The

M&A Lawyer

February 2003 • Volume 6 • Number 8

Contents

Shareholder Access Proposals Conflict with Federal Proxy Rules and State Law

By **Andrew R. Brownstein** and **Igor Kirman**

Amid the myriad of shareholder proposals for the 2003 proxy season relating to corporate governance is a well-organized campaign that, if successful, might result in a significant change in the governance of American corporations. The pension plan for the American Federation of State, County and Municipal Employees ("AFSCME") has targeted several prominent companies for a proposal to require inclusion in company proxy materials of director candidates nominated by holders of 3% of the company's outstanding shares.[1] In addition, AFSCME has announced that it is lobbying 150 public employee pension funds to adopt voting policies in favor of such "shareholder access" initiatives.[2]

Open access to company proxy materials for shareholder director nominations is not a novel idea. Over the past 60 years, Congress, the Securities and Exchange Commission ("SEC"), commentators and shareholder activists have made proposals to grant access to company proxy materials for shareholder director nominations.[3] Generally, the frequency of such proposals has risen during periods when the corporation and management have been under attack,

(continued on page 3)

Andrew R. Brownstein and **Igor Kirman** are with the firm of Wachtell, Lipton, Rosen & Katz. They are representing Sears, Roebuck & Co. in connection with a shareholder access proposal submitted by AFSCME.

Navigating Troubled Waters: Managing the Relationship Between Merging Companies

By **David A. Balto** and **Scott A. Sher**

The antitrust laws protect and enhance consumer welfare by requiring firms to compete aggressively and restricting improper coordination among rivals. The laws pose a unique and difficult challenge for merging parties who are supposed to compete aggressively while they negotiate a merger transaction and await regulatory approval. Merging parties have a substantial need to share information and act collectively. The practical challenge for merger partners is to draft merger agreements, conduct due diligence and plan for eventual integration without running afoul of the antitrust laws. At the same time, parties must satisfy their needs to collect information regarding each other to determine whether to enter into—and ultimately how to value—a transaction, plan integration efforts, and preserve the value of the target company in the often uncertain period between signing and closing.

Merging parties have a substantial need to share information and act collectively.

This article discusses the important legal principles that limit merging parties' behavior during the period between reaching an agreement to merge and ultimately closing the transaction. After setting forth those principles, we address some of the more frequent questions that concern the scope of permissible conduct before parties consummate a transaction, and then close with practical advice on how to steer clear of possible antitrust liability.

The Paradox of Antitrust for Merging Parties

In order to properly ascertain how to value and ultimately whether to enter into a transaction, parties sometimes must exchange competitively sensitive information with each other. Proper evaluation of a target company is often tied to its pipeline sales, sensitive research and development plans, and financial information, including gross margins, costs of goods sold and overhead expenses. Quick integration following the closing also may require a detailed analysis of next generation products and the profitability of certain existing product lines.

After signing a definitive merger agreement, an acquiring party must be able to protect the value of the business that it intends to acquire. Without the authority to place strict limitations on the target's ability to conduct business before the closing of a merger, a buyer often finds that by the time it assumes control over the target's operations, the value of the acquisition has diminished substantially. Targets take (or fail to take) actions that dilute the value of their assets—for example, they enter into long-term and less-than-favorable contracts with suppliers, allow key employees to leave in anticipation of the upheaval following closing, or lose important contracts because customers perceive the uncertainty surrounding the transaction as a reason to look for a more stable supplier of goods or services. Or the target's employees may act to maximize short-term gains. For example, salespersons can take a "fire sale" approach and enter into unwise or unprofitable contracts. These problems are even more substantial for firms that are subject to investigations by the antitrust agencies (*i.e.,* the Federal Trade Commission and the Antitrust Division of the Justice Department) that can take several months during which merging firms are in competitive limbo.

These legitimate business concerns sometimes conflict with the antitrust laws, which are designed to protect and promote competition. The antitrust laws—specifically the Sherman Act and the Hart-Scott-Rodino Antitrust Improvements Act ("HSR Act")—procedurally and substantively limit the conduct of

David Balto is the former Assistant Director of the Office of Policy and Evaluation of the Bureau of Competition of the Federal Trade Commission and is a Partner at White & Case LLP and **Scott Sher** is an Associate with the law firm of Wilson Sonsini Goodrich & Rosati, PC. The views expressed herein represent only the views of Mr. Balto and Mr. Sher and do not necessarily represent the views of their respective law firms.

parties from the time that merger negotiations begin until the time that the merger closes. The antitrust laws require competitive rivalry, and that rivalry cannot be diminished until a merger is consummated. As a former Assistant Attorney General observed "the pendency of a proposed merger does not excuse merging parties of their obligation to compete independently."[1] Thus, the antitrust laws require the merging parties to maintain their separate identities and prohibit them from integrating their operations until the time that the transaction has been consummated. Putative merger partners that once competed with each other must continue to compete as though no merger agreement was in place—even *after* signing a definitive agreement to combine operations.

