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# FTC GENERAL COUNSEL CLARIFIES BOUNDARIES OF "GUN JUMPING" DOCTRINE

In a recent speech, FTC General Counsel William Blumenthal provided much-needed guidance in the area of "gun jumping," the antitrust standards governing pre-closing coordination between parties to a business combination. In his remarks (available at http://www.ftc.gov/speeches/blumenthal.htm), Blumenthal attempted to correct misconceptions about what, in the federal antitrust agencies' view, is and is not permitted prior to closing.

Blumenthal acknowledged that merging firms have a legitimate interest in engaging in certain forms of pre-closing coordination, usually in the form of due diligence and transition planning. But parties proposing to merge are not yet a single entity, and must respect certain limitations on integration activities under U.S. antitrust laws: (1) until closing, they are subject to Section 1 of the Sherman Act, prohibiting anticompetitive collusion among competitors: and (2) in transactions requiring premerger filings under Section 7A of the Clayton Act, also known as the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR"), one party may not acquire beneficial ownership of the other until expiration of a statutory waiting period.

During the last ten years, the FTC and the U.S. Department of Justice have brought six enforcement actions against firms that had "jumped the gun" by excessive coordination before closing. These cases, all of which involved egregious behavior, have had the intended effect of educating the public on the issue of gun-jumping. In each action, the merging firms had prematurely combined significant aspects of their day-to-day operations and managed themselves as one. None of the cases, Blumenthal points out, involved conduct designed or intended merely to facilitate future integration.

Blumenthal commented, however, that the enforcement agencies are beginning to see indications that many in the legal community are reading these cases to impose prohibitions on conduct beyond those the agencies intended. In fact, he conceded that concerns about gun-jumping that result from overly conservative counseling can sometimes result in insufficient planning and reduce the likelihood of success for a post-merger company. He therefore sought to "reset the rhetoric and provide greater clarification of the balances [the agencies] strike."

In that connection, Blumenthal described how the antitrust agencies analyze premerger coordination under Section 1 and under Section 7A.

**Section 1 Analysis.** Under Section 1, Blumenthal explained, a merger:

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> is a lawful form of contract to which otherwise-suspect restraints will often be ancillary. Where premerger coordination is reasonably necessary to protect the core transaction, the conduct is assessed under the rule of reason. For the 95% of transactions that do not raise competition issues … the reasonableness analysis should be simple, and the conduct will seldom present serious competitive questions. For the other five percent of transactions, though--those in which the merging parties are among a limited number of competitors or in which their relationship presents complex competitive issues--the reasonableness analysis is more complex. It typically is highly fact-specific, requiring a balancing of potential adverse effects against the strength of the justification for the conduct, taking into account alternative means by which the legitimate objectives of the conduct might be realized.

Blumenthal emphasized, though, that not all forms of premerger coordination between merging firms would be considered ancillary to the core transaction. For instance, he stated that coordination on prices to be charged during the interim period or on the allocation of accounts during that period "will almost never be reasonably necessary to protect the merger." As a result, agreements of this type between competitors will generally remain *per se* illegal.

**Section 7A Analysis.** The analysis under §7A turns on whether the conduct has had the effect of shifting beneficial ownership. The HSR rules do not define "beneficial ownership" and the beneficial ownership analysis can be difficult in the merger context because merger agreements typically include provisions that shift some indicia of beneficial ownership to the buyer as soon as the merger agreement is signed. For example, price-adjustment provisions will often shift some of the right to gain or risk of loss from seller to buyer. Merger agreements also typically limit the seller's investment discretion by including covenants that prohibit extraordinary transactions without the buyer's consent. While none of these provisions is inherently problematic, Blumenthal explains, if too many indicia of beneficial ownership have shifted to the buyer (for example by giving the buyer access to confidential information and control over key decisions) prior to expiration of the HSR waiting period, a violation of §7A could be found.

After generally describing the overall analytical framework, Blumenthal provided some commentary and guidance on three specific examples of coordination issues that merging competitors frequently encounter: (1) spill-over effects from ordinary due diligence and transition planning; (2) planning for post-closing matters requiring preliminary premerger implementation; and (3) joint marketing activities.

As to spill-over effects, Blumenthal commented that, in addition to competitors' built-in private incentives not to divulge too much confidential information and the use of merger agreement confidentiality provisions to prevent inappropriate disclosure of proprietary information, there exist a range of potential fixes to consider in the "fraction of transactions" that pose real spill-over concerns, including: (1) the exchange of only historical or aggregated information; (2) the use of an otherwise isolated internal "clean team" or outside consultants for integration planning; or (3) where practicable, delaying the most sensitive integration activities. Regarding planning for post-closing matters requiring preliminary premerger implementation – for example, decisions not to proceed with capital projects under consideration pre-transaction that may be rendered redundant or inefficient post-transaction – Blumenthal clarified that “the agency position is not one of categorical opposition,” but rather involves a fact-intensive inquiry examining a host of factors, including: (1) whether any such decisions were made unilaterally by the seller, mandated by the buyer, or something in between; (2) the magnitude of efficiencies realized from the decisions; (3) whether the decisions are reversible if the merger is not consummated; (4) how the decisions affect the seller’s competitiveness and the overall level of market competition; and (5) whether the decisions represent a material change in the operation of the seller. Finally, as to joint marketing activities, Blumenthal eliminated ambiguity as to the propriety of joint advertisements that simply announce or support the merger, and joint courtesy calls to customers and suppliers touting the benefits of the merger, explaining that they do not run afoul of gun-jumping prohibitions.

Blumenthal’s remarks help clarify the agencies’ position in the area of premerger coordination: Even though due diligence and transition planning involve exchanges of information and collaboration that would not occur among independent firms, these forms of coordination are usually reasonable and even necessary to implement the objectives of the merger agreement and achieve available efficiencies and “within appropriate limits, both are unobjectionable from an antitrust enforcement perspective.”

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