Compliance With Gun-Jumping Rules Keeps M&A Deals On Track

By **Scott Perlman** (October 18, 2022)

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One of the most common issues facing antitrust counsel advising a party to a pending transaction is counseling their client on how to avoid gun jumping.

Put simply, in the U.S., gun jumping consists of preclosing activities by one or both parties that are inconsistent with the requirements that:

- Under the Hart-Scott-Rodino Act, the transaction can not be consummated until the HSR waiting period has expired or been terminated; and
- That parties who are competitors for purposes of the antitrust laws continue to compete pending closing or after the transaction is terminated in the event that it does not close.

With mergers and acquisitions receiving closer scrutiny from the U.S. Department of Justice and the Federal Trade Commission, it is more important than ever for clients to comply with the rules against gun jumping.

Gun jumping issues can arise in a number of contexts. First, there is the question of the degree to which a buyer can control the target's preclosing activities, including with respect to the scope of restrictions in a definitive agreement regarding the conduct in which the target can engage between signing and closing without the buyer's consent.

Second, there is the issue of whether and to what degree the parties can exchange sensitive business information for due diligence and integration planning purposes.

Failure to observe the restrictions on gun jumping can have serious consequences, including distracting the agency reviewing a merger from focusing on possible substantive issues, delaying agency clearance of the transaction, a costly and time-consuming compliance investigation, substantial fines and, in extreme circumstances, potentially causing the transaction not to be approved.[1]

In theory both the buyer and the seller can be liable for gun-jumping violations, though the principal focus in enforcement actions almost always is on the buyer. With appropriate guidance, however, a buyer can place reasonable restrictions on the target's preclosing business activities and engage in necessary due diligence and integration planning without raising gun-jumping concerns.

Sources of Gun-Jumping Regulation

In the U.S. The rules against gun jumping are enforced in the DOJ's Antitrust Division and the FTC.

There are two legal sources of the restrictions on gun-jumping activities: The HSR Act and Section 1 of the Sherman Act — Title 15 of the U.S. Code, Section 1. The HSR Act provides that parties to transactions meeting certain dollar thresholds are required to file pre-merger

notification forms with the FTC and DOJ and observe a waiting period, usually 30 days, before the transaction can be consummated.

For purposes of the HSR Act, the buyer cannot obtain beneficial ownership of the target prior to expiration or termination of HSR waiting period, for example, by making decisions about how the target operates in the ordinary course of business with respect to pricing, marketing or production.

Exchanges of sensitive business information about these topics also may be evidence of the buyer attempting to control the target's business prior to closing in violation of the HSR Act. These restrictions apply regardless of whether the parties are competitors until expiration or termination of the HSR waiting period.

Section 1 of the Sherman Act prohibits agreements that unreasonably restrain trade. In particular, Section 1 can be violated by agreements between competitors with respect to the products or services on which they compete concerning prices, the customers or territories to which they sell, what they will pay employees or suppliers of non-labor inputs, and whether to develop or introduce new products.

Agreements to fix prices or allocate customers or markets are per se illegal, and can result in criminal penalties. Even if competitors do not agree on such matters, Section 1 can be violated by the parties exchanging information relating to these topics.

In the context of a transaction, parties that are competitors remain competitors for purposes of Section until closing even if the HSR waiting period already has expired — while beyond the scope of this paper, there are restrictions on gun jumping in many other jurisdictions, including Europe, China and Brazil.

Managing Gun-Jumping Risks in Definitive Agreements

Definitive agreements typically contain covenants that prohibit the seller or target from taking certain actions between signing and closing without the buyer's consent.

The buyer has a legitimate interest in ensuring that during this period, the seller or target do not take any actions that would alter the fundamental nature of the target's business or seriously undermine the value of the buyer's investment. Among the restrictions the antitrust agencies have found to be appropriate for these purposes are:

- Declaring or paying dividends or distributions of the target's stock;
- Issuing, selling, pledging or encumbering the target's securities;
- Amending the target's organizational documents;
- The target agreeing to acquire or acquiring other businesses;
- Mortgaging or encumbering the target's material assets;
- Making or agreeing to make large new capital expenditures;
- Making material tax elections or compromising material tax liabilities;
- Paying, discharging or satisfying claims or liabilities outside the ordinary course; or
- Commencing lawsuits other than routine collection of bills.[2]

Such covenants can raise antitrust concerns, however, if they represent an attempt by the buyer to obtain control the target's ordinary course of business activities (1) prior to expiration of termination of the HSR waiting period, or (2) if the parties are competitors, prior to closing.

In particular, these provisions raise concerns where they restrict the target's ability to operate and compete in the ordinary course of business.

Among the covenants or other preclosing restrictions that have raised gun-jumping concerns have been:

- Restrictions on the target's ability to grant discounts in excess of a certain percentage and the buyer placing employees permanently on-site at the target's offices, as in the 2002 United States v. Computer Associates International Inc. decision in the U.S. District Court for the District of Columbia;
- Restricting the target's ability to make or receive payments in amounts necessary to operate in the ordinary course of business, as in the 2006 United States v. Qualcomm Inc. decision in the District of Columbia; and
- Exercising the right to control the target's output or to receive its profits and losses prior to closing, as in the 2015 United States v. Flakeboard America Ltd. decision in the U.S. district court for the Northern District of California.

