

Antitrust & Trade Regulation

MAY 2003

Department of Justice Attacks Premerger Cooperation

The Antitrust Division of the United States Department of Justice recently brought a challenge under both Section 1 of the Sherman Act and the Hart-Scott-Rodino Act (“H-S-R Act”) to the pre-closing conduct of two merging competitors, even though there was no antitrust challenge to the legality of the merger itself. The government’s pursuit of injunctive relief and civil penalties under such circumstances emphasizes the importance of merging parties’ maintaining independent decision-making up until the closing of the transaction and restricting the pre-closing flow and use of confidential information. The case is noteworthy not only because it imposed sanctions even though the merger itself was not challenged, but also because it assessed the maximum available sanctions against both merging parties. The total civil penalties assessed were \$5,676,000.

Gemstar International, Inc. (“Gemstar”) and TV Guide, Inc. (“TVG”) were competitors in offering interactive program guides (“IPGs”) to cable, satellite and other multichannel subscription television service providers. During the first half of 1999, Gemstar and TVG entered into negotiations to settle long-standing patent infringement litigation between them. Eventually these negotiations led first to a joint venture proposal and then, in October, 1999, to a merger agreement between Gemstar and TVG. After executing the merger agreement, Gemstar and TVG filed with the Federal Trade Commission and the Antitrust Division the premerger notifications required by the H-S-R Act. The Antitrust Division conducted an investigation of the proposed merger, after which it advised the parties it would not seek to enjoin the merger. After expiration of the waiting period under the H-S-R Act, Gemstar and TVG consummated the merger on July 12, 2000. At no

time did the Antitrust Division or the Federal Trade Commission seek to prevent the merger under Section 7 of the Clayton Act, 15 U.S.C. §18, on the grounds that the merger was likely to reduce competition substantially in the sale of IPGs or in any other line of commerce.

Nevertheless, over two years after the consummation of the merger, the Antitrust Division sued the merged Gemstar and TVG, alleging that the conduct of Gemstar and TVG prior to the consummation of the merger had violated Section 1 of the Sherman Act and the H-S-R Act. Section 1 of the Sherman Act, 15 U.S.C. §1 (“Section 1”), prohibits, *inter alia*, agreements, combinations or conspiracies among competitors that unreasonably restrain competition. Such proscribed agreements include agreements among competitors to fix prices, to allocate customers or to allocate markets. Hard core violations of Section 1, like price-fixing or customer allocation agreements among competitors, are often prosecuted criminally. The H-S-R Act, on the other hand, establishes procedures to help the antitrust enforcement agencies review mergers and acquisitions before they are consummated. It prohibits parties to transactions of the requisite size from merging or from acquiring assets or securities until after the parties have filed premerger notifications in compliance with the Act and until the prescribed waiting period has expired following the filing of the requisite notices.

THE ALLEGED VIOLATIONS

In its Complaint, the Antitrust Division alleges that Gemstar and TVG committed several acts in violation of Section 1 of the Sherman Act between the inception of negotiations and the consummation of the merger:

