

THE RHETORIC OF GUN-JUMPING

Remarks before the Association of Corporate Counsel

**Annual Antitrust Seminar of Greater New York Chapter:
Key Developments in Antitrust for Corporate Counsel**

**New York
November 10, 2005**

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Thank you for inviting me to join you this afternoon at your Annual Antitrust Seminar. I would like to use this opportunity to address an issue that is often of interest to corporate counsel and that has been an interest of mine for fifteen years, namely the antitrust standards governing coordination between merging firms before they close the transaction.¹

On the one hand, firms proposing to merge are not yet a single entity, and their activities are subject to Section 1 of the Sherman Act,² which governs collective action in restraint of trade. Depending on the size of the transaction and the timing of the coordination, their activities may also be subject to Section 7A of the Clayton Act,³ more commonly known as the Hart-Scott-Rodino Antitrust Improvements Act, which prohibits

* These views are those of the speaker and do not necessarily represent the position of the Federal Trade Commission or of any individual Commissioner.

¹ An article I published in 1994 was the first extended treatment of the topic of premerger coordination to appear in a scholarly journal. See William Blumenthal, *The Scope of Permissible Coordination between Merging Entities Prior to Consummation*, 63 ANTITRUST L.J. 1 (1994) (hereinafter *Scope*). The article followed earlier work on the topic during my term as Chair of the ABA Antitrust Section's Clayton Act Committee. See, e.g., William Blumenthal, *Moderator's Background Materials and Notes*, in SPRING MEETING COURSE MATERIALS (ABA 1994) (materials prepared in connection with session entitled "Scope of Permissible Coordination Between Merging Entities Prior to Consummation" at ABA Antitrust Section Spring Meeting on Apr. 7, 1994).

² 15 U.S.C. § 1. In enforcement actions by the FTC against conduct that would violate Section 1, the matter is brought under Section 5 of the FTC Act, 15 U.S.C. § 45.

³ 15 U.S.C. § 18A.

the acquisition of beneficial ownership without first filing premerger notification and observing a waiting period. I will speak about these provisions in greater detail in a few moments.

On the other hand, the merging firms have a legitimate interest in engaging in certain forms of coordination that would not be expected except in the merger context. The most common forms are due diligence and transition planning, both of which necessarily will involve exchanges of information at levels of detail that would not normally occur among independent firms. In addition, merging firms sometimes enter into covenants or engage in practices that would not normally be seen among independent firms. These forms of premerger coordination will often be reasonable and even necessary to implement the legitimate objectives of the merger agreement. Where the merging firms are competitors or are otherwise in a relationship that affects competitive interactions in the marketplace, however, premerger coordination can present issues under Section 1. And regardless of the competitive posture of the merging firms, excessive premerger coordination can present an issue of beneficial ownership under Section 7A.

Over the past decade the Federal Trade Commission and the U.S. Department of Justice have brought six cases against firms that “jumped the gun” on their mergers by engaging in excessive coordination before closing.⁴ The cases are described in detail in complaints, analyses to aid public comments, competitive impact statements, and other agency materials available on our web sites; and I have provided short descriptions in the Background Materials distributed to persons attending this Seminar.⁵ My colleagues and predecessors at the enforcement agencies have also discussed the cases in numerous speeches.⁶ With that wealth of source materials on the cases, I am not going to take your

⁴ United States v. Gemstar-TV Guide Int’l, Inc., No. 03-0198, 2003 WL 21799949 (D.D.C. July 11, 2003); United States v. Computer Assocs. Int’l, Inc., No. 01-02062, 2002 WL 31961456 (D.D.C. Nov. 20, 2002); Complaint, United States v. Input/Output, Inc., No. 99-0912 (D.D.C. filed Apr. 12, 1999), available at <http://www.ftc.gov/os/1999/04/inputoutput.pdf>; In re Commonwealth Land Title Ins. Co., 126 F.T.C. 680 (1998); In re Insilco Corp., 125 F.T.C. 293 (1998); United States v. Titan Wheel Int’l, Inc., No. 96-01040, 1996 WL 351143 (D.D.C. May 10, 1996). As described in greater detail in Background Materials, see *infra* note 5, the complaints in the cases alleged several different theories. *Gemstar* and *Computer Associates* were brought under both Section 1 and Section 7A; an earlier complaint in *Computer Associates* had alleged separate violations of Section 7. *Input/Output* and *Titan Wheel* were brought under Section 7A. *Commonwealth Title* and *Insilco* were brought under Section 5 (for conduct of a type that would also violate Section 1); the transactions were also challenged under Section 7. For discussions of gun-jumping cases prior to 1995, see *Scope*, *supra* note 1, and *Steptoe*, *infra* note 6.