After signing a definitive merger agreement, an acquiring party must be able to protect the value of the business that it intends to acquire.

In the pre-closing context, the antitrust laws address two particular concerns. First, the laws limit the ability of merging parties to exchange competitively sensitive information with each other. If parties improperly share competitively sensitive information it will become easier for them to collude (either explicitly or tacitly) if the transaction is abandoned—and many transactions are not consummated for legal or business reasons. Second, the antitrust laws prevent acquiring parties from exercising too much operational control over their targets. Securing control over a company before closing could lead a potential buyer to degrade or destroy the ability of that target to act independently. Not only will competition be diminished during the interim period, but if the transaction is abandoned, the ability of the former target to compete effectively will be diminished.

Basic Principles of Law and Recent Government Enforcement

Under the antitrust laws, agreements to restrain trade are unlawful. Specifically, under Section 1 of the Sherman Act, "[e]very contract, combination . . . or conspiracy, in restraint of trade . . . is . . . illegal."[2] Where a practice or policy "facially appears to be one that would always or almost always tend to restrict competition and decrease output" rather than "one designed to increase economic efficiency and render markets more, rather than less, competitive," that practice or policy is *per se* illegal and condemned as unlawful without further analysis.[3] Among such *per se* offenses are agreements between competitors to fix prices, allocate markets and divide customers.

In addition, the HSR Act prevents merging parties from consummating a merger until the appropriate HSR filing is made with the antitrust agencies and the waiting period expires. Thus, the Act places an absolute ban on "gun-jumping," that is, prematurely combining business operations.[4]

If parties improperly share competitively sensitive information it will become easier for them to collude (either explicitly or tacitly) if the transaction is abandoned[.]

In other words, the antitrust agencies contend that parties to a merger may not integrate their operations in any respect before receiving regulatory approval. Especially where the parties compete, the government is concerned that competition remain as it was prior to the signing of a merger agreement. Again, the antitrust laws ostensibly are interested in protecting competition in the "what-if-the-merger-does-not-close" world, because, of course, if the merger does indeed close as the parties had planned, there is little or no competitive harm associated with prematurely sharing information and integrating operations. By requiring companies to operate at arms-length until a merger closes, the HSR Act protects competition between companies who had planned to merger but for whatever reason, were unable to close a contemplated transaction.

Interestingly, the antitrust agencies' steadfast position that pre-closing coordination between parties to a merger agreement absolutely runs afoul of the antitrust laws is not entirely supported by case law. In fact, the one appellate court opinion that has addressed the issue, *International Travel Arrangers v. NWA, Inc.*, holds the contrary.[5] In *International Travel Arrangers*, the Eighth Circuit held that it was a question of fact for a jury to determine whether parties to a merger agreement had a "unity of economic interest and purpose" such that they were no longer "separate entities capable of conspiring."[6] If a jury concluded that the parties were sufficiently close in interest—for example, if they had completed many of the conditions to closing—then a jury could conclude that it would be impossible for them to conspire even though the transaction had not yet closed. Notwithstanding the tension between the agencies' position and the holding of *International Travel Arrangers*, parties to a merger agreement must consider that the government does not recognize the "unity of economic interest and purpose" paradigm and will prosecute claims where parties coordinate too closely with each other pre-close.