- As part of their joint venture discussions, Gemstar and TVG allegedly agreed to slow down or “slow roll” their respective negotiations with two customers for whose business they were at the time competing. The slow roll was intended to permit the prospective, combined operations of Gemstar and TVG to enter into agreements with these customers on terms that were agreed upon by Gemstar and TVG. Negotiations with these customers were allegedly postponed until after the merger was consummated.
- Upon execution of the merger agreement and prior to closing, competition between Gemstar and TVG generally ceased pursuant to an understanding that Gemstar would phase out its marketing of IPGs to cable and direct broadcast service providers in favor of licensing IPGs to OEM electronics manufacturers, while TVG would continue marketing to cable and direct broadcast providers.
- Within days after reaching the agreement to merge, Gemstar and TVG allegedly agreed between themselves which one would approach specific customers during the interim between execution of the merger agreement and consummation of the merger.
- Further, after reaching the agreement to merge, Gemstar and TVG agreed upon the prices and other principal terms that would be incorporated in the proposals to service providers in the interim period. The terms that they agreed would be used in the interim period were the same ones the parties proposed to offer after consummation of the merger and differed materially from those TVG had previously been offering.
- TVG and Gemstar in the interim period shared detailed and specific information about the terms that they would offer to service providers and kept one another apprised of the status of individual contracts with service providers. TVG, for instance, provided its draft contracts to Gemstar and received from Gemstar detailed comments on proposed changes.
- Gemstar allegedly acquired substantial operational control over TVG’s business when TVG submitted numerous marketing and sales decisions for review and approval by Gemstar, including submission of draft customer contracts, review of a customer’s request to extend a pricing deadline and requests for guidance on responding to customer counterproposals.
- TVG acted as Gemstar’s agent in negotiating with service provider customers, informing the customers that it was acting as Gemstar’s agent.
- TVG used its goodwill with an equipment manufacturer to negotiate a settlement of litigation between Gemstar and the manufacturer, even though certain terms of the settlement would have precluded TVG from competing for business with the manufacturer if the merger failed to close.
- TVG and Gemstar shared confidential information regarding their pricing and capabilities for advertising space on IPGs, met jointly with consultants hired by TVG to develop marketing and pricing strategies and discussed the optimum prices and capacity for their IPG advertising business.
- During the interim period, TVG and Gemstar shared information and acted jointly with respect to numerous business opportunities.
- Gemstar shut down many of its competitive marketing operations, shared substantial amounts of confidential information with TVG and shared business opportunities, effectively merging their operations prior to closing the transaction with TVG. TVG thereby allegedly acquired substantial control over Gemstar’s business of providing IPGs to service providers.

The Antitrust Division also alleges that the actions of Gemstar and TVG in the interim between the execution of the merger agreement and the expiration of the Hart-Scott-Rodino waiting period violated the H-S-R Act in the following respects:

THE AGREED REMEDIES

Gemstar and TVG consented to a final judgment that prohibits antitrust violations and imposes substantial civil penalties. To remedy the Section 1 violations, the defendants agreed to the following relief:

- An injunction prohibiting Gemstar and TVG from entering into any agreement with a competitor from the beginning of negotiations to the consummation or abandonment of a transaction, if the agreement would fix, raise, set, stabilize or otherwise establish prices or the level of output for any product in which the parties compete.

- The parties are also prohibited, during the period from the start of such negotiations to the consummation of the transaction, from agreeing to delay or suspend sales or marketing efforts with respect to any product in which the parties compete and from allocating markets or customers among the parties.
- An injunction prohibiting, in the interim between the start of negotiations and the consummation of the transaction, the disclosure or the receipt of information or projections relating to future prices or contract offers for products in which the parties compete. Notwithstanding the foregoing, the defendants may conduct or participate in reasonable and customary due diligence, provided that (1) any disclosure of confidential information relating to future pricing or contract offers is reasonably related to the receiving party's understanding of the future earnings and prospects of the disclosing party, and (2) such disclosure occurs pursuant to a non-disclosure agreement that (a) limits use of the confidential information to conducting due diligence and (b) prohibits disclosure of any such information to any employee of the recipient who is directly responsible for the marketing, pricing or sales of competing products.
- An injunction permitting customers who signed contracts with Gemstar or TVG from the inception of the Gemstar-TVG negotiations to the consummation date to terminate their contracts with Gemstar or TVG.
- The injunctive relief expressly permits the defendants to enter into a transaction agreement that requires a party to "operate in the ordinary course of business" prior to closing and requires a party, prior to closing, to "forego conduct that would cause a material adverse change in the value of the business or assets to be acquired."

