Corporate striptease

Merging businesses often end up doing a dance of the seven veils

by ***Susan Bright, Janet McDavid*** *and* ***Tim Capel****

It is widely accepted that early transitional planning and rapid implementation are key to the success of most mergers. It is thus often difficult in the middle of a deal to rein in the understandable desire to start the process of integration at an early stage. Nonetheless, it is vital to ensure that the merging parties do not jump the gun by implementing the merger before completion. Adopting the right strategy is crucial, but it might not be practical for external advisers to provide the hands-on, day-to-day advice that is invariably needed. This means that in-house counsel must take the lead in managing the process.

Following an overview of the enforcement landscape in the US and Europe, this article looks at how to deal with the issues that commonly arise in many transactions, and where to draw the line on what is – and what is not – acceptable pre-merger.

The enforcement experience

While there have been several gun-jumping cases brought by the US antitrust agencies in the last 20 years or so, enforcement in this area in Europe has been modest by comparison.

The United States

In the US, the federal antitrust agencies have become increasingly sensitive to gun-jumping by parties to anticipated mergers, with a number of cases resulting in the imposition of fines. Initially, the Federal Trade Commission was the prime mover in this enforcement activity but, in recent years, the Department of Justice (DoJ) has taken up the baton, with cases being brought most recently in 2006 in relation to the Qualcomm/Flarion merger and earlier this year against Smithfield Foods in its acquisition of a competing pork processing business. Not only are the penalties imposed for gun-jumping significant (up to US$11,000 per day) but if the authorities become concerned about the parties' pre-closing activities, then they will often shift their focus to gun-jumping issues, leading to a delay in the merger investigation itself and potentially resulting in enforcement action.

The US authorities' enforcement activity is driven by the dual concerns that: (1) the buyer must not take operational control over the target's day-to-day activities prior to closing (in violation of the Hart-Scott-Rodino Act (HSR)); and (2) the pre-closing exchange of competitively sensitive information may facilitate co-ordination between competitors (an infringement of the Sherman Act). An effective enforcement policy for gun-jumping offences ensures that there is the opportunity to impose effective relief if the transaction is blocked, with the authorities being particularly keen to ensure that the target remains a viable standalone business until closing. Thus, as part of the analysis of the documentation submitted by the parties pursuant to an HSR filing, the authorities will carefully scrutinise the provisions contained in the merger agreement and any other information that points to the premature consummation of the merger, including the comments received from third parties.

Europe

In Europe, by contrast, visible enforcement activity has been relatively limited, particularly at EU level. In the main, where cases have been brought, these have been as a result of a failure to notify the concentration altogether, rather than the parties integrating their activities too quickly following the filing of the merger notification.

The European Commission has the power to impose a fine of up to 10% of turnover for failure to notify a merger or for implementing the merger prior to clearance. The risks were brought home by the €20m fine imposed by the Commission on Electrabel in 2009 for failing to notify its acquisition of sole control of Compagnie Nationale du Rhône. In setting the fine, the Commission took into account the fact that the standstill obligation is a cornerstone of the EU merger control regime, that the infringement had lasted for a significant period of time and that Electrabel is a sophisticated company with experience of the Commission's procedures. However, the Commission also took into account the fact that Electrabel had itself brought the matter to the Commission's attention and that the acquisition did not raise any substantive competition law issues – so clearly the fine could have been significantly higher.

The objective of the standstill obligation under the EU regime is similar to that of the HSR – namely, to ensure that there is adequate opportunity for the ex ante review of notifiable mergers so that, in appropriate cases, remedies can be imposed without having to "unscramble the eggs". In relation to the various member states that operate mandatory merger control regimes, it is apparent that the Bundeskartellamt in Germany has been particularly active in taking a firm line on failure to notify, with several cases being brought in the past few years. Of these, the most eye-catching was the €4.5m fine imposed on Mars in 2008, a case which also provided a salutary lesson in the risks inherent in attempting to carve out part of the deal (in this case, by transferring to a third party the distribution rights for the target's products in Germany).

The Commission has also sometimes acted where parties have appeared to implement a merger too early, although it has not, as yet, imposed fines for such behaviour. For example, in 1997, the Commission warned Bertelsmann and Kirch in the context of the notification of their joint digital platform for television, Première, that the pre-closing utilisation and marketing by Première of Kirch's d-box decoder product amounted to the partial implementation of the proposed merger. Ten years later, the Commission flexed its muscles by carrying out unannounced inspections at the premises of Ineos and Kerling, following up

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concerns that the parties may have implemented a concentration prior to the Commission's clearance decision, although, again, no enforcement action followed.

