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M&A and Antitrust Compliance

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Webinar

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Introduction: Four Key Topics

- We will focus today on four key topics of relevance to antitrust compliance in merger control:
  - Data room organization and access;
  - Confidentiality provisions and restrictions;
  - Managing the deal documentation; and
  - Integration planning and compliance.

Data Room Organization and Access; As Much a Commercial Issue as Antitrust

- From an antitrust perspective, the parties must compete effectively up until completion.
- If the transaction aborts, the parties must have preserved their ability to compete effectively in the market.
- The above require that purchaser employees and executives are not contaminated by Target information to which they have had access.

Data Room Organization and Access; As Much a Commercial Issue as Antitrust

- From a commercial perspective, the seller will have a business motivation to protect its position in case the deal does not proceed.
- The seller will, at the same time, wish to reduce its liabilities under any reps and warranties and indemnities by making a full informational "disclosure".

Data Room Organization and Access; As Much a Commercial Issue as Antitrust

- The purchaser will, in practice, have considerable leverage over Data Room access issues.
- A key message is that Data Room access and compliance is a mix of commercial and antitrust concerns, and it is key to combine corporate and antitrust expertise.
- The advice that follows reflects this mix of corporate and antitrust expertise.

Data Room Organization

- It is standard practice to divide data into different categories of sensitivity in a Data Room.
- The is no scientific approach to categorization but the following would be a commonly adopted approach:
  - (1) Non-Sensitive Commercial Information: This will be general, aggregated, historic (at least 12 months old) or already in the public domain;
  - (2) Commercially Sensitive Information ("CSI"): This will be sufficiently current and precise data which if disclosed would be capable of distorting competition in the market; and
  - (3) Highly Sensitive CSI: The disclosure of this data would inevitably risk a serious distortion of competition. This category would typically comprise short-term forward or backward looking price sensitive data.
- The division addresses both commercial and antitrust requirements.

Data Room Access

- Data Room "access" is typically controlled in a number of ways:
  - Data Rooms are established via a third party Data Room provider (with technology/know-how to control/monitor access to the specific categories of data);
  - Access is usually limited to individuals nominated as members of a defined deal team;
  - Access is usually password protected to the deal team;
  - Data Room information is made subject to confidentiality protection set out in a non-disclosure agreement ("NDA");
  - The disclosure of Data Room data is often made subject to a timing cascade, with sensitive data only being released later on in the deal process when there is greater deal certainty.

Access and "Clean" Deal Team Members

- As noted, Data Room access is typically limited to defined members of a deal team.
- There is a general antitrust principle that individuals having access to a competitor's confidential information should not be engaged in competing day-to-day market-oriented activities.
- Individuals are considered "Clean" if they are drawn from non-market-oriented areas of the purchaser's business– hence the term "Clean Team".

Data Room Organization and Access: The Distinction Between CSI and Highly Sensitive CSI

- Access to:
  - CSI is typically limited to the Clean Team;
  - Highly sensitive CSI is typically limited to outside professionals (legal/accountancy) who are authorized to make a non-confidential summary for the Clean Team (lawyers will, under most bar rules, need to be relieved of their duty to share knowledge with their client).
- These refinements reflect antitrust requirements. They also reflect commercial requirements: protecting the Target's confidential information, particularly if the deal aborts.

Data Room Organization

Non-Sensitive Commercial Information	Commercially Sensitive Information ("CSI") (1)	Highly Sensitive CSI (2)
• Published reports and account(s). • 10K(s). • Teaser(s) for Information Memoranda. • Aggregated company data. • Historic company data (ca. 12 months plus).	• Information Memoranda. • Management Presentations. • Management Accounts. • Sales data by site/product line. • Capex by site/product line. • Cost data by site/product line. • Capacity utilisation data by site. • Profitability by site/product line. • Customer sales data/records. • Strategic plans.	• Details of key intellectual property and know-how. • Details of key R&D or pipeline or prototype products. • Details of recent price negotiations/deals with key customers. • Details of prospective key customer offers.

Notes:
1. CSI, by definition, will typically be disaggregated and recent (say last 12 months).
2. Highly sensitive CSI will be very dependent upon the industry and business specifics. These examples are hypothetical.

Confidentiality: The Basic NDA

- Deals typically start with a standard non-disclosure agreement ("NDA").
- A standard NDA will contain at least the following:
  - A requirement that the purchaser keeps confidential all information relating to the Target that it receives/obtains from the seller (save for public domain information or information lawfully already known);
  - A limitation upon disclosure to those with "a need to know" or a named "deal" team;
  - A requirement that the purchaser's outside professional advisors (law/tax etc) are bound by the NDA;
  - A requirement to return or destroy documentary information should the deal abort; and
  - Reciprocity in the terms where each party discloses data to the other (for example in a JV context).