The antitrust agencies have stressed the importance of regulating parties' pre-merger conduct, through speeches[7] and enforcement actions.[8] For instance, just last year, the DOJ sued Computer Associates for pre-merger conduct violations in connection with its acquisition of Platinum Technology. In March 1999, Computer Associates and Platinum entered into an agreement to merge.[9] The two companies were direct competitors—and in some instances, the only two competitors—in different segments of the mainframe software management industry. The DOJ challenged the merger, and the parties ultimately agreed to divest substantial assets in order to maintain competition in the problematic areas. Subsequently, the DOJ sued Computer Associates and Platinum for illegal pre-merger coordination activity. That lawsuit culminated in a $638,000 civil penalty imposed upon Computer Associates by the Department of Justice.[10]

In *Computer Associates*, the DOJ alleged that the merger agreement contained extraordinary "conduct of business" provisions that prevented Platinum from engaging in certain activities during the HSR waiting period (*i.e.*, before the merger was consummated) without first obtaining Computer Associates' approval.[11] Specifically, the Merger Agreement stated that Platinum could not unilaterally determine the prices and terms it would offer to its customers. Under the Merger Agreement, Platinum could not:

- offer discounts greater than 20 percent off list prices;
- vary the terms of customer contracts from a mutually agreed-upon 'standard' contract;
- offer computer consulting services over 30 days at a fixed price; or
- enter into contracts to provide Y2K remediation services.

Computer Associates was "the sole arbiter" of whether to grant exceptions to these business restrictions during the HSR waiting period.[12] In fact, Computer Associates installed a Division Vice President at Platinum headquarters to approve Platinum customer contracts. Platinum even announced in its Form 10-Q filing dated May 14, 1999 that these "extremely tight restrictions" on the ability to conduct business "could have a severe detrimental effect" on business.

On March 30, 1999, the day after the merger was announced, Platinum's President sent an e-mail notifying senior management that:

> The point is that we will make it clear that all deals worldwide are to be negotiated at no more than 20% off current list. Any discount greater than that will not necessarily get turned down but I'm going to act like it will until we see the specific paperwork and approve it. If that means an impact on our business then we will see, but this is serious and there will be no exceptions what-so-ever to the revue process. We can absolutely NOT do what we have been doing. No deals will be accepted, commissions will not get paid, customer contracts will NOT be honored and who ever does it will be immediately terminated.[13]

According to the DOJ, these documents were crystal-clear evidence that the parties had engaged in illegal pre-merger coordination and integration of their businesses, violating both the Sherman and HSR Acts.

[T]he antitrust agencies and the courts will not look favorably upon parties that use the merger process as a subterfuge to exchange competitively sensitive information[.]

Although there may have been legitimate reasons to attempt to prevent fire-sale prices, which could have diminished the value of Platinum's business, both the agreement to prevent all discounting, as well as the fixed-price agreements were simple price fixing. Moreover, the agreement not to provide Y2K remediation services was a clear market division. These agreements would be *per se* illegal in any other setting; the need to preserve the value of the business could not have justified these otherwise illegal agreements.

The Limits of Information Sharing and Pre-Merger Integration

Computer Associates appears to be a fairly straightforward case. Even more important than the enforcement action itself was the DOJ's attempt to articulate general principles in this complex area by issuing a detailed Competitive Impact Statement explaining the DOJ's position with regard to pre-merger coordination.[14] The Competitive Impact Statement provided important guidance for parties contemplating mergers and acquisitions that will assist in gauging whether contemplated pre-merger coordination and behavior is permissible business conduct or instead represents illegal collusion. Below, we outline the legal principles for two general areas covered by the *Computer Associates*' Competitive Impact Statement: (1) the scope of permissible information exchange between merger partners, and (2) the extent to which a buyer may exert operational control over a merger target.

1. *Information Exchange Restrictions*

It goes without saying that the antitrust agencies and the courts will not look favorably upon parties that use the merger process as a subterfuge to exchange competitively sensitive information and never intend to consummate the transaction. Such evidence, if discovered, would be clear proof of collusion between competitors and would violate the Sherman Act.[15]

More generally, the antitrust laws are concerned about restricting the flow of competitively sensitive information to protect competition during the interim period before a closing—and in the event that a merger ultimately is abandoned. If a merger is not consummated after competitively sensitive information is shared between merger partners, the quality of competition between those competitors-turned-merger-partners-turned-competitors would diminish if the flow of such competitively sensitive information is not adequately regulated.[16]

[S]haring even competitively sensitive information may be permissible if the parties have a legitimate business purpose (e.g., diligence or post-close planning) and they take efforts to limit its distribution.

