) the parties agree to limit the use of the information to conducting due diligence and enter into a non-disclosure agreement; and 3) the personnel reviewing the other party’s competitively sensitive information are not responsible for the marketing, pricing or sales of the competing products. “Competitively sensitive” information could include but is not limited to customer- and supplier-specific information, strategic plans, current or forward-looking price or cost data, and current bid data. The purpose of these safeguards is to minimize the risk that if the deal does not go forward the prospective merger partners will not be able to use the information they have learned about one another to temper their own competitive actions in the marketplace. Obviously, this risk only occurs if the parties compete with one another.

The government has recognized that there may be circumstances where merging parties have a legitimate need to exchange competitively sensitive information for the limited purpose of valuing a transaction. For example, in 2002, the DOJ brought a gun jumping enforcement action against Computer Associates International, Inc. and Platinum Technology International, Inc., but at the time the DOJ recognized a narrow exception to the general rule that a merging party should not obtain the other party’s prospective, customer-specific bid information prior to closing. The DOJ concluded that the merging parties may need to obtain pending bid information of the other party for due diligence purposes, but only to the extent that the bids are material to the understanding of the future earnings of the other party. However, the DOJ noted that such disclosures should occur only pursuant to a non-disclosure agreement that would ensure that the employees who receive the information do not use it to harm competition, and that the information would not be provided to employees who are directly involved in the marketing, pricing or sale of competing products.

There are other ways to minimize the antitrust risk associated with information exchanges during the due diligence phase. The parties could mask specific customer or supplier names, or they could exchange only aggregated data or historical data. Another alternative is to retain a third party to collect and review any competitively sensitive information.

Merger agreement covenants that cover the period between signing and closing also can create gun jumping risks. While a deal is pending, buyers typically want to limit the seller’s ability to alter or impair the value of its business. As a result, transaction agreements normally include some restrictions on the seller’s pre-merger business activities. However, gun jumping concerns arise if the restrictions are too extensive, such as significantly limiting the seller’s ability to compete or requiring the seller to coordinate routine business activities with the buyer, or are applied too broadly to achieve these same results. For example, in 2006 the DOJ alleged that a merger agreement entered into between Qualcomm and Flarion prevented Flarion from engaging in certain basic business activities during the waiting period without first obtaining Qualcomm’s written consent, including entering into agreements to license its intellectual property to third parties and presenting business proposals to customers or prospective customers.

To avoid such concerns, contract provisions governing the seller’s pre-merger operations should distinguish between activities that the seller would undertake in the ordinary course of business and those that are extraordinary. A buyer can restrict the seller from engaging in extraordinary business activities that would result in a “material adverse change”
(“MAC”) to the value or operations of the business. A general MAC provision does not raise any gun jumping concerns. Alternatively, a MAC clause may set out specific dollar thresholds below which actions would be deemed to be in the ordinary course and not subject to restrictions. However, to the extent that a MAC provision includes a specific list of activities that define what constitutes a material adverse change, the parties should examine whether any of these restricted activities are ordinary course. For ordinary course of business activities that are consistent with the seller’s past practice, the seller should face no restrictions. Of course, what types of actions are in the ordinary course will depend on the specific industry and seller.

Although limitations on extraordinary actions usually are safe, even here some consideration may be given to the way such restrictions are structured. A requirement that the seller consult with or get the permission of the buyer before taking certain extraordinary actions would seem less restrictive than an absolute prohibition. However, in some cases, the absolute prohibition might actually present less risk because it does not invite ongoing dialogue or discussion between the parties about the seller’s pre-closing business activities.

Pre-closing & Integration Planning

Parties almost always want to engage in planning prior to closing to ensure rapid and smooth integration of the businesses after closing. While some pre-closing planning may be essential for successful integration, integration planning activities are the greatest source of gun jumping risk. As a practical matter, the government is most likely to take action when a merging party either assumes control or begins to integrate its operations with that of the other party prior to closing.

Simply exchanging competitively sensitive information or agreeing to restrictive merger covenants may trigger concern, but the agencies are much more likely to actually pursue an enforcement action if the merging parties have used that information or applied those covenants to take active steps towards transferring “beneficial ownership” from one party to another prior to closing. Such “active steps” that the agencies have challenged in the past include (but are not limited to): installing an employee at the target’s site to assume key management functions; giving some of the target’s key executives new email addresses, business cards, and office space at the buyer’s facilities; restricting the target’s ordinary course of business sales, discounting, and participation in trade shows; assuming control of customer lists and reviewing and approving contract sales; agreeing to stop competing for customers prior to closing; and allocating markets or service territories.