To avoid gun-jumping risks with respect to preclosing restrictions on the target's business, the following guidelines should be followed:

- No covenant should restrict the target's ability to set prices or discounts prior to closing.
- Restrictions on the target's ability to enter into new contracts should include a carve-out for contracts entered into with customers or vendors in the ordinary course of business.
- Restrictions on the target agreeing to changes in salaries or benefits also should allow exceptions for changes consistent with the ordinary course and/or past practice if necessary to retain critical employees.
- Dollar thresholds for capital investments and incurring new debt not requiring buyer consent should be set at a sufficiently high level so the target is able to pursue these activities in the ordinary course of business, while still requiring buyer consent for dollar levels that exceed ordinary course thresholds.

Any proposal to depart from these guidelines should be discussed first with antitrust counsel.

Managing Gun-Jumping Risks Arising From Due Diligence and Integration Planning

During the course of due diligence and integration planning, it is common for the buyer to request and the seller to provide a significant volume of documents, data and other information.

The two principal purposes for which this information is used include:

- To enable the buyer to determine whether to move forward with the transaction and what to pay for the target's equity or assets;
- To evaluate the potential efficiencies that can be realized from the transaction; and
- To plan for the rapid integration of the parties' businesses following closing.

Such information can touch on virtually every aspect of the target's business, including revenue, costs, profits, customer and vendor contracts, permits, documents relating to business plans and policies, and environmental and other legal liabilities.

Much of this information can be shared without raising antitrust issues. There are certain categories of information, however, that are sufficiently sensitive that the target sharing them with a buyer who also is a competitor can raise serious antitrust concerns.

The principal concern is that the exchange of this information may facilitate the parties entering into per se illegal agreements on prices, other terms of sale, or which customers or markets to service either prior to closing or if the transaction fails.

In addition, even if exchanging such information does not result in an agreement, it may reduce the degree to which the parties compete either while the transaction is pending or after the transaction is terminated without closing.

Among the types of information most likely to be competitively sensitive are:

- Current or future prices or pricing plans for products or services on which the parties compete;
- Other negotiated contract terms with customers;
- Product or customer specific cost or margin data;
- Strategic, marketing or other types of business plans;
- Nonpublic information related to research and development, or plans to introduce or withdraw any product or service from the market;
- Market research or other competitive intelligence related to products or services on which the parties compete;
- Information regarding salaries or benefits paid to specific employees or categories of employees, including in particular key executives; and
- Other information the target regards as competitively sensitive.

In general, information of this nature should not be shared by the target with the buyer on an unrestricted basis. In some cases, however, the buyer may need access to information in one or more of these categories to engage in legitimate due diligence or integration planning activities. Where that is the case, a common solution is to exchange competitively

sensitive information through a clean team process.

In general, parties employing a clean team process enter into a clean team agreement, with terms that typically provide for the following. The clean team must consist of individuals who are not involved in making pricing and marketing decisions for the buyer with respect to any products or services on which the buyer and the target compete.

These individuals may be buyer employees with other responsibilities — e.g., from the finance department — employees of a third-party consultant, and/or outside counsel.

Each clean team member must agree not to disclose any of the information provided to the clean team to any non-clean team members except as provided in the clean team agreement. In general, clean team members must agree that if for any reason the transaction does not close, they will not move to a position in which they have responsibility for prices or marketing strategy for competitive products or services for some period of time after the transaction terminated — e.g., commonly six months to one year.

Competitively sensitive information can be provided to the clean team for review. The clean team then can prepare reports for non-clean team buyer employees that summarize the information in a manner that does not disclose the competitively sensitive details —e.g., by aggregating pricing and cost data into more general level profit data, or reporting on the overall profitability of a group of customer contracts without disclosing the prices or other sensitive terms of individual contracts.

Most commonly, the buyer's antitrust counsel will review the clean team's reports before they are distributed to non-clean team members to ensure the reports do not disclose competitively sensitive information. In this manner, the clean team process ensures that the buyer can obtain the benefit of access to competitively sensitive information without receiving the information in a form that would raise antitrust concerns.

Conclusion

As discussed above, a buyer in a merger or acquisition has a legitimate interest in restricting a target's businesses activities outside the ordinary course of business between signing of a definitive agreement and closing. The buyer also typically requires access to a wide range of information about the target in order to carry out legitimate due diligence and integration planning.

These activities can subject the parties to liability for gun jumping, and may result in delaying or even derailing the underlying transaction if, for example, the buyer attempts to exercise excessive control over the target prior to HSR clearance or closing, or to obtain competitively sensitive information in a manner that may raise issues under the HSR Act or Section 1 of the Sherman Act.

With proper guidance, however, the buyer can protect both its legitimate interests in ensuring the value of the target business is preserved prior to closing, and can obtain information required for due diligence and integration planning without the parties being exposed to undue risk of a gun-jumping investigation or enforcement action.

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[1] See, e.g., United States v. Computer Associates, Int'l, Inc., 2002-2 Trade Cas. (CCH) ¶ 73883 (D.D.C. 2002) (order requiring payment of $638,000 penalty); United States v. Qualcomm Incorporated, et. al. (D.D.C. Apr. 19, 2006) (final judgment requiring payment of $1.8 million penalty); United States v. Flakeboard America Ltd. (N.D. Cal. Feb. 2, 2015) (final judgment requiring buyer and seller each to pay $1.9 million penalty for violating HSR Act).

[2] Computer Associates Competitive Impact Statement at http://www.usdoj.gov/atr/cases/fl1000/11082.html.