Gun-jumping:
Antitrust Issues Before Closing the Merger

Richard Liebeskind
Partner, PILLSBURY WINTHROP LLP
Washington, D.C.

Presented to
ABA Section of Business Law, Antitrust Committee
ABA Annual Meeting
San Francisco, California
August 8, 2003

What is "gun-jumping"?

"Gun-jumping" is the term used by the federal antitrust agencies (the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission) to refer to a variety of actions that merging parties might enter into prior to closing to facilitate the merger and expedite the integration of the companies.[1] While the government acknowledges that most mergers are motivated by efficiency concerns and are pro-competitive,[2] the government has nonetheless warned that premature integration – before the merger closes – might lead to civil or even criminal antitrust enforcement. The government's position is that firms must remain competitors until closing, and cannot lessen competition between them in order to facilitate a merger that has not been consummated.

The clearest example of gun-jumping is coordination between merging parties on prices or terms to be offered to customers for sales prior to closing the merger, or allocating customers for sales to be made prior to closing. The government has also maintained that a gun-jumping violation occurs if, prior to closing, merging firms coordinate their negotiations with customers for sales to be made *after* the merger closes (*e.g.*, negotiations of long-term contracts).

Other issues may arise in connection with pre-closing planning regarding products, distributors or employees. In addition, the exchange of detailed information concerning customers, prices, and product plans, while often part of pre-closing due diligence, can raise "gun-jumping" concerns.

Companies negotiating a merger, or conducting pre-closing due diligence and planning activities, therefore need to be aware that the antitrust agencies might view their activities as violations of federal law. The agencies have drawn a distinction between planning or post-merger integration and implementing those plans. Merging parties should consider prophylactic

---

[1] The antitrust agencies typically use the term "merger" to include asset acquisitions. This paper follows that usage. Gun-jumping issues can arise in any transaction that involves the acquisition of stock or assets.

[2] U.S. Dep't of Justice and Federal Trade Comm'n, *Horizontal Merger Guidelines*, introductory statement (1997) ("sound merger enforcement must prevent anticompetitive mergers yet avoid deterring the larger universe of procompetitive or competitively neutral mergers").

measures, including notices to business people handling the closing *and* to sales and operations staffs, to make sure that employees do not inadvertently cross the line in order to facilitate post-merger integration. Many of these measures may make prudent business sense, since there is often a risk (apart from antitrust risk) that a merger might not close, and therefore that the firms will need to compete with each other going forward.

What is the law on gun-jumping?

The government has asserted gun-jumping violations under two laws: (1) Section 1 of the Sherman Act, 15 U.S.C. § 1, which prohibits agreements in restraint of trade (such as price fixing and market allocation), and (2) the Hart-Scott-Rodino ("HSR") Act, Section 7A of the Clayton Act, 15 U.S.C. § 18a, which requires merging parties to abide by waiting periods following notification to the government of certain stock or asset acquisitions. In the context of gun-jumping, these two laws are largely overlap, but have some key differences.

Sherman Act § 1 prohibits anticompetitive agreements between independent firms.[3] Criminal violations of the Sherman Act almost invariably involve hard-core price fixing, where defendants knowingly and intentionally (and often secretly) meet to fix prices or allocate markets or customers. Other *per se* violations of the Sherman Act can involve price fixing, customer allocation, or other agreements not to compete, and can be the subject of civil litigation (including treble damage actions) even if they lack the hard-core aspects that the Antitrust Division believes make a case appropriate for criminal enforcement. Therefore, even inadvertent violations, or those believed by their participants to be procompetitive, might be asserted to violate Sherman Act § 1.

Conduct that is not illegal *per se* can be challenged under Section 1 under the "rule of reason," under which the government or plaintiff must prove an adverse effect on competition, and defendants may introduce justifications for their conduct. For example, an agreement to enter into a joint venture to develop a new product would normally be judged under the rule of reason. In addition, an agreement (including price fixing) that would be analyzed under a *per se* rule in a stand-alone context might, in some circumstances, be judged under the rule of reason if the agreement is ancillary to a legitimate, pro-competitive joint venture.