⁵ Background Materials On Premerger Coordination (Nov. 10, 2005), available at <http://www.ftc.gov/speeches/blumenthal.htm>.

⁶ See, e.g., Daniel Ducore, Assistant Dir., Bureau of Competition, Fed. Trade Comm’n, “Gun-jumping” – The Antitrust Laws and Pre-merger Conduct (Aug. 8, 2003) (hereinafter Ducore 2003 Speech); Charles A. James, Assistant Attorney Gen., Antitrust Div., U.S. Dep’t of Justice, Prepared Statement before the Subcommittee on Antitrust, Competition, and Business and Consumer Rights of the United States Senate Committee on the Judiciary, at 7 (Sept. 19, 2002), available at <http://www.usdoj.gov/atr/public/testimony/200233.pdf>; Marian R. Bruno, Assistant Dir., Premerger Notification Office, Bureau of Competition, Fed. Trade Comm’n, Prepared Remarks before the ABA

time describing them in detail here. What is important for me to note, though, is that all were easy cases that involved egregious conduct.

Through our public statements, agency officials have tried to educate the public about the violations in the six cases and to discourage similar conduct by others. That effort has been largely successful. Our experience is that most inside counsel and outside advisers involved in mergers have become alert to the issue of gun-jumping.

We are beginning to see some indications, however, that we may have been too successful – that our message may have been heard by some in our audience to prohibit conduct beyond what we intended. As I mentioned a moment ago, we are mindful that many forms of premerger coordination are reasonable and even necessary and that care needs to be taken not unduly to jeopardize the ability of merging firms to implement the transaction and achieve available efficiencies.

The issue of calibrating legal standards so that they are neither underinclusive nor overinclusive is not a new one. It is commonplace, for example, for legal commentators to analogize to statistics and to speak of Type 1 and Type 2 error, where Type 1 error is defined as stopping conduct that would be socially beneficial and where Type 2 error is

Conference on Mergers & Acquisitions: Getting Your Deal Through the New Antitrust Climate, at n.11 and accompanying text (June 13, 2002), *available at* <http://www.ftc.gov/speeches/other/brunohts25.htm>; Daniel Ducore, Assistant Dir., Bureau of Competition, Fed. Trade Comm'n, Remarks before ABA Clayton Act Session (Apr. 25, 2002) (hereinafter Ducore 2002 Speech); William J. Baer, Dir., Bureau of Competition, Fed. Trade Comm'n, Report from Bureau of Competition before ABA Antitrust Section Spring Meeting 1999, at n.46 and accompanying text (Apr. 15, 1999), *available at* <http://www.ftc.gov/speeches/other/baerspaba99.htm>; Joseph G. Krauss, Assistant Dir., Premerger Notification Office, Bureau of Competition, Fed. Trade Comm'n, New Developments in the Premerger Notification Program, at n.11 and accompanying text (Oct. 7, 1998), *available at* <http://www.ftc.gov/os/1998/10/dcbar.htm>; William J. Baer, Dir., Bureau of Competition, Fed. Trade Comm'n, Report from the Bureau of Competition before the ABA Antitrust Section Spring Meeting 1998, at nn.25-26 and accompanying text (Apr. 2, 1998), *available at* <http://www.ftc.gov/speeches/other/baeraba98.htm>; cf. 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 (ABA Antitrust Section), Summer 2002, at 13 (newsletter article). For additional recent speeches with incidental references to the gun-jumping cases, see, e.g., R. Hewitt Pate, Assistant Attorney Gen., Antitrust Div., U.S. Dep't of Justice, Antitrust Enforcement at the DOJ – Issues in Merger Investigations and Litigation, at 4-5 (Dec. 10, 2002), *available at* <http://www.usdoj.gov/atr/public/speeches/200868.htm>; Deborah Platt Majoras, Deputy Assistant Attorney Gen., Antitrust Div., U.S. Dep't of Justice, Merger Enforcement at the Antitrust Division, at 4 (Sept. 27, 2002), *available at* <http://www.usdoj.gov/atr/public/speeches/200285.pdf>; Charles A. James, Assistant Attorney Gen., Antitrust Div., U.S. Dep't of Justice, Recent Development and Future Challenges at the Antitrust Division, at 5, 21 (Sept. 17, 2002), *available at* <http://www.usdoj.gov/atr/public/speeches/200239.pdf>. For an agency speech discussing the cases prior to 1995, see Mary Lou Steptoe, Acting Dir., Bureau of Competition, Fed. Trade Comm'n, Prepared Remarks before the ABA Antitrust Section Spring Meeting 1994 (Apr. 7, 1994), *available at* 1994 WL 642386.

permitting conduct that is socially harmful.⁷ In the context of gun-jumping, we have done quite well in reducing Type 2 error, but perhaps at the cost of Type 1 error.