Confidentiality: The Challenges of Reporting to Senior Management

- An identified Clean Team typically undertakes due diligence in relation to the Target and will be expected to address, *inter alia*, deal problems/risks, synergies/cost savings, valuation and post merger integration and strategy (including R&D).
- A Clean Team will have access to all CSI in the Data Room, but the senior management of the purchaser (or the parents in a JV context) will not usually be in the Clean Team.
- This means that reporting in detail to senior management potentially risks a breach of the NDA.

Internal Deal Documentation: What do Merger Control Authorities Typically Require?

- All merger control systems routinely call for deal-related documentation.
- The rationale is to test whether the merger case put forward by the lawyers/economists in the notification (and subsequently) is consistent with the parties' own records and views (as expressed, *inter alia*, in board papers, business reports, strategic documents and, importantly, documentation prepared when there was no deal in prospect).
- The supporting documentation required to file a "complete" merger notification has become increasingly sophisticated. The EU provides a good benchmark of the approach.

Internal Deal Documentation: The EU Merger Control Benchmark

- An EU merger notification must be accompanied by the following:
  - All of the transaction documents (SPA/offer document and all related documents);
  - The purchaser's and Target's report and accounts (internet address or the most recent copies);
  - Copies of the following documents "prepared" by or for any board member or "reviewed" by any board member or the shareholders:
    - Minutes of meetings where the transaction was discussed.

    Note: Board is construed widely (executives, full board (execs and non-execs), supervisory board as well as any other party(s) exercising similar functions).

Internal Deal Documentation: The EU Merger Control Benchmark

- Analyses, reports, slides, presentations (and similar documents) analysing or assessing the transaction with respect to:
  - The Rationale for the transaction (or an alternative transaction);
  - Market shares;
  - Competitive conditions;
  - Competitors (actual and potential);
  - The potential for sales growth and expansion into other product or geographic markets; and
  - General market conditions.

Internal Deal Documentation: The EU Merger Control Benchmark

- Any analyses, reports, slides, surveys (and similar documents) "in the last two years" which assess any of the "affected markets" in relation to:
  - Market shares;
  - Competitive conditions;
  - Competitors (actual and potential); and
  - The potential for sales growth and expansion into other products/geographic areas.

*Note: An affected market is: (1) a market where the parties overlap horizontally with a combined market share of 20% or more; or (2) a vertically related market where one (or more) of the parties have a share of 30% or more on either the upstream or the downstream market. Note that for vertically related affected markets, the parties do "**not**" have to be in an existing supplier/customer relationship.*

Internal Deal Documentation: What Can Go Wrong?

- Where mergers go into an in-depth second phase investigation, the authority's access to internal documents becomes effectively open-ended (viz US second requests and cartel style document trawls in the EU).
- A classic disaster in merger control occurs where there is a conflict between the "advocacy" in support of the merger and the company's own internal records.

Internal Deal Documentation: What Can Go Wrong?

- Internal documents will not only potentially undermine the rationale for a merger, they can also crucially impact other vital elements of the case.
- For example, in relation to market definition and the question of who the merging parties compete against, internal strategic documents are vital:
  - Which rivals do the internal documents identify and monitor?
  - What products or services are seen as substitutes?
  - What geographic areas are monitored?
  - Why are certain competitors discounted?
  - What market shares have been estimated?

Internal Deal Documentation: Recommended Best Practices

- There is a total control over the channels and media of the deal documentation;
- The deal is only ever assessed via slide packs prepared in draft form by the Clean Team;
- No emails, internal reports or other reporting media are used;
- Each draft slide pack is passed by outside counsel for checking and clearance in a legally privileged manner.

Internal Deal Documentation: Recommended Best Practices

- Outside counsel ensure that the slide pack(s) comply with the confidentiality obligations in the NDA and CTCA and accord with the substantive antitrust arguments that will be made in support of the merger;
- No non-deal related market studies or analyses are created;
- The slide packs are continuously updated and refined as the deal progresses, each time subject to the same outside counsel scrutiny.

Joint Ventures Require a Greater Level of Care

- With joint ventures, parties pay particularly close attention to the timing of access to CSI and the use of external experts to deal with highly sensitive CSI.
- In a JV context, an early outside counsel task will be to agree on the approach to Data Room organization and access, confidentiality and disciplined deal documentation.

Integration Planning Compliance: What is Covered?

- Integration planning typically concerns the following types of operational issues:
  - Production capacity and utilization (in particular the rationalization of inefficient or excess capacity and the more efficient utilisation of remaining capacity);
  - Plans and timetables for capacity closure(s);
  - Liabilities/costs re: capacity closures (in areas such as environmental clean up, input supplies and employee redundancies);
  - Transfer(s) of customer supplies to remaining plants;
  - Centralized and streamlined fixed cost economies: administration, HR, finance, legal, sales and marketing, IT/software;
  - Centralized and streamlined R&D; and
  - Timetables and steps necessary to integrate the two businesses and achieve the cost-saving synergies.

Integration Planning Compliance: What is Covered?