The HSR Act has been interpreted by the Antitrust Division to prohibit an acquirer from exercising "substantial operational control"[4] over an acquired firm prior to the expiration of the HSR waiting period, typically 30 days after filing the HSR, unless the government requests

---

[3] A parent and a 100% subsidiary, or two 100% subsidiaries of the same parent, are a single entity; thus an agreement between them (*e.g.*, on prices or customers) cannot be a violation of § 1. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984). Lower courts have generally extended *Copperweld* to firms owning substantially all of the stock of another firm, but have been somewhat more reluctant as the ownership approaches 50%. At least one circuit has held that *Copperweld* immunity can attach at the time of the merger agreement, rather than not attach until closing. *See* note 6 below.

[4] *U.S. v. Gemstar-TV Guide International, Inc.*, complaint ¶ 56 (D.D.C. filed Feb. 6, 2003) (No. 03 CV 000198).

additional information.[5] For this purpose, the Antitrust Division has construed "control" to mean directing (even partially) the affairs of the to-be-acquired firm.

Does it matter what statute applies?

There are three principal distinctions between the two statutes: the conduct prohibited, the time frame during which the statute applies, and the penalties.

Conduct. In theory at least, gun-jumping should not violate the Sherman Act unless the underlying conduct would violate the Sherman Act even absent a merger.[6] If two firms could engage in the conduct in question even if they were not merging, they should be able to engage in that conduct *while* merging. For example, if two firms could engage in a collaboration under which one managed the other's business as part of an efficiency-enhancing joint venture, the Sherman Act should not prohibit that conduct just because the parties *also* intend to merge.[7] The government might not agree, but (assuming the separate agreement was not a pretext) might be challenged to explain why the fact of the merger makes this conduct a violation of the Sherman Act.[8]

By contrast, the government interprets the HSR Act to prohibit an acquirer from exercising "control" over an acquired firm before the expiration of the statutory waiting period. In *Gemstar-TV Guide*, the government explained its reasoning as follows:

---

[5] If the antitrust agency reviewing the HSR filing issues a "request for additional information," commonly known as a "Second Request," the waiting period expires 30 days after the parties have provided the requested information. The government can grant early termination of either waiting period. Shorter waiting periods apply in cash tender offers and bankruptcy proceedings. The HSR Act requires both the acquirer and the acquired person to file notifications with both antitrust agencies, and adhere to the waiting periods, in any acquisition of voting stock or assets valued at $50 million or more. There are, however, many exceptions and qualifications to the filing requirements, which are beyond the scope of this paper.

[6] There is an argument that many types of gun-jumping (at least after signing a merger agreement) does not violate Sherman Act § 1 at all. In *International Travel Arrangers v. NWA Inc.*, 991 F.2d 1389, 1397-98 (8th Cir. 1993), the court affirmed a jury verdict finding that a merger agreement brought the "economic substance of the relation" between the firms within *Copperweld*, even though the merger had not yet closed, and affirmed the judgment that there was no Sherman Act violation on that ground. Therefore, the very actions that would (in the government's mind) constitute improper exercise of control of the acquired firm by the acquirer can be argued to give rise to a merger-in-fact that would invoke *Copperweld.* The Antitrust Division apparently disagrees with the holding of this case.

[7] The antitrust agencies have made clear that there is a wide range of efficiency-enhancing integrations of economic activity that can be engaged in by otherwise independent firms, and that in the context of those integrations the firms can limit competition (by, for example, fixing price) in ways that would be illegal but for the integration. U.S. Dep't of Justice & Federal Trade Comm'n, *Antitrust Guidelines for Collaborations of Competitors* § 3.2 (2000). It is important, however, that the agreement to limit competition does not go beyond the scope of the efficiency-enhancing integration. *Freeman v. San Diego Ass'n of Realtors*, 322 F.3d 1133 (9th Cir. 2003).