For example, in an action involving Insilco Corporation, the Federal Trade Commission charged that Insilco and its merger partner improperly shared sensitive information, specifically: "[n]on-Aggregated, Customer-Specific Information" including "customer-by-customer price quotes; current pricing policies and strategies; and detailed, customer-by-customer future pricing strategies" "all of which is the type of information that would likely have been detrimental to competition" if the merger did not close.[17]

That is not to say that merging parties cannot collect all such competitively sensitive information to conduct due diligence or evaluate a potential transaction. In fact, in the *Computer Associates* Competitive Impact Statement, the DOJ made it clear that such information sharing indeed may be necessary to properly value and execute a merger.[18] The DOJ warned, however, that parties should take appropriate precautions to ensure that such information is used properly and regulated closely. Specifically, the DOJ set forth that Computer Associates was permitted to:

- Conduct "reasonable and customary due diligence";
- Share competitively sensitive bid information with a competitor-target where such information was necessary to understand "the future earnings and prospects of the other party." However, such information could not be distributed to sales or marketing personnel involved in the sale or marketing of a product line that competes with the target;
- Share "pending contacts in the pipeline," but only to the extent that such information is necessary to value to business.[19]

Thus, sharing even competitively sensitive information may be permissible if the parties have a legitimate business purpose (*e.g.*, diligence or post-close planning) and they take efforts to limit its distribution.[20] If a buyer needs sensitive information to properly value a transaction, it could obtain such information if the parties take care to restrict its dissemination to only those who need such information as part of the effort to evaluate the wisdom of entering into the transaction, keep it out of the hands of those who could use it for improper purposes (sales and/or marketing personnel, for example), and create firewalls to limit its distribution until the merger closes or is abandoned.[21] In other words, even competitors contemplating a merger may share sensitive information, so long as they take proper precautions to restrict the dissemination of such information to those who could use it improperly. Companies such as Insilco Corporation find themselves embroiled in litigation with the antitrust agencies not because they share competitively sensitive information with their merger partners; rather, they find themselves in trouble because they share such information for the wrong reasons, and without taking proper precautions to limit the flow of such information.

2. *Operational Restrictions on the Target Company*

Under the HSR Act regulations, there are two distinct restrictions upon the transfer of operational control of the target to the buyer: (1) the target cannot transfer "beneficial ownership" or indicia of "operational control" to the acquiring party prior to receiving HSR clearance, and (2) where the target and buyer compete, they cannot lessen competition prior to closing.[22] Thus, in all instances, merging parties must await HSR clearance before transferring the indicia of beneficial ownership from the target to buyer. And where merger partners compete, they additionally must continue to compete up until the time of closing (even after HSR clearance). This means that, in general, any form of integration—including joint sales calls, joint bids, or customer allocation—is illegal.[23]

Under the HSR Act, prior to closing, parties must maintain their "separate and independent economic" identities,[24] and a buyer cannot exercise "influence over the direction of the business" of the target.[25] Parties may, however, place certain "ordinary course" restrictions prohibiting merger targets from materially changing business models during the pendency of a merger.[26] Thus, limiting a target's ability to declare dividends, issue securities, amend by-laws, enter into material contracts, and undertake "new large capital expenditures" does not contravene the letter or intent of the antitrust laws.[27] On the other hand, restricting a company's ability to offer discounts, make ordinary course sales to customers, or offer new services constitutes "extraordinary" restrictions that are "not reasonably ancillary to any legitimate goal."[28]

Computer Associates, as part of the resolution of the Department of Justice's action, entered into a Consent Decree that limited the scope of the company's pre-closing conduct in any future transactions that the company contemplated. Under the Consent Decree, Computer Associates could not:

- influence a transaction partner's ability to set prices or discount;
- require its approval before the target could enter into contracts with customers;
- improperly use competitively sensitive (*e.g.*, pricing) information.

As important, the Competitive Impact Statement provides further guidance on the limits of permissible conduct. To that end, the DOJ concluded that in the future, Computer Associates may continue to:

- enter into "interim covenants" to protect the value of a business, e.g., requiring a target company "to operate in the ordinary course of business";
- prohibit a target company from engaging "in conduct that would cause a material adverse change in the business";
- secure pending bid information of the other party for due diligence purposes, only to the extent that the bids are material to the understanding of the future earnings and prospects of the other party and are subject to a carefully drawn confidentiality agreement that allows only non-sensitive employees to view such information;
- submit joint bids where "the joint bid would be lawful in the absence of the planned acquisition" (*i.e.*, where Computer Associates and the target otherwise would not be competing for the customer account);
- enter into an agreement whereby Computer Associates and the transaction target "are or would be in a buyer/seller relationship and the agreement would be lawful in the absence of the" transaction.[29]

Thus, parties—especially where they compete—must be careful to ensure that they are not lessening competition in the period before closing. Nevertheless, acquiring companies should carefully consider which restrictions on the target's business are necessary to ensure the viability of the assets upon the closing of the transaction. The antitrust laws do not require buyers to assume complete risk with regard to potential acquisition targets. Instead, the laws require parties to carefully contemplate the necessity of such limitations on a target's conduct and the likely impact on competition of such restrictions. Reasonable, tempered and legitimate restrictions on business conduct likely will survive antitrust scrutiny in this context.

