

## **Parties Violate HSR Act and Pay \$1.8 Million “Gun-Jumping” Fine**

**April 17, 2006**

In another of a series of enforcement actions over pre-closing activities by parties to a merger, the Department of Justice (DOJ) last Thursday charged two companies with violating the Hart-Scott-Rodino Act (HSR Act) by giving the buyer improper influence over the seller’s business before the HSR Act waiting period expired. The parties settled the lawsuit by agreeing to pay a fine of \$1.8 million.

In general, the HSR Act requires parties meeting certain size requirements to file a pre-merger notification with the DOJ and the Federal Trade Commission (FTC) and to observe the applicable waiting period prior to closing transactions over a certain value. “Gun-jumping” occurs when the buyer tries to exercise control or “beneficial ownership” of a seller before expiration of the waiting period.

The DOJ’s complaint charged QUALCOMM Incorporated (QUALCOMM) and Flarion Technologies (Flarion) with gun jumping because of the terms of their merger agreement, coupled with the parties’ conduct prior to closing the transaction.

The merger agreement contained “stand-still provisions” that required Flarion to obtain QUALCOMM’s written consent before Flarion could do any of the following:

- enter into any intellectual property license agreement with a third party;
- enter into (a) any agreement, with certain exceptions, involving payments or receipts of \$75,000 or more per year or \$200,000 or more in the aggregate (this term was later revised to \$250,000 per year and \$1 million in the aggregate); (b) “agreements relating to the disposition or acquisition of intellectual property rights,” except certain licenses with purchase prices of less than \$10,000; or (c) any “material contract”;
- “hire any employee ... except in the ordinary course of business in accordance with its standard past practice”;
- present business proposals to any customer or prospective customer (later amended to allow Flarion to submit proposals “in the ordinary course of business in accordance with its standard past practice”).

In general, “stand-still” provisions are designed to ensure that the seller cannot damage the business being acquired between signing and closing. Accordingly, provisions that ensure that the seller will engage in conduct that is in its ordinary course of business and consistent with its past practices have never been challenged by either the FTC or the DOJ.

Here, however, the DOJ alleged that, after the merger agreement was executed and pursuant to these stand-still provisions, QUALCOMM impermissibly influenced and controlled Flarion's fundamental business decisions in various ways that went beyond the usual stand-still:

- Flarion sought QUALCOMM's review and approval before marketing products and services to customers and potential customers.
- Flarion submitted entire drafts of customer proposals for QUALCOMM's review.
- Flarion requested approval to send price quotations to a potential customer, which QUALCOMM denied in part.
- Flarion requested QUALCOMM's approval to discount products to a customer, which QUALCOMM denied.
- QUALCOMM "discouraged Flarion from business opportunities it might otherwise have pursued."
- On one occasion, after Flarion sought consent to enter a contract with a certain company, QUALCOMM sent representatives to that customer to discuss a solution using QUALCOMM's technology.

Companies – including their officers, directors, and partners – are each subject to fines of \$11,000 per day for each day the violation of the HSR Act continues. The alleged violation here occurred from the date the merger agreement was signed (July 25, 2005) through the expiration of the statutory waiting period, which was extended for three months (to December 23) as a result of a request for additional information. QUALCOMM and Flarion were thus jointly and severally liable for aggregate fines of more than \$3 million. The fine was reduced, however, because the parties reported the gun jumping and took some steps to change their contract and conduct.

*This enforcement action demonstrates yet again that the DOJ and the FTC intend to bring cases against parties that reduce competition, transfer beneficial ownership, or allow the buyer to exercise control prior to expiration of the waiting period. Put simply, a buyer must allow a seller to conduct its business in the ordinary course consistent with past practices between signing the definitive purchase agreement and obtaining HSR Act approval. It is unclear whether the DOJ had concerns about each stand-still provision or only when the quoted provisions were considered together. If the former, this enforcement action raises questions about whether a buyer can restrict the seller from behaving outside the ordinary course without creating any potential HSR risks. For example, the DOJ quoted the stand still related to hiring of employees even though the restriction allows the seller to hire new employees in the ordinary course. With the assistance of antitrust counsel, however, pre-acquisition conduct can be monitored carefully so that the parties can exchange competitively sensitive information related to due diligence, plan for post-closing integration, and execute stand-still provisions, each of which is essential to any deal, without running afoul of the HSR Act.*

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