[8] The FTC might pursue a similar claim as a violation of Section 5 of the FTC Act, 15 U.S.C. § 45, which prohibits unfair methods of competition. While the FTC can proceed under Section 5 to challenge anticompetitive conduct that violates the Sherman Act, its authority to challenge conduct that does *not* violate the Sherman Act is limited to cases in which actual anticompetitive effect can be proven. *Boise Cascade Corp. v. FTC*, 637 F.2d 573 (9th Cir. 1980).

> Whether a *de facto* acquisition has occurred [in violation of HSR] depends on the facts of each particular case. Courts have recognized that the execution of an acquisition agreement, combined with the assumption of significant operational or decision-making influence over the to-be-acquired business, can amount to an "acquisition" under Section 7 of the Clayton Act, even if the parties have not formally consummated the transaction. Similarly, once parties have entered into an executory agreement subject to Section 7A's requirements, they may not effectuate the acquisition by, for example, merging their operations or otherwise transferring significant operational, management or decision-making control over the to-be-acquired assets. In other words, once Section 7A is triggered, parties to a merger agreement must, at a minimum, avoid combining prematurely in a way that would constitute an acquisition under Section 7.[9]

The Division did not identify the cases on which it relied for the proposition that an "acquisition" can occur under Section 7 before ownership passes.[10]

The FTC gave a somewhat different explanation of its theory of the statutory authority for gun-jumping:

> In the jargon of HSR, signing the contract transfers some *indicia of beneficial ownership.* By itself, that transfer is entirely lawful. But the transfer of additional indicia of ownership during the waiting period – such as assuming control through management contracts, integrating operations, joint decision making, or transferring confidential business information for purposes other than due diligence inquiries – are inconsistent with the purposes of the HSR Act and will constitute a violation.[11]

Under this formulation, while entering into a merger agreement does not itself constitute "acquiring" stock and therefore does not violate HSR, unspecified "additional indicia" can violate that law – including acts that themselves are not *per se* violations of the antitrust laws and might, under the Sherman Act, be found to be procompetitive (such as management contracts and information exchanges).

The HSR Act does not define "acquire," but the HSR regulations define "control" precisely – and not in the manner drawn by the Antitrust Division's analogy. Instead, "control" under HSR regulations means one of three things: 50% or more of the outstanding voting securities; if no voting securities, 50% of the profits or 50% of the assets on dissolution; or in either event the present contractual power to appoint 50% or more of the directors (or similar individuals in unincorporated entities). 16 C.F.R. § 801.1(b). Thus, the government has (perhaps unwittingly) asserted that, for gun-jumping purposes, "control" means something different than "control" means under the HSR regulations.

---

[9] *Gemstar-TV Guide* Competitive Impact Statement at 12-13.

[10] There are a couple of cases holding that it is a question of fact under Clayton Act § 7 when an "acquisition" takes place, depending on the economic context, and that an acquisition can occur prior to transfer of title. *Nelson v. Pacific Southwest Airlines*, 399 F. Supp. 1025, 1028 (S.D. Cal. 1975); *McTamney v. Stolt Tankers and Terminals (Holdings) S.A.*, 678 F. Supp. 118 (E.D. Pa. 1987).

[11] William J. Baer, "Report from the Bureau of Competition (1999)," ABA Antitrust Section spring meeting, available at http://www.ftc.gov/speeches/other/baerspaba99.htm (emphasis in original).

The HSR Act's applicability generally does *not* turn on whether the merger would indeed reduce competition, or even whether the merging firms are competitors. Indeed, as discussed below, in two of the last three gun-jumping cases the government did not conduct an antitrust investigation of the merger. Therefore, if the merging firms coordinate their activities in a manner that constitutes control, prior to the expiration of the waiting period, the government might in theory challenge the conduct *whether or not* there is any competitive overlap between the companies.