Legal commentators also sometimes speak of Type 3 error, which is defined as the imposition on business and government of excessive transaction costs associated with enabling the public to distinguish between permissible and impermissible conduct.⁸ We are aware that merging firms are sometimes requiring substantial guidance from counsel to minimize concern about possible gun-jumping exposure. And we have seen that some third-party advisors such as accounting firms and investment banks have begun to market services that permit detailed due diligence and transition planning without gun-jumping exposure. Transaction costs of these types may well be unavoidable or advisable in some circumstances, but we want to make sure that the business community is electing to incur them on a considered basis and not out of ignorance or fear.

In light of these considerations, my primary objective this afternoon is to try to reset the rhetoric that surrounds the gun-jumping issue and to begin to provide some clearer guidance on what, in our judgment, is and is not permitted. My comments will not be comprehensive, but we hope they will be a step in an ongoing process of clarifying our views.

I want to call your attention to some of the agencies' more obscure prior statements on gun-jumping issues. The six cases that the agencies elected to bring are well known, but the business community does not seem to have the same level of awareness of some of our public analyses that recognize the importance of transition planning and rapid implementation for the success of a merger and for the attainment of merger efficiencies. Those analyses do not excuse unlawful conduct, but they obviously inform our judgment as to where lines should be drawn.

At a 2002 FTC-DOJ workshop, Paul Pautler, Deputy Director of the FTC's Bureau of Economics, submitted a review of the business consulting literature examining whether or not most mergers are successful and seeking to identify the key attributes of mergers that are successful.⁹ By most measures, he concluded, the majority of mergers

⁷ See, e.g., ABA ANTITRUST SECTION, MONOGRAPH NO. 12, HORIZONTAL MERGERS: LAW AND POLICY 52-53 (1986); Alan Fisher & Robert Lande, *Efficiency Considerations in Merger Enforcement*, 71 CAL. L. REV. 1580, 1586, 1670-71 (1983).

⁸ See authority cited at *supra* note 7. Fisher and Lande define "Type 3 error to cover excessive litigation, enforcement, business uncertainty, and related costs." 71 CAL. L. REV. at 1586.

⁹ Paul Pautler, *The Effects of Mergers and Post-Merger Integration: A Review of Business Consulting Literature*, at 27-28 (Draft of Jan. 21, 2003), submitted at joint FTC-DOJ Merger Workshop, *Understanding Mergers: Strategy and Planning, Implementation and Outcomes* (Dec. 9-10, 2002) and available at <http://www.ftc.gov/be/rt/businessreviewpaper.pdf>. Other papers and presentations from the Merger Workshop also provide useful perspectives on pre-consummation conduct, integration of merging parties, and gun-jumping. These presentations are available on the FTC's website at <http://www.ftc.gov/be/rt/mergerroundtable.htm>.

are not successful;¹⁰ the broad consensus among consultants, however, was that “early planning for the integration of new physical and human assets improves the chances for success”¹¹ and that “[f]ast-paced integration and early pursuit of available cost savings improves outcomes.”¹² His review summarized common themes found in the business consulting literature:

The consulting literature stresses several factors that are thought to improve the chances that the deal implementation will prove effective. These factors include: early planning for the integration process, setting and communicating clear goals, identifying the responsible managers and providing them with appropriate incentives, moving quickly to define those areas where gains can be achieved, keeping everyone informed with tailored messages including employees and customers, integrating systems quickly, being sensitive to cultural issues, retaining key employees, and retaining sales force activism to avoid the loss of customers to rivals. The importance of these factors may vary from deal to deal as characteristics of the deals change, but the one over-riding factor is the need to plan early for the integration of the new assets. This early planning is intended to allow the combined firms to obtain the merger-related gains quickly and to build an early period of enthusiasm surrounding the transaction.¹³

Executives involved in successful mergers expressed similar views. Pautler noted a 1998 PriceWaterhouseCoopers survey that reached the general finding

that firms that moved faster than their normal operating speed to integrate newly acquired assets and communicate with new employees considered their deals to be more successful and to gain more in all dimensions than did firms who moved more slowly than their normal speed to integrate new assets. Faster transitions also reduced the costs imposed by the three leading integration hurdles: incompatible information systems, divergent management philosophies, and incongruent management practices. One particularly striking result was that early use of transition teams led to much better employee retention. PwC thus concluded that speed of integration *is* important.¹⁴

¹⁰ Pautler, *supra* note 9, at 14 (“Failure rates for mergers in the range of 35% to 60% are common in academic studies depending on the benchmark chosen for success”) (footnote omitted). *See also id.* at 35.