Practical Advice: How to Manage Pre-Closing Relationships

With these antitrust principles in mind, what can parties do? And what is prohibited in the context of pre-closing conduct? Again, in general, any attempt to combine the operations of two companies could violate both the HSR and Sherman Acts. On the other hand, buyers can place restrictions on a target company's behavior and merging parties can work together to plan for integration. In the end, actions must be measured on a continuum of risk: the more substantial the coordination, the more careful the parties must be in regulating that cooperation.

Parties also must be wary about sharing competitively sensitive information during the period before closing. Such information should be limited to that necessary for valuation—or for eventual integration—and should be restricted to only those individuals who are responsible for or who have a "need to know" in planning for integration. Parties should be aware that sharing cost, pricing, marketing or product development plans, current or future production quantities, and details on sales terms or efforts with specific customers are risky if the transaction partner is a competitor.

From our experience, there are a number of specific situations in which clients need guidance as to how to conduct themselves prior to closing of a transaction. Below, we analyze common situations in which business necessities sometimes collide with antitrust realities.

1. Exchanging Information Between Parties

Diligence, of course, is essential to the M&A process. To what extent do the antitrust laws allow the parties to exchange information? Generally, even during the diligence process, competitors (actual or potential) should avoid exchanging information regarding current or future prices, costs, terms of dealing, production quotas, non-public product or technical specifications, sales, business or product plans, marketing, specific customer information, profitability or margins, and other competitively sensitive topics.

One effective method to ensure that competitively sensitive information is not improperly shared between parties is to establish a "clean room."

To the extent that merger partners need to exchange competitively sensitive information for a valid business purpose, such information should be exchanged and disseminated only to a core group of personnel, on a need-to-know basis, and pursuant to a confidentiality agreement. In addition, to the extent that pricing information, for example, is being shared among competitors, the parties should aggregate the information so that it does not appear that the parties are exchanging such information in an attempt to facilitate collusion. In fact, where parties are direct competitors, they often conclude that it is sufficient to share such sensitive information with outside consultants—*e.g.*, investment bankers who conduct a net present value of the assets to be acquired—who manage and evaluate such data.

In sum, where possible, the parties should:

- aggregate competitively sensitive data;
- limit dissemination to those with a legitimate need to know;
- prevent its dissemination to sales or marketing personnel who might use it in the marketplace;
- ensure there is a sufficient justification for the information disclosure (e.g., valuation or integration planning); and
- adhere carefully to the provisions of a confidentiality agreement.

One effective method to ensure that competitively sensitive information is not improperly shared between parties is to establish a "clean room." Such a clean room would include individuals from both parties who are tasked with the responsibility of reviewing potentially competitively sensitive information with each other in order to plan for integration, develop new product roadmaps, decide which employees would be fired post-closing, and set pricing schedules.

In some situations, clean rooms include high-level employees from product divisions, who, in the event that the merger is never consummated, are prohibited from returning to their prior positions (thus minimizing the risks that they would use the information they learned during diligence). Clean room employees often are firewalled from the rest of the company. In addition to not being able to discuss their activities with their peers, these persons use separate computers, are issued new e-mail addresses, and store their information on servers that only can be accessed by other clean room participants. Such protections minimize the risk of inadvertent disclosure to members outside the "clean team."

2. Continue to Compete

Merging parties must continue to act as if they will remain separate and independent for the foreseeable future. There can be no diminution in planning, marketing, and selling. Companies should not agree to enter into joint bidding situations where they once competed and certainly should not withdraw from competitive bidding situations prior to the closing of the transaction.

Marketing—even marketing directed against one's merger partner—likewise should not abate. Again, to the extent that competitively sensitive information must be shared—for example, customer lists—such information should not be shared with employees who could use that information to diminish present-day competition.

Merging parties must continue to act as if they will remain separate and independent for the foreseeable future.