An interesting wrinkle in gun-jumping analysis is that the *acquiring* firm may unilaterally change its business operations before the merger closes. Section 1 of the Sherman Act only prohibits agreements, and the HSR Act does not prohibit the acquirer from running its own business as it sees fit. So long as there is no agreement between the firms, the acquirer should be able to abandon products, research or customers in anticipation of acquiring products, customers or research with the merger. However, the antitrust agency might investigate to determine whether there was in fact an agreement – which of course can be inferred from circumstantial evidence.[12]

Timing. The HSR Act's (implied) prohibition on gun-jumping terminates with the expiration of the waiting period, whereas (according to the government) the Sherman Act continues to prohibit agreements limiting competition between merging firms until they have in fact completed their merger. For gun-jumping analysis, the government considers firms to be independent up until the time of closing. Since it is not unusual for there to be a significant period of time between the expiration of the HSR waiting period (and thus *its* gun-jumping prohibitions) and the actual closing, it is important to remember that the government contends that the Sherman Act continues to apply up until actual closing. *But see International Travel Arrangers*, note 6 above.

Penalties. Sherman Act § 1, which prohibits anticompetitive agreements between independent firms, can be enforced civilly or criminally. There have been no criminal prosecutions for gun-jumping *yet*. The HSR Act is enforced civilly by the Attorney General, who can obtain civil penalties of $11,000 per *day* of violation.

What conduct has been found to constitute gun-jumping?

There have been no cases, under either the Sherman Act or the HSR Act, in which any judge has actually confirmed that gun-jumping allegations actually violate these acts, or that any specific conduct constitutes gun-jumping: All of the government's gun-jumping enforcement actions have involved settlements.[13] The four cases that have been brought have been settled for

[12] *See, e.g., High Fructose Corn Syrup Antitrust Litigation*, 295 F.3d 651, 659-664 (7th Cir. 2002) (inferring conspiracy from circumstantial evidence, including e-mails, overheard comments, fact of another independent conspiracy, and economic conditions consistent with coordination).

[13] The four filed cases are *TV Guide-Gemstar*, cited above; *U.S. v. Computer Associates International, Inc.* (D.D.C. filed Sept. 28, 2001) (No. 1:01 CV 02062); and *U.S. v. Input/Output, Inc.* (D.D.C. filed April 12, 1999) (No. 1:99 CV 00912); and *U.S. v. Titan Wheel International, Inc.* (D.D.C. final judgment filed May 10, 1996) (No. 96-1040). *TV Guide* and *Input/Output* were filed with consent judgments; *Computer Associates* settled six months

civil penalties ranging from $130,000 to almost $5.7 million. Their facts, as alleged by the government, suggest that there was little room in these cases to explore questions regarding the limitations of gun-jumping claims:

- *Input/Output* entered into a merger agreement on September 30, 1998, with Laitrim Corporation to purchase its subsidiary, DigiCOURSE, in exchange for approximately 11.5% of Input/Output. On October 10, prior to filing the HSR (much less the expiration of the waiting period), executives of DigiCOURSE moved into Input/Output's offices and began running a division of Input/Output while also running DigiCOURSE.[14]

  According to the government, by these actions Input/Output "took operational control of DigiCOURSE's business," which (together with some rights specified in the merger agreement) "constitute a transfer of beneficial ownership of DigiCOURSE to Input/Output prior to the expiration of the waiting period."[15] Apparently recognizing the impropriety, the parties "took steps to halt the premature consummation of the acquisition" on November 3. The government allowed the HSR waiting period to expire on November 13, without seeking additional information – indicating that the government had no competitive concerns with the merger itself. The government sought and obtained $450,000 in penalties for the three weeks of violation.

- *Computer Associates* ("CA") and Platinum Technology International, Inc. *agreed* to merge on March 29, 1999. "Prior to March 1999, Platinum aggressively competed with CA in the development and sale of numerous software products, including mainframe systems management software products."[16] The Antitrust Division agreed with CA and Platinum to allow the merger to proceed with divestiture of some software products, and the merger closed on May 28, 1999. During this 60-day period, the merger agreement restricted Platinum's ability to enter into fixed-price contracts for more than 30 days (*i.e.*, contracts that would be part of the assets CA would acquire), or to offer non-standard terms or discounts of more than 20%, except with CA's express approval – and a CA division vice president was designated to be the approver.