¹¹ *Id.* at 9; *see also id.* at 6 (“Managers of successful deals credit acquirer and target complementarities, especially careful planning, and speedy, well-directed implementation”) (reviewing comments of Mercer Group) and 29 (“Quick transitions provide greater ultimate value in almost all dimensions”) (reviewing comments of PriceWaterhouseCoopers).

¹² *Id.* at 9.

¹³ *Id.* at 35-36.

¹⁴ *Id.* at 27-28 (internal citations omitted) (describing PriceWaterhouseCoopers, Speed Makes a Difference: A Survey of Mergers and Acquisitions (2000) (reporting on 1998 survey)). Similarly, Pautler notes a McKinsey & Co. view that “fast transitions matter because they reduce the period of uncertainty in direction and the time headhunters have to steal sales and management people.” *Id.* at 29.

McKinsey and Co. examined particular successful mergers and recognized the importance of these principles in practice. One reason that the BP/Amoco/Arco merger was successful, they concluded, was that “BP had all its people in place on day-one of that combination.”¹⁵

In essence, the literature concludes that the keys to a successful merger include planning and speed. Two companion factors appear to be catalysts for a successful transition process. The first is “frequent and tailored communications,” a factor emphasized by firms that had engaged in successful mergers.¹⁶ The second is the use of transition teams, which can be a valuable tool for communicating goals and plans. Taken together, these factors appear to help merging firms speedily and effectively integrate their cultures, systems, employees, and physical assets, all while easing the concerns of customers, suppliers, lenders, and investors.

At a 2004 FTC-DOJ Merger Workshop, David Scheffman, a former director of the FTC’s Bureau of Economics, emphasized that “planning and implementation [are] really important. That’s a leading reason why mergers aren’t successful.” Scheffman added that concerns about gun-jumping are “why companies can’t do as much planning as probably even they could do if they didn’t have such conservative counseling.”¹⁷ Even sophisticated executives, attorneys, and business consultants question how they can improve a merger’s outcome without running afoul of the antitrust laws.¹⁸

The conservatism to which Scheffman refers may be occurring because managers and their advisors, particularly those who are less experienced and sophisticated in antitrust matters, have read the agencies’ interventions and statements over the past decade as implying a more absolutist approach than is actually the case. It is possible, too, that the public has mistakenly read the relief provisions in the consent orders settling the agencies’ interventions over the past decade as representing across-the-board prohibitions applicable to all situations, whereas the relief actually was targeted to particular violators whose objectionable conduct occurred as part of a wider array of activities.¹⁹

¹⁵ *Id.* at 26 (describing Presentation to the Fed. Trade Comm’n on Issues in Post-Merger Integration (May 8, 2002)).

¹⁶ *Id.* at 31-32 (describing Conference Board, Merging and Acquiring for Growth (2001)).

¹⁷ Transcript, U.S. Dep’t of Justice & Fed. Trade Comm’n Joint Workshop on Merger Enforcement, at 18 (Feb. 19, 2004) (comments of David Scheffman), available at <http://www.ftc.gov/bc/mergerenforce/040219ftctrans.pdf>.

¹⁸ For example, McKinsey & Co. expressed concern that “due to legal restrictions, companies do not improve their cost estimates during the HSR period unless they bring in a third party or a ‘clean team’ because management teams are forbidden to consult with each other.” Pautler, *supra* note 9, at 29.

¹⁹ *Cf. infra* notes 22-23 and accompanying text (describing significance of accumulation of factors). The relief adopted through negotiated settlements sometimes included fencing-in provisions that barred violators from engaging in the future in certain conduct that might not ordinarily be objectionable.

The agencies' overriding enforcement message has been, and remains, that merging firms are separate entities and that they must continue to reflect those separate identities until the applicable legal standards allow them to do otherwise. Under Section 1 the merging firms are not permitted to engage in collective actions that adversely affect competition; conduct is particularly risky where it is not reasonably necessary to protect the integrity of the merger transaction and where the merging firms are competitors or are otherwise in a relationship that affects competitive interactions in the marketplace. Under Section 7A the merging firms are not permitted to engage in conduct that effectively transfers beneficial ownership of the acquired business until the Hart-Scott-Rodino waiting period has ended. As a practical matter, the most serious transgressions have occurred where the merging firms prematurely combine significant aspects of their day-to-day operations and manage themselves as one. In the six cases that the agencies elected to bring, the conduct clearly violated this proscription. In none of the cases was the conduct designed or intended merely to facilitate an integration that would occur in the future. Rather, the parties acted as if the merger already had occurred. Where illegality is so flagrant, agency explanations and cautions need to be commensurately clear and forceful, as does relief.

