U.S. ANTITRUST REGULATORS CONTINUE ENFORCEMENT OF HSR "GUN JUMPING"

The U.S. Department of Justice ("DOJ") has imposed a fine of $1.8 million on QUALCOMM Incorporated ("Qualcomm") and its now-subsidiary, Flarion Technologies, Inc. ("Flarion"), for "gun jumping" under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"). For transactions meeting certain thresholds, the HSR Act requires the parties to file notification forms with the Federal Trade Commission and DOJ and observe a waiting period before one party may take control of another. Gun jumping concerns may arise where parties to a transaction conduct business as if the proposed transaction has closed before all applicable waiting periods have expired.

In the Qualcomm case, according to DOJ, contractual provisions in the merger agreement and conduct by the parties demonstrated that operative control of the target was transferred to the purchaser prior to the expiration of the HSR Act waiting period. Notably, Flarion offered wireless communication technology that competed directly with Qualcomm's technologies and each party theretofore had marketed their competing technologies to wireless network operators worldwide. While the competitive relationship between the parties was sufficient to warrant a request for additional information (a "second request") during the HSR review process, DOJ ultimately did not challenge the underlying transaction.

The merger agreement prohibited Flarion from engaging in the following activities without first obtaining Qualcomm's consent:

- entering into agreements to license its intellectual property to third parties;
- entering into agreements involving the obligation to pay or receive $75,000 or more in a year or $200,000 or more in the aggregate;
- entering into agreements relating to the disposition or acquisition of intellectual property rights, except for "shrinkwrap" software licenses with purchase prices of less than $10,000; and
- presenting business proposals to any customer or prospective customer.

In addition, the merger agreement severely limited Flarion's ability to support already deployed technology, as it prohibited Flarion from either expanding the scope of those deployments or committing to deliver additional supporting equipment without Qualcomm's prior consent. According to DOJ's allegations, the parties' conduct went beyond even the contractual limitations referenced above, and demonstrated that Qualcomm had assumed operational control of Flarion's business in advance of obtaining HSR approval.

DOJ alleged that, almost immediately after signing, Flarion began to seek consent before entering into almost any transaction with a third party, even where the merger agreement did not require such consent. Even routine day-to-day business decisions were submitted to Qualcomm for review and approval -- demonstrating Qualcomm's effective control over Flarion's business. DOJ seemed particularly concerned about the competitively sensitive, customer-specific matters that were being submitted to Qualcomm -- Flarion's competitor -- and the potentially anticompetitive impact of Qualcomm's decisions.

The DOJ complaint alleged that "Flarion sought Qualcomm's review and consent before it marketed products and services to customers and potential customers. These occasions included the submission of entire drafts of customer proposals for Qualcomm's review, requests for approval of price quotations, and a request to offer a discount to an existing customer. As a result of Qualcomm's influence and control, Flarion was discouraged from pursuing smaller accounts that were of very little interest to Qualcomm, created a policy on providing price information to mirror Qualcomm's policy, and did not pursue a customer proposal that would have met Flarion's own margin targets." Thus, according to DOJ, Flarion's competitive independence was effectively lost upon signing the merger agreement.

Notably, the parties themselves brought certain of the more troubling covenants to DOJ's attention and took some remedial actions to amend certain covenants as well as their conduct. DOJ has stated that, as a result of the parties' forthrightness, it reduced the penalty from the statutory maximum (which could have subjected each of Qualcomm and Flarion to a fine of approximately $1.66 million).

Implications

The Qualcomm settlement confirms that the U.S. antitrust enforcement agencies continue to treat gun jumping as a serious matter. Gun jumping concerns are likely most acute in strategic mergers where conduct and contract terms demonstrate that (i) the target of an acquisition has ceded control over its competitive conduct to a purchasing competitor, and (ii) the resulting actions may be viewed as potentially anticompetitive.

The settlement, however, should not be viewed as a blanket prohibition against purchasers overseeing certain target conduct after signing a merger agreement but before closing the transaction. The enforcement agencies recognize that a purchaser has legitimate commercial and practical interests in ensuring that a seller does not unduly dissipate the value of a target during the pendency of the acquisition. To that end, the agencies expect and allow reasonable post-signing covenants designed to protect that value.

Where a purchase agreement limits a target's pre-closing conduct, however, those limits cannot permit the purchaser to exercise operative control over a target's business prior to the expiration of the HSR waiting period. Particularly where merger parties are competitors, a target must retain its competitive independence and its freedom to conduct its ordinary-course business in the marketplace unless and until clearance under the HSR Act has been obtained.

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If you have any questions about this settlement, or gun jumping issues generally, please contact Bill Rooney (212-728-8259, wrooney@willkie.com), Barry Nigro (202-303-1125, bnigro@willkie.com), Ted Whitehouse (202-303-1118, twhitehouse@willkie.com), Jonathan Konoff (212-728-8627, jkonoff@willkie.com), David Park (212-728-8760, dpark@willkie.com), or the attorney with whom you regularly work.

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