  The government contended that CA's exercise of control over Platinum's pricing decisions constituted both price-fixing, in violation of the Sherman Act, and an acquisition of control, in violation of the HSR Act. CA paid $638,000 in penalties, and – as a frequent purchaser of other companies – accepted an injunction limiting the types of material adverse change clauses it would be allowed to have in future merger agreements (discussed below).

after the action was commenced. In addition, there have been investigations of gun-jumping issues that have not resulted in enforcement action.

[14] *Input/Output* complaint, ¶ 15.

[15] *Id.* ¶ 16.

[16] *Computer Associates*, Competitive Impact Statement at 3 (filed April 23, 2002).

- *Titan Wheel* was acquiring a plant from Pirelli, but the workers were on strike, so Pirelli allowed Titan to negotiate a settlement to the dispute while the merger was pending. The FTC concluded that negotiating with the union at a *plant* closed by strike constituted taking control of the plant, and objected; Titan withdrew from the negotiations, but paid a fine of $130,000 for the period in which it was allegedly in violation.

- *Gemstar-TV Guide* was formed by the July 2000 merger of Gemstar and TV Guide, which (like Input/Output) was not itself challenged by the antitrust agencies, even though they were the only two established providers of interactive program guides for cable and satellite TV. After about six months of discussions on possible patent cross-licenses or joint ventures to settle patent litigation, on October 4, 1999, they agreed to merge. The merger was then the subject of a seven-month investigation, after which the Antitrust Division determined not to challenge the merger, and it closed on July 12, 2000.

  Well before the merger agreement, while discussing whether they could settle their patent litigation by forming a possible joint venture, executives of Gemstar and TV Guide "acknowledged the need to slow roll" their independent discussions with two major customers, and each firm then abandoned negotiations with a customer of the other's. Upon entering into a merger agreement, the parties agreed to phase out competing marketing operations, to allocate customers, and to agree on prices to be offered prior to closing the merger. The government contended that all of these acts constituted violations of *both* the Sherman Act and the HSR Act.

So what does this mean for planning and implementing a merger?

Quite a lot. There is conduct that the government is likely to view as violations of one or both statutes:

- agreements on prices or customers in advance of closing, even as to sales to be completed post-closing;
- the acquirer's taking operational control of the acquired firm in advance of closing;
- holding out the companies as having merged before the merger is complete, or at least before the expiration of the HSR period.

Other issues are less clear. At what point can the companies begin making plans for long-term research and development that they will conduct post-merger? Must the companies proceed independently with different (and costly) development projects, even though the very purpose of the merger might be to consolidate these activities? (Does that make it worse?)

Because the HSR Act applies *whether or not* the merger raises competitive issues, the need to avoid "combining prematurely" is present whether or not the merging companies are competitors. Counsel and business people should be aware that the government could well take the position that sending an executive in to run a business you are about to acquire is an HSR violation, even if the businesses do not compete. Indeed, in *Input/Output* there was no antitrust

investigation. Similarly, these restraints would apply in situations where two merging firms each have multiple businesses, and the government's inquiry is limited to one or a few of those businesses – the HSR Act would, on the government's reading, still prevent the premature integration of businesses in which the government has acknowledged it has no competitive concerns.

Employee issues present special problems. During the pendency of a merger, there may be employees who would like to know whether they have a future with the merged company. Can the acquirer make offers to the acquired firm's employees? Can the acquirer confirm to the acquired firm's employees that they will have a place in the new company? Likewise, can the acquirer tell some of the acquired firm's employees to start looking for a new job? The *Titan Wheel* case (where the acquirer took over negotiations with the seller's union) may be an extreme example, but employee issues are often present during a merger, and need to be dealt with. Consultation with the agency during the HSR waiting periods might resolve these concerns, but the agencies need to be mindful of the consequences of asserting that acquirers are prohibited from attempting to work through employee concerns before closing, or before the waiting period expires.

What about the merger agreement?