Current enforcement practices are far more nuanced, however. The agencies recognize that some information exchanges and pre-consummation collaboration necessarily occur in all mergers.²⁰ Such activity generally has fallen into two overlapping categories, due diligence and transition planning. Both are necessary; and within appropriate limits, both are unobjectionable from an antitrust enforcement perspective.

With those policy considerations as useful background, let me spend the remainder of my time this afternoon describing the manner in which we analyze premerger coordination. I will provide some illustrations of some of the most frequently-encountered issues, but first let me quickly review the governing legal standards.

The analysis under Section 1 of the Sherman Act is a standard ancillary-restraints analysis, informed by the recognition that the merger transaction is a lawful form of

²⁰ See, e.g., Final Judgment, *United States v. Gemstar-TV Guide Int'l, Inc.*, No. 03-0198 (D.D.C. July 11, 2003) (expressly permitting certain forms of interim agreement, including ordinary course covenants, material adverse change limitations, certain provisions in intellectual property licenses, reasonable and necessary due diligence subject to specified protections, and disclosure of confidential information subject to protective order in litigation and settlement discussions), available at <http://www.usdoj.gov/atr/cases/f201400/201493.htm>; Proposed Final Judgment, *United States v. Computer Assocs. Int'l, Inc.*, No. 01-02062 (D.D.C. Apr. 23, 2002) (expressly permitting certain forms of interim agreement, including ordinary course covenants, material adverse change limitations, reasonable and customary due diligence subject to specified protections, and certain joint commercial transactions that would be lawful in absence of planned acquisition), available at <http://www.usdoj.gov/atr/cases/f11000/11083.htm>. Some of the more detailed speeches in which FTC personnel offer nuanced distinctions are not accessible on the Web, but are available from the agency upon request. See, e.g., Ducore 2003 Speech, *supra* note 6, at 8-9; Ducore 2002 Speech, *supra* note 6, at 4-5.

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 and that can be cleared without detailed examination,²¹ 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.

I should emphasize that not all forms of premerger coordination between merging firms are ancillary to the core transaction. Coordination on prices to be charged during the interim period or on the allocation of accounts during that period, for example, will almost never be reasonably necessary to protect the merger. Without intending completely to rule out the possibility that parties might be able to establish the necessary linkage in exceptional cases, agreements of this type will generally remain per se illegal when reached between competitors, just as they would have been under Section 1 outside the merger context.

The analysis under Section 7A generally yields consistent conclusions, but turns on different considerations because Section 7A and Section 1 have different policy objectives. Section 7A requires an analysis of whether conduct has had the effect of shifting beneficial ownership. The Hart-Scott-Rodino rules do not specifically define the term “beneficial ownership,” nor do analogous provisions in most other fields of law, and the identification of the beneficial owner of a security or other asset typically turns on a large number of factors – including the right to gain in the value of the underlying asset, the risk of loss in value, the right to receive distributions, the right to vote stock or designate management, and discretion over investment decisions. Like the reasonableness analysis under Section 1, a typical beneficial ownership analysis under Section 7A is highly fact-specific.

Beneficial ownership analysis can be particularly complicated in the merger context, because merger agreements typically include provisions that bear on the pertinent factors, even before one begins consideration of the types of conduct that are at the heart of the gun-jumping cases. For example, merger agreements will typically specify a transaction price and, depending on termination provisions and price-adjustment provisions, will often shift some or all of the right to gain or risk of loss from

²¹ See Fed. Trade Comm’n & U.S. Dep’t of Justice, *Twenty-Sixth Annual Report to Congress Pursuant to Section 201 of the Hart-Scott-Rodino Antitrust Improvements Act of 1976* app. A (Sept. 7, 2004) (hereinafter *HSR Report*), available at <http://www.ftc.gov/reports/hsr05/050810hsrrpt.pdf>. That appendix summarizes HSR statistics from fiscal year 1995 through fiscal year 2004. The percentage of transactions receiving Second Requests in a given year ranged from 2.1% to 4.3% over that decade. The term “Second Request” refers to requirement by the FTC or DOJ for “submission of additional information or documentary material” under 15 U.S.C. § 7A(e)(1)(A) by a person filing HSR notification, with the effect of extending the HSR waiting period until the person has complied, *id.* § 7A(e)(2).