- Integration planning may also need to address "other" issues:
  - Specific legal issues identified in the due diligence (e.g. Litigation, environmental, etc.);
  - The development of a joint business plan in a situation where the transaction is leveraged (*i.e.* financed by third party banks) against its future performance;
  - The corporate and fiscal restructuring of the merged "group";
  - Customer and supplier visits (in particular where the successful transfer of contracts is key to the Target's value).

Integration Planning Compliance: The Legal Constraints

- Competition law constrains integration in two key ways:
  - Article 101 (and equivalents) prohibit competitors from fixing prices, sharing customers, sharing markets or disclosing strategically sensitive information. These are cartel-type offences.
  - Merger control regimes prohibit the parties from implementing the merger prior to receiving formal merger control clearance.
- There are severe civil and criminal penalties for cartel-type offences.
- There are financial sanctions for implementing mergers ahead of merger clearance (so called “gun jumping”).

Integration Planning Compliance: Fines for Gun Jumping

- EU Commission: EUR 20 million (Electrabel and Marine Harvest);
- Brazil: EUR 15.000-15 million;
- China: EUR 42.000 previously imposed, maximum EUR 70.000;
- DOJ: USD 5 million (Flakeboard), USD 5.6 million (Gemstar), USD 1.8 million (Qualcomm);
- Germany : EUR 4.5 million (Mars);
- South Korea: EUR 11.000-30.000 previously imposed;
- Taiwan: EUR 260.000 was largest fine; most are > EUR 90.000;
- Ukraine: EUR 3.000-60.000 previously imposed.
  - Following the EU, there is a clear trend towards higher levels of financial penalty for gun jumping.

Integration Planning Compliance: The Danger of Carve-outs

- It is essential to avoid a premature implementation of a merger.
- Carve-outs where a part of the Target business is retained by the seller pending merger control clearance merit particular caution.

Integration Planning Compliance: “Dos” and “Don’ts”

- Formalities for integration planning
  - Do ensure that all integration planning meetings follow agreed formalities:
    - Agendas and minutes, recording the purpose of the meeting, what was discussed/agreed (the agendas and minutes to be approved by external counsel);
    - Follow-up actions must not "extend" to measures which wholly or partially implement the transaction or which might impact the parties’ external market conduct.

Integration Planning Compliance: "Dos" and "Don'ts"

- Presentations to customers and suppliers
  - Integration planning can include presentations of the transaction to key customers and/or suppliers of the Target in advance of completion. Draft speaking notes for such meetings should be prepared and approved by the purchaser's external counsel. A minute of any such meeting should also be approved by the purchaser's external counsel;
  - Presentations should be made by each party individually. Joint presentations should be subject to very specific prior legal advice;
  - Customer or supplier presentations can explain the background, context and potential commercial benefits of the transaction, but must expressly avoid any act, statement or implication that the two businesses have already merged;
  - Commercial offers conditional on the transaction closing are not ruled out but require specific prior legal advice.

Integration Planning Compliance: "Dos" and "Don'ts"

- The formation of integration planning teams
  - Do ensure that personnel engaged in customer facing marketing and sales are not selected for membership of the integration planning team(s);
  - Do ensure that the personnel engaged in integration planning are clearly identified, are coordinated under an integration leader, are made aware of the integration compliance formalities and written compliance guidance and that all commercially sensitive information received as part of the integration planning process is held subject to the terms of the NDA (and CTCA if relevant).

Integration Planning Compliance: "Dos" and "Don'ts"

- The parties must compete until closing
  - Do ensure that the purchaser and Target businesses are run entirely independently from each other and in full competition until closing;
  - Do ensure that no statement or action takes place pre-completion which might indicate that the purchaser has already taken control of the Target and/or that the purchaser and the Target businesses are no longer in full competition, e.g.
    - a combined price list; or
    - a joint procurement of in-puts; or
    - a refusal to quote separate prices or make separate procurements.

Integration Planning Compliance: “Dos” and “Don’ts”

- Managing communications
  - Do ensure that in any communication pre-completion with the Target’s staff it is made clear that the communication is for consultation or informational purposes only and that it is not in any manner contractually binding;
  - Don't at any time use use language that might inadvertently indicate, suggest or imply pre-completion that the transaction is:
    - Bound to happen;
    - Has already happened;

Integration Planning Compliance: “Dos” and “Don’ts”

- Will lead to particularly advantageous commercial gains such as: price rises, margin increases, cost savings, plant rationalisation, a better functioning market, a "shorter" market, a more "disciplined" market; or
- That the two businesses are already being operated as one or in coordination.

– Don't forget that there is legal advice and assistance available at all times in the event that you have any query or uncertainty with regard to integration compliance and that it is essential to seek advice before you act.

Final Recommendation

- Increasingly, merger control compliance is being consolidated into a single short bullet point document dealing with the compliance essentials of:
  - Data Room organization and access;
  - Confidentiality;
  - Deal documentation management; and
  - Integration planning and compliance.

Thank you

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