COMPETITIVE CONCERNS *BEFORE* A TRANSACTION CLOSES: PRE-MERGER CONDUCT BETWEEN COMPETITORS

The competitive concerns arising from pre-merger conduct between competitors have received increased attention from enforcement officials, antitrust practitioners and corporate counsel. Recent developments demonstrate that the federal antitrust enforcement agencies are vigilantly monitoring transactions between parties in the same or adjacent markets for pre-merger conduct that might violate either the Sherman Act or the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"). Parties to such transactions should be particularly sensitive to the manner and timing of information exchanges and integration planning and implementation.

The Federal Trade Commission ("FTC") and the Department of Justice ("DOJ") contend that taking significant steps toward combining businesses, including granting to the prospective purchaser control over the target's activities, before closing constitutes "gun-jumping" and violates the Sherman Act and/or the HSR Act. Indeed, the FTC and DOJ have each independently acted recently to investigate or prosecute gun-jumping concerns. The FTC has reportedly commenced an investigation of alleged gun-jumping in connection with the abandoned acquisition by TMP, parent of Monster.com, of HotJobs.com.[1] The DOJ has recently filed a lawsuit in the District Court for the District of Columbia, *U.S. v. Computer Associates International, Inc. and Platinum Technology International, Inc.*, (D.D.C. 1:01CV02062), attacking pre-merger conduct as gun-jumping by parties to a transaction that was cleared with a consent agreement in May 1999.

Although the facts relating to the FTC's investigation are sparse at this time, the DOJ's Computer Associates complaint vividly illustrates the importance of prudent restraint in pre-closing information exchanges and integration activities, particularly those that may affect the competitive independence of the parties prior to closing. Even if some may view the conduct that Computer Associates challenges as particularly aggressive, the DOJ's complaint reflects the enforcement authorities' continued insistence that parties to an acquisition or merger agreement are, and remain, separate economic and competitive entities until closing.[2]

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[1] See FTC:Watch, No. 579, Dec. 17, 2001

[2] The Computer Associates case may implicate a decision by the Eighth Circuit Court of Appeals in International Travel Arrangers v. NWA, Inc., 991 F.2d 1389 (8th Cir.), *cert. denied*, 510 U.S. 932 (1993). That case held that whether two entities that had agreed to merge may be capable of "conspiring" within the meaning of the Sherman Act following their agreement to merge may be a question of fact for a jury to decide. According to the Eighth Circuit, that issue may be guided by whether the merging parties "lacked independent economic consciousness" after they had agreed to merge.

Corporate counsel play a particularly important role in identifying potential legal issues arising from pre-merger conduct. Once identified, corporate and outside antitrust counsel typically develop means of accommodating legitimate business objectives while reducing legal risks. This memorandum provides an overview of the Computer Associates complaint and offers observations that may assist in crafting due diligence and integration planning guidelines in transactions between parties in the same or adjacent markets.

BACKGROUND

The DOJ's complaint against Computer Associates International, Inc. ("CA") and Platinum Technology International, Inc. ("Platinum") alleges that the parties' 1999 merger agreement and related conduct were unlawful under Section 1 of the Sherman Act and the HSR Act. Section 1 of the Sherman Act prohibits, among other things, contracts, combinations, or conspiracies that restrain trade. The HSR Act requires that parties to mergers or acquisitions that meet certain jurisdictional thresholds provide notice to the FTC and the Antitrust Division of the DOJ and observe a statutory waiting period before closing the notified transaction.

Pre-closing covenants that require only that the target operate in the "ordinary course" and limit extraordinary activities are standard contractual provisions and have not been challenged by the antitrust authorities. As discussed more fully below, however, restrictions that significantly constrain the target's ordinary course of business, permit one party to control another, or restrict a party's pricing, output or other competitive conduct raise serious antitrust concerns.

CONDUCT CHALLENGED BY THE DOJ

The DOJ alleges that CA "exercised unlawful control over Platinum's business" by, among other things:

- installing CA employees at Platinum headquarters to review and approve customer contracts;
- restricting Platinum's right to set discounts for software products and consulting services without CA approval;
- limiting Platinum's right to negotiate terms of customer contracts without CA approval;
- limiting Platinum's right to enter into fixed price contracts without CA approval;
- limiting Platinum's right to offer Y2K remediation services without CA approval;
- collecting and disseminating within CA competitively sensitive Platinum information, including the identity of Platinum's prospective customers and the specific price, discounts and contract terms offered to each customer; and

- making day-to-day management decisions, including decisions related to the recognition of revenue as a matter of accounting and participation at industry trade shows.

Although no decision has yet been issued in Computer Associates, the foregoing provisions, the DOJ contends, transferred to CA "control of Platinum's essential competitive assets – the right to independently set prices and conditions of sale." Significantly, the DOJ also cited the dissemination within CA of competitively sensitive Platinum information as integral to the Sherman Act and HSR violations.