seller to buyer. Those are two of the beneficial ownership factors. Merger agreements will often contain capital adjustment provisions, the formulas in which will sometimes address distributions. That's a third factor. Merger agreements will typically limit the seller's investment discretion by including covenants that prohibit extraordinary acquisitions or dispositions of its assets without buyer consent. That implicates a fourth factor of beneficial ownership. I do not mean to suggest that these commonplace provisions, together or in isolation, are inherently problematic – they're not. Nor are they or other individual factors²² dispositive of the Section 7A analysis. My point is that the typical merger begins at the time of agreement by shifting a number of pebbles on the scale of beneficial ownership. At a certain point, if too many other pebbles have accumulated on the buyer's tray through indicia such as access to confidential information and control over key decisions, one can reasonably find that the scale has tipped in the direction of the buyer.²³

Before I turn to illustrations, let me remind you of three important doctrinal distinctions between Section 1 and Section 7A. First, the Section 1 analysis applies to all transactions, even those that are not subject to a reporting obligation under Hart-Scott-Rodino. The Section 7A beneficial ownership analysis applies only to the subset of transactions that exceed HSR's statutory thresholds and satisfy the other jurisdictional requirements of the statute and regulations. Second and related, the application of Section 7A to a given transaction concludes once the HSR waiting period has expired. The application of Section 1, however, formally continues until the merger has been consummated, even when that occurs significantly after HSR clearance has been obtained. As I noted earlier, though, the receipt of clearance may be relevant to the competitive effects component of a reasonableness analysis. Third, competitive effects are generally central to the Section 1 analysis, but are largely immaterial to the Section 7A analysis. The competitive effects of a practice historically have not been considered by FTC staff in its determination of beneficial ownership or its exercise of prosecutorial discretion under Section 7A.

²² For example, the agencies have indicated that they believe Section 7A prohibits merging firms from entering into an interim management agreement pursuant to which an acquiring firm obtains operational control over the target, since that agreement, when combined with other attributes of beneficial ownership inherent in the merger agreement, tips the scale. Outside of the merger context and where other attributes of beneficial ownership are not found, however, operational control is not itself dispositive – the mere execution of a management agreement, without more, historically has been viewed by the agencies as a transaction that is not within the scope of HSR. See, e.g., Lawrence R. Fullerton, Deputy Assistant Attorney Gen., Antitrust Div., U.S. Dep't of Justice, Current Issues in Radio Station Merger Analysis, at 7-8 (Oct. 21, 1996), available at <http://www.usdoj.gov/atr/public/speeches/8210.pdf>, discussed in ABA ANTITRUST SECTION, PREMERGER NOTIFICATION PRACTICE MANUAL ¶ 53 (3d ed.2003); Informal FTC Staff Opinion No. 8509012, Letter to Andrew Scanlon (Sept. 20, 1985) (question b), available at <http://www.ftc.gov/bc/hsr/informal/opinions/8509012.htm>.

²³ Cf. *Input/Output Complaint*, *supra* note 4, at ¶¶ 14-16 (“Executing the Agreement transferred some of the indicia of beneficial ownership, including risk of loss, benefit of gain, and the ability to dispose of the business, but did not by itself transfer beneficial ownership. . . . Additional indicia were transferred when Input/Output began to exercise operational control. . . . The actions described . . . by which Input/Output, in connection with its contract to acquire DigiCOURSE, took operational control . . . , constituted a transfer of beneficial ownership”).

With that background, let me turn to three particular coordination issues that merging competitors encounter with some frequency. I focus on competitors because, as a practical matter, that is where the issues arise most frequently.²⁴

1. Spillover Effects from Ordinary Due Diligence and Transition Planning. As I have already noted, bona fide due diligence and transition planning are assessed under the rule of reason. Due diligence is needed to protect the fluidity and integrity of capital markets. Transition planning is needed to enable the merging firms to integrate their businesses effectively and rapidly after consummation, thereby allowing for the realization of available efficiencies. Although some isolated comments from agency staff during the 1990s suggested hostility towards these activities, I'm not sure that that was a considered view, and it certainly has not been the agencies' enforcement philosophy for a number of years.

In general, when weighing the volume of and methods for information to be exchanged, the merging firms (and especially the seller) have private incentives that are consistent with the government's enforcement priorities under Section 1 and Section 7A. First, the firms typically prefer not to divulge too much confidential information, since excessive disclosure may leave them vulnerable to exploitation such as attempts to hire away key employees, woo important customers, appropriate proprietary know-how, or preempt attractive opportunities. Second, firms have mechanisms for self-protection such as confidentiality provisions in merger agreements to limit the use of confidential information and prohibit secondary disclosure.