The paucity of such cases potentially reflects the realities of the Commission's enforcement priorities, although it is also arguable that the availability of a derogation from the standstill obligation (under article 7(3) of the ECMR – where there is good reason) means that the parties might choose to request the Commission's permission to close a deal early in some circumstances, instead of being tempted to jump the gun (there were five such derogations granted by the Commission in 2009). However, further examples are available at national level, including the Norwegian competition authority's decision in 2009 to impose a fine of NOK100,000 (around €11,800) on the law firm Advokatfirmaet Steenstrup Stordrange for the early implementation of a merger with DLA Piper Bergen.

Avoid gun-jumping concerns

Businesses involved in mergers will usually be well briefed by their legal advisers on the merger control pitfalls, including the circumstances in which gun-jumping risks are likely to arise. Often, many of the issues stem from the difficulty of striking a balance between the limitations imposed by competition law and the business imperatives of detailed due diligence and early integration planning. In practice, the urge to co-ordinate strategy and business planning can be very difficult to ignore. Therefore, numerous practical issues need to be addressed, including (1) due diligence, (2) integration planning, (3) preserving the value of the business and (4) joint activities:

- **Due diligence.** In conducting due diligence, how does the buyer manage to carry out the necessary investigations without infringing the competition rules? Issues are only likely to arise where there is competitive overlap between the parties and thus a risk of adverse effects. It is perfectly legitimate to share confidential information about the target business where that is necessary to understand and value the business, with suitable protections in place. Solutions are likely to include limiting access to such information – for example, by ensuring that it is only provided to specified individuals within the other party on a need-to-know basis, buttressed by confidentiality agreements. Typically, this means that access to the most sensitive information will be limited to individuals who would not use it in the ordinary course of business: for example, it may be appropriate for the chief financial officer to see certain information that it would not be appropriate for the directors of sales or marketing to see.
- **Integration planning.** Early transition planning and rapid implementation are key to the realisation of efficiencies and the success of most mergers. However, despite entering into an agreement to merge, the parties must remain separate until merger clearances have been obtained and closing takes place. In practice, the operation of clean teams or the use of third party advisers in planning the transition can help avoid spillover effects, while still allowing a reasonable degree of preparation. Back-office functions, including planning for the integration of IT systems, are likely to be less problematic. However, greater care will need to be taken in relation to customer-facing activities and it may be that less information should be shared at this stage than when conducting due diligence. Difficulties arise when planning reveals issues that need to be dealt with before closing – for example, whether the target should continue with a major investment which would not be needed if the transaction goes ahead. Significant issues like this will need to be discussed with the relevant competition authorities before deciding what action to take.
- **Preserving the value of the business.** The buyer will want to preserve the target business's value in the period prior to closing. It is normal to include restrictions in the merger agreement requiring the seller to operate the business in the ordinary course or not to undertake actions which would have a material adverse effect. Sometimes merger agreements contain provisions which are regarded as going too far (eg *US v Computer Associates International Inc*, 2002), but the issues are more likely to arise from the behaviour of the parties, whatever the merger documentation says. In particular, issues arise where the target seeks consent for day-to-day decisions so that, in effect, operational control is transferred prior to closing.
- **Joint activities.** The parties to a merger will be keen to tell the outside world and particularly their customers about the benefits the merger will bring and there will often be huge enthusiasm to pursue marketing and commercial opportunities at the earliest opportunity. There is a distinction between joint activities to promote the benefits of the merger itself and joint marketing of products and services pre-closing. The risk is that a courtesy call to a major customer to explain the benefits of the merger can slide into a discussion of the terms on which business will be conducted before closing. In practice, counsel will typically advise the merging parties only to have joint meetings with customers or suppliers on request or with their consent.

Conclusion

Merging two businesses is a dynamic process and advising on gun-jumping risks is not simply a question of listing out what the parties can and cannot do before closing. The issues must often be addressed on a daily basis and it is important to manage the sharing of information and integration planning in a progressive fashion. As the merger nears completion (and particularly once merger clearances have been obtained and other conditions fulfilled) it is often possible to increase the amount of information shared and the level of integration planning. In many ways, the merging parties are engaged in a dance of the seven veils, revealing more and more to each other as consummation of their merger draws closer.

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References

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