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**

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**William Blumenthal[*]
General Counsel
Federal Trade Commission
Washington, D.C.**

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

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[*] 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

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

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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/brunohsr25.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

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

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[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/businesreviewpaper.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.

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, Davi

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.

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

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 factors[22] 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

With that background, let me turn to three particular coordination issues that

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

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

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.

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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%.

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[30] *See HSR Report*, *supra* note 21.