Computer Associates raises a practical problem: How does an acquirer ensure that the target will not enter into long-term contracts at below-market rates? Even if the parties include customary "ordinary course of business" provisions in the Purchase and Sale Agreement, the acquirer still may have a problem policing the actions of the target. Acquirers often are concerned about the target's long-term contracts and whether the pricing generates sufficient return, and due diligence often does not reveal the level of detail regarding these contracts necessary to assess the pricing issue. Moreover, the targets sales force may be interested in entering into below market deals to inflate their own sales figures, particularly where they are compensated by commission.

Certainly, managing the pricing decisions of a competitor, as Computer Associates did with Platinum, went too far. One solution to this problem may be to have the target's contracts reviewed by an employee (or a retiree) of the acquirer who has no involvement in pricing decisions. That employee should be required to sign an agreement prohibiting disclosure of the sensitive information to anyone else at the company. He or she can then prepare a report, which in general terms, provides an assessment of whether the pricing terms are sufficient. To further insulate the information from improper disclosure, the parties should make sure that individual customers are de-identified, and in certain cases, the data should be aggregated. In addition, the report should be reviewed by counsel. In this way, the acquirer can assess whether the target is devaluing its product, while at the same time, minimize the disclosure of sensitive information.

3. Continued Business Independence

Neither party should allow employees of the other to dictate its competitive activities in any fashion. Where the companies may have competed before signing a merger agreement, they should continue to compete vigorously until closing. Again, it is largely a fiction that merging parties are separate, but because of the concern that a merger may never close (or may take a long time to consummate), competition between separate entities should be preserved until they no longer are legally separate.

It is essential when drafting the merger agreement to restrict the target company only to the extent necessary to preserve the value of the business and not to influence the ordinary course of the target's business. Thus, while it is permissible to write covenants into a merger agreement that restrict material changes in a target company's behavior prior to closing, it is not acceptable to include covenants that limit the target's ability to control its ordinary course of business. Thus, covenants designed to preserve the status quo and, therefore, the value of the business being sold to the purchaser should pass antitrust muster.

As in *Computer Associates*, it would be improvident for the parties to negotiate conduct provisions in a merger agreement that require the target to seek consent from the acquirer for every pricing change, new contract, facility lease or employment decision. On the other hand, it is perfectly permissible to place limitations on the target that prohibit it from any extraordinary actions—for example, entering into a major contract, materially altering the terms of its licensing structure, and issuing new stock—in order to protect the value and integrity of the business being purchased.

4. Scope of Customer Contacts

Customers—especially of the target—inevitably will be sensitive as to the nature of their dealings with the parties following the closing of the transaction. Customers will also be very concerned about what the future holds for them. Customers generally are wary of purchasing products from a target company prior to the time that integration has occurred, to ensure that product that they are purchasing will not be end-of-lifed and consequently not supported or serviced adequately. Thus, it is essential for merging parties to contact their customers soon after the merger is announced to reassure them of the parties' post-closing plans and secure their business post-closing. Although the parties can take some actions to assure their respective customer bases—even together—such communications must be carefully monitored.

First, joint sales calls between merging competitors are prohibited. Where the parties competed before, they must continue to compete and competitive bidding situations must remain competitive until closing. Merging parties that once offered competitive products cannot visit customers together and cooperate for their business. Period.

[I]t is essential for merging parties to contact their customers soon after the merger is announced to reassure them of the parties' post-closing plans and secure their business post-closing.

However, high-level introductions are generally permissible. Thus, CEOs or high-level Vice-Presidents should feel relatively comfortable if they decide to visit and/or call customers to announce a business combination, explain the merger process and set forth the reasons why the parties have decided to merge. It is unwise, however, to allow sales and/or marketing personnel to attend such meetings. As soon as a joint contact with a customer seems more like a sales pitch, antitrust concerns arise.

5. Business Accommodations

Often, relationships between merging parties are not so cut-and-dry. For example, two companies may have a longstanding OEM relationship in one product area where one party filled a hole in a product line by purchasing that product from the other, but nonetheless competed vigorously for business with respect to several other product lines. As a result of this long-standing OEM relationship, the companies may ultimately decide that their corporate cultures are very similar and that a combination of their business operations would generate significant efficiencies. How do the companies manage this integration during pre-closing?