To minimize the risk that legitimate integration planning activities go awry and expose the merging parties to antitrust liability, parties should ensure that any planning discussions are prospective and relate only to how the parties will operate as a combined entity. The parties generally should not discuss or reach agreement on their current stand-alone strategies or other competitively sensitive aspects of their individual operations. Keep in mind that while it is appropriate to plan for what the combined entity will do once the merger closes, the parties should continue to independently operate their existing businesses.

A good approach to manage these issues is to have a dedicated integration planning committee and to include legal counsel (either outside or inside) on the committee. Having such a committee minimizes ad hoc contacts and discussions regarding integration planning and permits committee members to be specifically educated about the antitrust considerations in integration planning. Including legal counsel on such committees ensures that committee members have an immediate avenue for seeking further legal guidance if questions or concerns arise.

Where it is necessary to evaluate competitively sensitive information as part of pre-closing integration planning, parties should consider employing a “clean team” of individuals that are not involved in day-to-day operations and that would be prohibited from sharing with operations personnel any information learned. For example, a buyer may find it necessary to evaluate the manufacturing operations and cost structure of the seller’s business as part of an assessment of possible synergies. To ensure that details regarding the seller’s business do not affect the buyer’s competitive activities, the buyer should staff its integration planning com-
mittee with individuals from unrelated businesses or with no direct involvement in competitive decisions for the relevant business line. In some cases, it may be appropriate to employ consultants or other third-parties as the “clean team.” Employing such safeguards will minimize the risk that the prospective merger partners will be able to use any sensitive information received during the planning process to lessen competition either prior to closing or in the future if the deal does not go forward.

Another potentially sensitive issue that may arise during the pre-closing period involves personnel and staffing. While a deal is pending, a buyer may fear losing some of the seller’s key employees due to general uncertainty about the transaction and which personnel will be retained. As a result, a buyer may want to communicate its intention to retain certain employees of the seller after the transaction closes. However, such communications may also effectively inform other seller employees that the buyer does not intend to retain them, which is likely to increase the risk of some employees leaving. Where such departures would jeopardize the standalone competitiveness or viability of the seller (either while the deal is pending or if the deal does not go through), the employee communications raise gun jumping concerns. The U.S. antitrust enforcement agencies have expressed the concern that if the merging parties make premature, pre-closing employment announcements and the merger ultimately does not close, either or both firms may experience significant employee attrition that lessens their ability to compete.

One way to minimize the gun jumping risk associated with personnel decisions is for the seller to offer retention bonuses to key employees that stay with the seller to the completion of the transaction (or alternatively bonuses for any key employees that stay until the deal closes, but ultimately are not retained). Such an approach protects both the seller and the buyer from employee departures without raising substantial gun jumping concerns.

In sum, “gun jumping” is real, but manageable. Merging parties must be sensitive to gun jumping risk throughout the transaction planning process—from due diligence through to closing, but with proper counseling parties can achieve their business objectives while still complying with the law.

NOTES

4. The HSR Act requires pre-merger notification of transactions that have a value of $59.8 million or greater, provided the parties also meet the Act’s size-of-person thresholds as well. The $59.8 million size-of-transaction threshold is adjusted annually.
5. The waiting period is 15 days in the case of a case tender offer.
6. The HSR Act provides that “[N]o person shall acquire directly or indirectly, any voting securities or assets . . . unless the waiting period . . . has expired.” 15 U.S.C. § 18(a). The implementing regulations of the HSR Act, in turn, define an “acquiring person” as any “person which . . . will hold voting securities, either directly or indirectly or through fiduciaries, agents or other entities.” 16 C.F.R. § 801.2(a). “Hold” is defined as “beneficial ownership, whether direct or indirect, through fiduciaries, agents, controlled entities or other means.” 16 C.F.R. § 801.1(C).
7. As they have been interpreted, Section 1 of the Sherman Act and Section 5 of the FTC Act set out essentially the same standard for gun jumping.
9. U.S. v. Qualcomm Inc., No. 06-00672, 2006 WL [xxxxx], (D.D.C. April 13, 2006). Note that the restrictive merger covenants were not the sole basis for the DOJ’s complaint. The DOJ also alleged that Flarion deferred to Qualcomm on business decisions even when the merger agreement did not purport to oblige Flarion to do so.
10. For example, the DOJ objected to a provision in the Computer Associates/Platinum merger agreement that required Platinum’s sales representatives to obtain Computer Associates’ consent before entering into contracts that granted discounts greater than 20 percent off of the list price, because these discounts were routine and sometimes approached 80 percent.
11. Of course, information exchanges on subjects without real competitive sensitivity are not likely to raise concerns.