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Antitrust Risks in Pre-Merger Negotiations between Competitors

Subodh Prasad Deo & Ajay Goel

Due diligence inquiriesand pre-merger negotiation, unless carefully crafted, may expose parties to the risk of competition law violations. Businesses are obviously keen to seek detailed information from the other party in order to make an assessment whether the target would fit in well with their own operations and business. Further, they are also keen to impose certain ancillary restrictions on the other party in order to ensure that the value of the target remains adequately protected by the other till the closure of the deal.

In general, the competition authorities are neither inimical to the bona fide requirement of exchange of business information nor to the imposition of ancillary restrictionsthat are necessary to the implementation of the merger. However, they require the parties to remain effective competitors till the time the proposed deal has been approved by the competition authority, with or without modification.Exchange of confidential business information between the parties may impair the exercise of independent business decisions and facilitate collusion or otherwise deprive consumers from the benefit of the process of competition. Further, the exercise of decisive influence by one of the party over the other, even before the proposed deal has been approved by the competition authorities, violate the standstill obligations under the competition Act. In cases where the parties are competitors or potential competitors, the harm to the process of competition would likely be direct and grave.

Thus, there is a need to exercise caution during the due diligence and pre-merger negotiation phase as every negotiationmay not fructify into a successful acquisition / merger. Further, there is no certainty that every merger filing will be approved as it isby the competition authority. Accordingly, parties to a merger / acquisition discussion must exercise adequate caution in revealing confidential business information to each other without putting adequate safeguards in place. Further, no action should be taken which can be construed as exercise of decisive influence over the other. Pertinently, even in cases that do not require filing to the competition authorities, either because the filing thresholds are not breached or is otherwise exempted from filing, it is incumbent upon the parties to remain effective competitors till such time the proposed deal has been concluded and closed.

In general, before commencing due diligence, parties must execute a confidentiality or non-disclosure agreement ("NDA") which prohibit unauthorised uses, and disclosure to third parties, of the confidential information exchanged. While NDA may help in keeping such information confidential, it may be noted that NDAs are insufficient as mere exchange of Competitively Sensitive Information ("CSI") between competitors or potential competitors has the potential to lead to coordinated market conduct which is a competition law infringement. It is accordingly, important to understand as to which information may be considered to constitute CSI. CSI are those information which, if known by competitor, could reduce the strategic uncertainty faced by that competitor in the market and hence it's decision-making independence. CSI includes, inter alia, current or future pricing plans, customer and supplier lists, prospective bidding plans, detailed cost and profit margins for individual products, current and future strategic plans by product, such as marketing plans, quantities supplied, costs, demand, sales, capacities investments, technologies and R&D programmes, etc. In determining whether an information is CSI, we should ask the question whether this information has the potential to give market advantage to a competitor or a potential competitor and whether access to such information could affect its market behaviour. While information regarding prices and quantities are considered to be the most sensitive since it provides a real-time view of the conduct of the party, sharing of aggregated information is considered to be less sensitive than individualised information of various product lines or territories. Further, historic information is considered to be less sensitive than current and future information.

In view of the above, it is important to establish a mechanismso as to ensure that

the recipient of the information cannot use it in a way which would affect its behaviour in the market. Such a mechanism may include:

(i) Limiting the individuals who will be exposed to the CSI by constituting a "Clean Team" thatmay include members of the recipient party who are not involved in roles particularly relating to sales, marketing or strategic decision making. In particular, no member of the clean team should be someone with price or cost-setting authority. Accordingly, such authority should also be fire-walled from seeing sensitive information obtained from the other party. The "cleanest" option may be to use a third party advisor (e.g. a consultant / counsel) to receive the CSI and assess it on behalf of the receiving party, disclosing to the receiving party only the non-competitively sensitive conclusions of that assessment.[1]

(ii) Requiring members of the Clean Team to sign a competition law-tailored individual NDA outlining the limitations of the use and disclosure of that information; and

(iii) Ensuring, through written rules that any member of the Clean Team is not, for as long as the CSI to which he/she has been exposed remains sensitive, in a position to influence the recipient party's behaviour in the market where the CSI is relevant.

(iv) Careful consideration should be given at the early stages of acquisition or merger discussions to what specific pieces of information should not be disclosed. Where comprehensive disclosure is necessary, it may be advisable to delay disclosure until there is a high degree of certainty that the transaction will proceed and confidentiality undertakings have been received.

(v) It is also important for the parties to document, in real time, all details regarding pre-merger activities, including the exchange of competitive sensitive information, if any, and pre-integration planning.

Apart from taking measures to firewall against anti-trust violations (read violations of Section 3 of the Competition Act, 2002), it is equally important to ensure that gun-jumping violations do not occur. Gun jumping violations may be understood as the failure to notify a transaction which is required to be notified and / or consummating a notifiable deal / transaction without securing clearance or approval from the competition authority. As pre-merger notification in cases that breach the prescribed monetary thresholds and are not otherwise exempt is mandatory in India, the parties are prohibited from consummating the proposed transaction until approved by the competition authority or elapse of 210 days, whichever is earlier. Serious monetary penalties may be imposed upon the parties for non-compliance with merger regulations and notification requirements. It is therefore important that prior to closing, the merging firms do not coordinate their negotiations with customers for sales to be made after the merger closes. Similar caution needs to be exercised as regards pre-closing planning regarding customers, prices, product plans, distributors or employees.

It is important to bear in mind the distinction between planning of merger integration and implementation of those plans. Care should be taken to ensure that neither party exercises decisive influence over the other or exchanges information in a manner that can alter the exercise of independent business decision by the other before clearance of the transaction by the competition authority.

In casesof straightforward acquisitions or acquisition with controlling stake, where the parties are competitors or potential competitors, therestriction on exchange of CSIduring the pre-merger negotiations is evident. In the case of acquisition of non-controlling minority stakes, to the extent that the acquirer groupand the target are actual or potential competitors, they also need to comply with the competition law restrictions on information sharing. Safeguards, therefore, need to be put in place to ensure that no illegitimate sharing of CSI occurs whilst allowing the investor sufficient data to monitor and protect its investment. In the case of JVs, JV structures should definitely not be used as a vehicle through which the parents share CSI. In relation to information flows between a parent and the JV, what is permissible will depend on the context, including whether the parents compete or may compete with the JV. In such cases again, safeguards may need to be put in place.

While it is advisable that confidentiality undertakings limit the use of the information disclosed and define the persons to whom that information will be available to the exclusion of others, it is important to bear in mind that the decision makers within the purchasing organisation, who will need to review the due diligence information, are likely to be the very persons in whose hands the information will have its most anti-competitive effect. Accordingly, it is important that confidentiality undertakings should state that the information received is to be used specifically for the purposes of evaluating the proposed transaction or meeting specific legal requirements only. In any case, since sharing of CSI between competitorsin the merger and acquisition context may involve serious competition law infringement risks, exchange of such information should be carefully monitored and cleared by antitrust counsel to avoid such an inference.

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[1]*It is important to make a mention herein that the French Competition authority, vide decision number16-D-24 dated 8.11.2016 in the Altice casehas held that transfer of commercially sensitive information to in-house counsels of the buyer, not subjected to any obligation of confidentiality, was not a mechanism that could prevent the dissemination of CSI and is equivalent to an access to the entire company of this information.*