To remedy the violations of the H-S-R Act waiting period requirements, even though the merger itself remains unchallenged, the agreed Final Judgment provides the following remedies:

- Gemstar and TVG agreed, during the period between executing an agreement which requires notification under the H-S-R Act and the expiration

of the statutory waiting period, to refrain from entering into any agreement with the other contracting parties to combine, merge or transfer (in whole or in part) any operational or decision-making control over the marketing or distribution of any product service or technology to be acquired in the proposed transaction.

- The merged company agreed to pay civil penalties of \$5,676,000. The amount of the penalty was calculated by assessing against each of the predecessor companies the statutory maximum of \$11,000 per day of violation.

SAFEGUARDS

The fact that the Antitrust Division pursued substantial civil penalties as well as injunctive relief in a case where it conceded the legality of the underlying transaction underlines the importance for all parties contemplating mergers, acquisitions or joint ventures of assuring that the parties continue to compete with one another as usual until the transaction closes. In the government's view, it is only upon the consummation of the transaction that consumers receive the benefit of the efficiency-enhancing integration of the two former competitors and, therefore, it is only after consummation that the parties should be permitted to eliminate the competition between them. In the government's view, until the transaction is consummated, the two parties remain independent competitors whose actions are subject to the regular functioning of the antitrust laws. While the detailed facts of each transaction need to be analyzed in detail, many parties to merger, acquisition and joint venture agreements are likely to adhere to the following types of procedures in order to avoid possible liabilities under Section 1 of the Sherman Act and the H-S-R Act in connection with the negotiation and implementation of such agreements:

- Parties contemplating a merger, an acquisition or the formation of a joint venture will maintain their status as independent economic entities prior to closing by continuing to act in the marketplace as they would have in the absence of the contemplated transaction.
- Parties to a proposed transaction will, in the period preceding the closing, make independent decisions on competitive actions like pricing, customer

selection and product development.

- As a general rule, according to the Antitrust Division's Competitive Impact Statement relating to the case, "competitors should not obtain prospective customer-specific price information prior to consummation of the transaction."
- Information that is not otherwise publicly available may be disclosed between parties to the transaction only to the extent that the disclosure is reasonably necessary to permit the transaction to proceed.
 - Where the disclosure by one party to another of nonpublic information is reasonably necessary to permit the proposed transaction to proceed, care can be taken to assure that such disclosure does not affect the parties' competitive behavior prior to closing.
 - Special care will generally be taken with respect to information regarding current or prospective prices or terms of sale.
 - Consideration will often be given to confining access to the competing party's sensitive pricing, marketing and sales information only to an outside consultant or, if and when company personnel must have access, restricting access to a "clean team" of company personnel who have no involvement in the receiving company's own ongoing pricing, marketing and sales decisions.
- During the interval between signing a transactional agreement and closing the transaction, it is not in itself unlawful for the parties to plan for consolidated, post-closing, marketing, sales and

pricing activities. However, if they do so, they will often wish to take affirmative steps to assure that the planning for post-closing activities does not affect pre-closing competitive decisions on such topics as pricing, customer selection or product development. In practice, insulating the parties' day-to-day decisions from the influence of planning for post-closing coordination may require that those involved in such planning be isolated from ongoing business decisions in the interim.

- The parties to a proposed merger, acquisition or joint venture generally should not, prior to closing, avoid or suspend competing with one another.
- The parties to a proposed merger, acquisition or joint venture generally should not, prior to closing, adapt their prices or other terms of sale to those of another party to the transaction unless such a modification is necessary to make the party modifying its prices or terms of sale more competitive with the other party to the proposed agreement (*i.e.*, cutting prices to meet or beat the other party's terms would be permissible, but raising prices in order to avoid competing vigorously would not).

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K&L's Antitrust and Trade Regulation practice provides comprehensive antitrust counseling to clients on achieving business objectives while complying with the antitrust laws. If you have any questions regarding the subject matter discussed in this Alert, please contact one of the following attorneys:

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