As discussed above, although the HSR and Sherman Act would preclude a combination of business interests before closing, it is still possible to manage, *at arms length*, existing OEM relationships. To the extent that the parties need to continue or expand that relationship, they should consider the following:

- If the parties re-negotiate or negotiate new OEM relationships with each other, such negotiations should occur independently of the merger agreement.
- Continuation of the OEM relationship should not be contingent upon the merger closing or not. In other words, the OEM contract should contain fair consideration and should continue for a date-certain, regardless of when or whether the merger closes.
- If competitively sensitive information is shared in the context of the OEM arrangement, make sure that information is not shared widely and is kept confidential pursuant to a standard Non Disclosure Agreement.
- In the end, ensure that the terms of the Agreement are fair and standard, and that the agreement is one that both parties feel comfortable with, and would have entered into regardless of whether they merge.

In addition, the parties, during the period between signing and closing, may also contemplate new business relations short of the merger. To the extent that such prospects are negotiated independently of the merger agreement as discussed above—and do not involve areas where the parties compete—such arrangements likely are permissible.

Thus, to the extent that the acquiring party needs a new input for its final product that it presently does not itself manufacture, it is permissible—on an arms-length basis—to negotiate an agreement to purchase that input from the other party to the merger, so long as fair consideration is exchanged and the terms of the agreement are consistent with normal purchasing practices for the companies and the industries. Thus, such purchases should be conducted by employees regularly engaged in such purchasing decisions, invoices should be created and maintained, and the closing of the merger should not be a condition of the validity or continuation of that contract.

6. External Communications

Some of the most damaging evidence suggesting illicit pre-merger coordination involves fairly obvious and unnecessary actions by merging parties. A careful external communication plan is essential; in most cases the government learns of HSR "gun jumping" violations where customers complain to the agencies that the merging parties have engaged in illicit coordination prior to close. In past government enforcement actions, merging parties have jumped the gun by engaging in the following activities before closing:

- announcing major internal restructuring at the combined company;
- having the phones answered at the target's offices under the buyer's name (or routing calls intended for the target to the buyer);
- jointly presenting at road-shows, industry trade events or major customers;
- requiring approval of the target's ordinary business requests by an officer at the buyer.[30]

That said, there are some more subtle issues that arise during the pendency of a merger that companies may need to consider. For example, a company may be acquiring a competitor to obtain several of its key employees. That buyer may be concerned, however, that before the merger closes, these key employees may leave because of the uncertainty that the merger announcement creates. How does the buyer ensure that those valuable assets do not flee without running afoul of the antitrust laws?

The antitrust laws create an expectation of rivalry that seems antithetical to the intense cooperation necessary to effectively pull off a complex merger.

Fundamentally, immediately upon signing (but before closing), the buyer cannot selectively hire those key employees from the target. That does not end the analysis, however. There are actions short of immediate hiring that the buyer could consider. Under the antitrust laws, it should be permissible for the buyer to send notices to employees of the target, stating that the buyer *intends* to make an offer employment *if* and *when* the merger closes, making the offer contingent upon the closing *actually* occurring, which should clearly be articulated to those employees is no *guaran-*

tee. Of course, such offers may raise a multitude of other issues—including employment law issues—and the buyer must be aware that such offers—even if contingent—may raise poaching or other business tort claims.

Conclusion

It is a thorny and complex task for two competitors to manage antitrust risks while at the same time negotiating and entering into an agreement to merge, and then planning for quick and smooth integration at close. The antitrust laws create an expectation of rivalry that seems antithetical to the intense cooperation necessary to effectively pull off a complex merger. Moreover, the lack of judicial decisions and agency guidance make managing this process all the more uncertain. Merging parties need extensive and careful counseling to avoid antirust risks in this area. M&A

Notes

1 Charles A. James, Assistant Attorney General, Antitrust Division, Recent Developments and Future Challenges at the Antitrust Division, Remarks Before the Dallas Bar Ass'n (Sept. 17, 2002), *available at* http://www.usdoj.gov/atr/public/speeches/200239.htm.

2 15 U.S.C. § 1 (1994).

3 *Broadcast Music, Inc. v. CBS*, 441 U.S. 1, 19-20 (1979).

4 *See* 15 U.S.C. § 18a (1994 & Supp. V 1999).

5 991 F.2d 1389, 1397 (8th Cir. 1993).