The Antitrust Division's case against *Computer Associates* expressed particular concern about the merger agreement's "material adverse change" clauses. In addition to a general clause against material adverse changes, the Computer Associates/Platinum merger agreement "also contained provisions not normally found in merger agreements that severely restricted Platinum's ability to engage in business as a competitive entity independent of CA's control."[17] In particular, the Division objected to the merger agreement's clauses that the seller would not offer firm price services for more than 30 days (*i.e.*, extending into the time when CA might own the company) or offer discounts of more than 20%. The merger agreement also provided that the buyer would have the right to grant exceptions on a case-by-case basis, putting the buyer in a position to approve the seller's efforts to compete with the buyer while the merger was pending.

While a buyer might want to protect against a wide variety of material adverse changes, detailed material adverse change clauses – particularly with regard to prices for sales or input purchases – could draw antitrust scrutiny. The Department's consent orders in *Computer Associates* and *Gemstar* provide some guidance as to what provisions the Department views as acceptable. In each case the consent order includes a permanent injunction against setting price or approving the seller's competitive offers after signing a merger agreement and the end of the HSR period. However, the injunction specifically allows merger agreements that:

- require the acquired person to continue to operate in the ordinary course of business consistent with past practices;

- require the seller not to engage in conduct that would cause a material adverse change in the business; or

[17] *Computer Associates*, competitive impact statement, p. 3.

- require the seller not to offer sales contracts with "enhanced rights or refunds" in the event of a change in control of the seller (*i.e.*, the merger).

Of course, the merging parties may believe they need more specific language than a general material adverse change clause. In that situation, they should recognize that they are entering into an area that might interest the antitrust authorities.

What about due diligence?

It is essential in most mergers for the acquirer to examine information beyond publicly available information in order to assess the value of the company to be acquired. In particular cases, it may be desirable to know about the acquired firm's customers, contracts with those customers, prices, the customers' historic purchases, and the acquired firm's future obligations. At the same time, this competitively sensitive information can easily facilitate price-fixing or customer allocation pending the merger – or after the merger is abandoned. Other competitively sensitive information – regarding costs, business strategies, product plans, patent applications or research – might also be on the due diligence inquiry list.

Information exchange (whether in the context of a pending merger or otherwise) should be judged under the rule of reason, and is not necessarily illegal. *U.S. v. U.S. Gypsum Co.*, 438 U.S. 422 (1978). However, the existence of an information exchange might be a piece of circumstantial evidence from which an agreement to fix prices might be inferred. *Petroleum Products Antitrust Litigation*, 906 F.2d 432, 445-50 (9th Cir. 1990). The antitrust agencies often express concern about information exchanges, and therefore have cautioned firms:

> As a general rule, competitors should not obtain prospective customer-specific price information prior to the consummation of the transaction. Access to such information raises significant antitrust risks, as it could be used to enter into an illegal agreement that would be harmful to competition if the transaction is subsequently abandoned. Notwithstanding, there may be situations during the due diligence process in which an acquiring person may need information regarding pending contracts to value the business properly.[18]

Therefore, some care should be taken with information exchanges, especially regarding current or future prices. It is preferable that sensitive information be shared on a need-to-know basis, and ideally kept away from line business people who could use the information competitively. In many situations, an outside auditor may be able to confirm facts stated in the aggregate ("so many millions of dollars of firm orders"), without business people seeing (and having an opportunity to use) sensitive information. The Antitrust Division has handled the issue in its *Computer Associates* and *Gemstar* consent orders by requiring the following conditions to disclosure of current or future prices or pending bids:

---

[18] *Gemstar-TV Guide*, Competitive Impact Statement at 15.

> (1) the information is reasonably related to a party's understanding of future earnings and prospects; and
>
> (2) the disclosure occurs pursuant to a non-disclosure agreement that (a) limits use of the information to conducting due diligence and (b) prohibits disclosure of any such information to any employee of the person receiving the information who is directly responsible for the marketing, pricing or sales of the competing products . . . .[19]

While this language is the carve-out from an injunction that bars future violations, proposed to be entered against a firm that the Division contends has violated the law, it provides a good general statement of an appropriate prophylactic measure for due diligence.

---

[19] *Gemstar-TV Guide*, proposed final order, ¶ V.D; *see Computer Associates*, final judgment, ¶ V.D.