These considerations may not provide a complete answer, though, for that fraction of transactions in which the merging parties compete in a market with a limited number of rivals – that is, transactions of a type likely to receive a Second Request. For those transactions, thorough diligence and transition planning will often present complex challenges for legal advisors with respect to so-called “spillover effects.” That term is seen most often in the joint venture context, but it is not so limited. It refers to situations where competitors are engaging in conduct (in this instance, information exchange and related planning discussions) for legitimate purposes, but where the conduct cannot be strictly contained and instead spills over into competitive activities, where it may have adverse effects.

Let me be more concrete. Thorough transition planning²⁵ will require the merging firms to formulate details of their post-merger business activities – prices, marketing, assignments of customers and accounts to their formerly-separate sales forces,

²⁴ Mergers between firms with no competitive relationship generally receive HSR clearance rapidly, thus reducing the likelihood of a Section 7A concern arising from interim activity. For reasons described at n.21 and accompanying text, they also are less likely to present concerns under Section 1.

²⁵ There are parallel problems in due diligence. I focus here on transition planning, though, because I have found it to present greater real-world challenges for legal advisors. The set of solutions at the planning phase also works at the diligence phase.

narrowing of product lines, strategy, identity and branding, and capital and investment decisions. In communicating about these matters during the premerger period, each firm may learn information that it had not known about its rival's operations. And the mere discussion to arrive at a joint post-merger plan may create a template that leads each firm, even without further agreement, to conform its behavior during the premerger period. That's simply human nature, but it is problematic in this context because of the prospect for adverse competitive effects both during the preclosing period and if the merger is blocked or abandoned.

For the subset of transactions posing spillover concerns of this type, there are a number of possible solutions. None is ideal or complete, and the challenge for legal advisors is to identify the solution that best enables the merging firms to proceed with the needed planning without encountering excessive spillover risk. Here are some of the usual possibilities:

- Planning for certain business functions may be able to proceed acceptably with information that is not sufficiently current or detailed to present spillover concerns. The use of lagged or aggregated information is a common response to competition concerns arising from information exchanges outside of the merger context.²⁶
- The personnel selected to conduct the planning activity may be different from the personnel involved in the line business operations that are the source of the spillover concern. For example, the development of post-merger pricing sometimes can be performed by a strategic planning department, with the results walled off from the sales and marketing personnel who will be continuing to set pricing and conduct negotiations during the premerger period.
- Planning can be outsourced to consulting and accounting firms that market integration and planning services.²⁷ This solution is costly, and it can present principal-agent problems, but it can allow for detailed planning without any material spillover risk.
- For business functions for which detailed planning can be deferred until after closing without a substantial efficiency penalty, merging firms sometimes simply wait.

There may be circumstances where none of these solutions is feasible – that is, where the parties have a legitimate, pressing need to engage in transition planning with respect to a particular function and cannot find a mechanism for doing so without risking potential spillovers. I'm not aware that we have had occasion to consider this circumstance in

²⁶ See, e.g., U.S. Dep't of Justice & Fed. Trade Comm'n, Statements of Antitrust Enforcement Policy in Health Care, Statement 6 (1996) (providing guidelines for dissemination of price and cost data among health care providers).

²⁷ Arrangements of this type are sometimes referred to as "clean teams" or "clean rooms." See Pautler, *supra* note 9, at 25 n.49; Ducore 2003 Speech, *supra* note 6, at slide 10 ("Hypothetical One") of accompanying slide presentation.

recent times, but when we do, I anticipate an analytical framework along the lines I have described here.

2. Planning for Post-Closing Matters Requiring Preliminary Premerger Implementation. I would like to focus for a moment on one particular form of transition planning that poses particularly difficult questions from an analytical perspective – namely, planning with respect to various types of extraordinary matters on which decisions must be reached and preliminary steps taken during the premerger period, but which will not be realized in full or sometimes even in part until after closing. The most common example – and the one I will use for illustrative purposes this afternoon – is the decision on whether to proceed with a significant capital project. Suppose that before the merger opportunity arose, the seller had begun to consider construction of a new plant that would not come on-line until well after closing; and suppose further that the seller would proceed with the project if the merger were not to occur, but that the new plant would be redundant and inefficient if the merger ultimately closes. In what forms of coordination, if any, may the merging firms engage with respect to the decision on whether to break ground on construction of the plant?

When the merging firms are competitors in the business to be served by the plant, this question presents a difficult policy choice. On the one hand, we are reluctant to prevent the parties from taking steps that would enhance efficiency and permit greater realization of the likely benefits of the merger. On the other hand, however, a decision not to proceed with the project would have the effect of reducing the seller's competitiveness if the merger were not to close. And even if the merger does close, a decision not to proceed with the project would have the effect of reducing the overall level of capacity that would have prevailed in the industry but for the merger, thus potentially affecting the vigor of competition.