The complaint focuses principally on the limitations placed on Platinum's ability to control its own competitive decision-making process and the impact those limitations had on prices. In particular, the merger agreement prevented Platinum from entering into customer contracts providing discounts in excess of 20% of list prices without CA's consent, even though Platinum had previously offered discounts far in excess of 20% where competitive circumstances warranted. The complaint alleges that:

> Platinum typically gave discounts over 20% off list prices, and discounts of up to 80% were not uncommon where Platinum faced significant competition, was attempting to displace CA's or other competitors' products, or was using the customer site to test a new product. Platinum also commonly discounted computer consulting services by more than 20% and routinely offered steep discounts or free consulting services related to the installation or implementation of Platinum software products where Platinum was displacing CA as the incumbent software vendor.

The restrictions in the merger agreement ended those historical discounting practices. According to the DOJ, those restrictions and the exchange of competitively sensitive information eliminated competition between CA and Platinum in violation of the Sherman Act and HSR Act.

The DOJ also cited extraordinary non-compete and consulting agreements with three of Platinum's senior executives as part of the Sherman Act and HSR violations. Those agreements had significant penalty provisions that held the executives personally liable for Platinum's failure to comply with the merger agreement's competitive restrictions during the pre-closing period. The non-compete agreements became effective immediately upon the execution of the acquisition agreement and not, as is customary, upon the closing of the acquisition. The DOJ cited those agreements as further evidence that CA controlled Platinum's day-to-day activities prior to closing, including pricing decisions, by imposing such personal liability on the executives.

IMPLICATIONS

Parties to transactions have legitimate and practical pre-merger informational needs, particularly with respect to due diligence, and equally legitimate and practical interests in planning for post-closing integration. The Computer Associates case does not challenge the exchange of information – when properly handled – to assess the value of the assets or stock to be purchased or to plan for post-closing integration. Computer Associates does, however, challenge conduct that, directly or indirectly, substantially restricts the competitive freedom of one or both parties to a transaction, or otherwise reduces competition between the parties, prior to closing.

The enforcement agencies' concerns regarding gun-jumping conduct are not limited to that challenged in Computer Associates, but rather illustrated by it. Conduct that is most likely to trigger antitrust concerns includes:

- limitations on ordinary-course pricing decisions and discount practices;
- limitations on customer negotiations, product offerings, form of customer contracts, and other terms of trade;
- placement of personnel at the target's headquarters or facilities, especially when intended to affect the target's day-to-day activities;
- provisions that require or permit the unrestricted disclosure and dissemination of specific and current price, customer and other competitively sensitive information;
- provisions and/or activities that imply joint competitive conduct, such as joint sales presentations, proposals or bids; and
- provisions that restrict pre-closing competition between the parties, including non-compete agreements and consulting agreements that take effect prior to closing.

Prudent guidelines in conducting due diligence and integration planning should be crafted to meet the specific facts of a given transaction. The following points may assist in developing such specific guidelines:

- The FTC and DOJ have consistently warned that, prior to closing, transaction parties should not:
  - coordinate business plans;
  - allocate markets, sales territories, customers or venders;
  - make joint pricing decisions; or

- ➢ negotiate jointly with customers or vendors.

- Discussions among officers, directors and employees of competing transaction parties should avoid competitively sensitive information. Although identifying competitively sensitive information frequently requires a specific factual context, enforcement officials have cautioned that, in general, discussions should not include:

  - ➢ current or prospective pricing, marketing and sales plans;
  - ➢ current or prospective individual customers or venders; or
  - ➢ detailed cost or profit information, particularly on individual products, customers or contracts.

- Where more detailed information may be required for due diligence or integration planning, enforcement officials have suggested that transaction parties:

  - ➢ reduce the competitive sensitivity of the information by redaction, aggregation, or otherwise limiting its competitive usefulness;
  - ➢ employ firewalls to restrict the dissemination and use of the sensitive information; or
  - ➢ use independent third parties to assist in reviewing the information.

CONCLUSION

Senior officials from the DOJ and the FTC have confirmed in public comments that gun-jumping issues are largely fact-specific. Particularly important is an assessment of the extent to which the conduct in question serves legitimate transaction-related objectives in a manner that avoids anticompetitive effects. In virtually all cases, legitimate transaction-related objectives can be accomplished, though prophylactic measures such as redaction, aggregation, informational firewalls or independent third parties may be necessary to avoid anticompetitive effects.

Corporate counsel in particular play central roles in facilitating a crucially important dialogue between business personnel and antitrust counsel to identify competitive concerns and devise practical and useful solutions. Each transaction presents unique issues that require both business and legal judgment. Recognizing the legitimate objectives and concerns in both the business and legal spheres is the first – and often the most important – step in promoting the efficient and effective consummation of a transaction while avoiding gun-jumping and other antitrust pitfalls.

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February 12, 2002