6 *Id.*

7 *See, e.g.*, David P. Wales & Margaret A. Ward, "U.S. v. Computer Associates: Pre-Merger Coordination Issues under Section 7A and the Sherman Act," Clayton Act Newsletter (Spring 2002) (hereinafter *Wales & Ward Article*); William J. Baer, Report from the Bureau of Competition, Remarks Before the American Bar Association Antitrust Section, Spring Meeting (Apr. 15, 1999), *available at* http://www.ftc.gov/speeches/other/baerspaba99.htm; Mary Lou Steptoe, Premerger Coordination/Information Exchange–FTC Competition Bureau Acting Director's Views, Remarks Before the American Bar Association Antitrust Section, Spring Meeting (Apr. 7, 1994), *reprinted in* [1985-1997 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 50,134, at 49,029 (1994).

8 There have only been a few enforcement actions over the last decade, including *United States v. Computer Assocs. Int'l, Inc.*, Complaint, Civ. No. 01-02064 (D.D.C. filed Sept. 28, 2001), *available at* http://www.usdoj.gov/atr/cases/f9200/9246.htm; *United States v. Input/Output, Inc.*, 1999-1 Trade Cas. (CCH) ¶ 72,528 (D.D.C. 1999); *In re Insilco Corp.*, 125 F.T.C. 293 (1998); *United States v. Titan Wheel Int'l, Inc.*, 1996-1 Trade Cas. (CCH) ¶ 71,406 (D.D.C. 1996); *In re Torrington Co.*, 114 F.T.C. 283 (1991). For an outstanding article detailing recent enforcement actions and discussing the relevant legal analyses in this area, *see* M. Howard Morse, *Mergers and Acquisitions: Antitrust Limitations on Conduct Before Closing*, 57 The Business Lawyer 1463 (Aug. 2002) (hereinafter "*Morse Article*").

9 *See Computer Assocs., Complaint at* ¶ 1, *supra* note 8. *See Wales & Ward Article*, *supra* note 7, for an extensive discussion of the case.

10 *See* Press Release, Justice Department Files Lawsuit Against Computer Associates for Illegal Pre-merger Coordination (Sept. 28, 2001), *available at* http://www.usdoj.gov/atr/public/press_releases/2001/9189.htm.

11 *See Computer Assocs.*, *Complaint* at ¶ 2, *supra* note 8.

12 *See id.* at ¶ 2.

13 *Id*. at ¶22.

14 *See United States v. Computer Assocs. Int'l, Inc.*, Proposed Final Judgment and Competitive Impact Statement, 67 Fed. Reg. 41,472 (2002).

15 *See* Mary Lou Steptoe, then Deputy Director, Bureau of Competition, Federal Trade Commission, Remarks Before the February, 1991 National Health Lawyers Ass'n Conference (Feb. 14, 1991).

16 *See generally* William Blumenthal, *The Scope of Permissible Coordination Between Merging Entities Prior to Consummation*, 63 Antitrust L.J. 1 (Fall 1994) (hereinafter "*Blumenthal Article*").

17 *In re Insilco Corp.*, 125 F.T.C. 293, 294-95 (1998).

18 *See Computer Assocs.*, Proposed Final Judgment and Competitive Impact Statement, 67 Fed. Reg. at 41,474.

19 *See id.* at 41,474, 41,479.

20 Howard Morse's article explains the rule-of-reason analysis that the government would undertake in examining the legality of such pre-merger conduct. *See Morse Article*, 57 The Business Lawyer at 1481-82, *supra* note 8.

21 *See* Ilene Gotts, *Information Sharing in the Pre-Merger Context: How to Avoid Antitrust Liability*, Vol. 45, No. 6, Practical Lawyer, pp. 23-32 (Dec. 1999).

22 43 Fed. Reg. 33,450 (1978).

23 *See Morse Article*, *supra* note 8, at 1469-71.

24 *Computer Assocs., Proposed Final Judgment and Competitive Impact Statement*, 67 Fed. Reg. at 41,478-79.

25 *See Blumenthal Article*, 63 Antitrust L.J. at 47-48, *supra* note 16.

26 *See Computer Assocs.*, 67 Fed. Reg. at 41,478-79.

27 *Id.*

28 *Id.* at 41,478.

29 *Id. See also Wales & Ward Article*, *supra* note 7.

30 *See, e.g., Input/Output, Inc.*, 1999-1 Trade Cas. (CCH) ¶ 72,528; *Titan Wheel Int'l, Inc.*, 1996-1 Trade Cas. (CCH) ¶ 71,406.