In balancing these conflicting considerations, agency staff historically has conducted a fact-intensive review that examines all factors that might be pertinent.²⁸ We have not yet been able to develop any bright-line tests to help legal advisors easily distinguish permissible coordination from what we would regard as violations, and the weight attached to various factors in a Section 1 analysis may differ from the weight in a Section 7A analysis. I can report, though, that staff typically asks questions such as the following:

- Was the decision not to proceed reached unilaterally by the seller, mandated by the buyer, or something in between?²⁹

²⁸ See, e.g., Ducore 2002 Speech, *supra* note 6.

²⁹ The spectrum of potential buyer control (from problematic to less so) runs from decisions (i) dictated by the buyer pursuant to powers under the merger covenants, to (ii) reached jointly by the merging firms during the planning process, to (iii) taken unilaterally by the seller after consultation with the buyer, to (iv) taken unilaterally by the seller entirely on its own initiative, although presumably with an eye towards the pendency of the merger.

- What is the magnitude of the efficiencies that would be realized from deferral of the project?
- How reversible is the decision not to proceed if the merger ultimately does not close?
- To what degree would the seller's competitiveness be harmed by the deferral (or abandonment) of the project, if the merger ultimately does not close?
- To what degree would the overall level of market competition be harmed if the seller's competitiveness were harmed?
- To what extent would the project represent a material change in the operation of the seller? If substantial, was it disclosed to the buyer or reasonably foreseeable by the buyer at the time of the merger agreement?

To the extent I can offer comfort concerning planning by merging competitors for extraordinary post-closing matters that require preliminary steps before closing, the comfort would be this: the agency position is not one of categorical opposition. There is some skepticism, but where steps during the interim period are necessary to achieve the legitimate objectives of the merger agreement, we are willing to consider the relevant circumstances.

3. Joint Marketing. The enforcement agencies have made clear that we do not acquiesce in coordination between merging competitors on prices to be charged during the interim period or on the allocation of accounts during that period. I am speaking here not of spillover effects from planning for post-merger activity, but of agreements with respect to pre-merger activity.

There is an important distinction, though, between joint marketing of competing products and joint marketing of the transaction; and I fear that our bright-line statements prohibiting the former have sometimes been taken as prohibiting the latter. Last year, before I entered government service, I was party to a many-lawyered conversation in which a senior antitrust partner at a major New York firm expressed the judgment that a full-page advertisement in the Wall Street Journal to tout the benefits of our clients' merger might be construed as impermissible joint marketing if it contained both firms' logos. That view was not widely shared by others on the call, but it wasn't unique to the one partner, either, and the advertisement never ran.

Let me be clear that we do not look askance on joint advertisements that simply announce or support the merger itself. If we did, of course, the Wall Street Journal and New York Times would be hotbeds of HSR noncompliance, since such advertisements are commonplace. We would, however, look askance at efforts by the buyer during the premerger period to redirect the seller's ordinary-course advertising program or to dictate the contents of the seller's advertisements for products in which the buyer and seller compete.

The distinction between competing products and the transaction itself also applies to sales calls. We generally are not troubled by extraordinary joint courtesy calls paid on important customers and suppliers to tout the benefits of the merger and to address any

possible concerns. Where such calls present the possibility of adverse spillovers, precautions can and should be taken by articulating ground rules to limit the scope of the discussion when both competitors are present. And we would be very concerned if the premerger coordination intruded into ordinary-course competitive selling – if routine sales calls were conducted jointly, for example, or if the acquiring firm redirected the target’s sales script or sales schedule, or if the acquiring firm assumed the target’s sales function.

* * *

The three illustrations I have discussed today – spillover effects from due diligence and transition planning, extraordinary matters that require interim coordinated steps for post-closing actions, and joint promotion of the transaction itself – are only a subset of the questions that arise in connection with good faith coordination among merging firms. As you can tell from the discussion, the drawing of bright lines and the rendering of unambiguous advice will not always be possible. My comments today aren’t intended as being comprehensive. The objective has been more limited: to reset the rhetoric and provide greater clarification of the balances we strike, with the further hope that my colleagues and I, over time, will be able to sharpen the lines and reduce the ambiguity in the field. At a minimum, I hope you take away the message that when it comes to reasonable and necessary premerger coordination, we are not so wooden as the public perception might suggest. Over the past decade, in the period covered by the six gun-jumping cases to which I’ve referred this afternoon, more than 25,000 mergers were filed under Hart-Scott-Rodino.³⁰ In framing enforcement policy, while we continue to have concern about the violations presented in cases such as the six, we also give appropriate regard to the legitimate needs of the other 99.9%.

³⁰ See *HSR Report*, *supra* note 21.