Tackling Competition Laws With Clean Teams

The authors discuss how companies negotiating a potential M&A can adopt a clean team approach to balance the twin objectives of obtaining information about the target company, while preventing any potential violation of competition law pertaining to information exchange before completion of a transaction.

2015 has been a milestone year for global mergers and acquisitions (M&A). As statistics (presented by Dealogic) indicate, last year alone, deal volumes touched US $4.9 trillion, racing past even the record deal volume of US $4.6 trillion set in 2007. In such a scenario, a key aspect that becomes imperative to successful M&A's is, careful consideration of several aspects, including potential antitrust (competition law) matters concerning different countries such as India, when planning and implementing global transactions. More specifically, a significant aspect of factoring in antitrust concerns in integration planning becomes the development of 'clean team' arrangements.

The Need for Clean Team Arrangements

To start with, it is fundamental that a buyer in any M&A transaction understands the business of a target entity before committing to a transaction. This is particularly relevant for private company transactions, where such details cannot be obtained from publicly available information. That being said, information exchange prior to completion of a transaction may also pose competition law issues. This is because competition laws require parties to a transaction to remain independent competitors until a transaction is closed. Failure to do so is referred to as 'gun jumping'. For example, the Competition Commission of India (CCI), and other competition regulators in the United States, the European Union, and several other jurisdictions have pre-merger control regimes that prohibit parties from consummating a transaction prior to receiving clearance by the relevant competition authorities. This implies that until the transaction is closed, the parties must remain independent companies and greatly limit the sharing of commercially sensitive information until deal completion.

As a result, parties to M&A must tread carefully during the pre-closing stage of a transaction to ensure that they do not exchange confidential, commercially sensitive information during the due diligence stage, that could violate the Indian Competition Act, 2002 (Competition Act) or other competition laws in other jurisdictions. The basic rule of thumb to follow is that any strategic decision that either party makes between the signing and deal completion should be independent of the transaction, i.e., it should be justified in the company's interest being absent in the transaction. For example, the exchange of pricing information (current or future), marketing, production, or future or strategic plans, and bid strategies are all potentially prohibited from a competition law perspective and may raise “gun jumping” concerns.

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Clean teams: the solution to the problem

A ‘clean team’ is a group of employees or consultants who work for a buyer guided by a set of procedures agreed upon by both the buyer and the seller. The members of a clean team should have no existing responsibility for setting prices, other terms of sale, or marketing strategy for competing products. Ideally, a clean team could be constituted of employees from the buyer’s finance department, third party consultants, and/or retired employees of the buyer. Clean team members could also be subject to a certain cool-off period before being involved with competitive product pricing or marketing.

In a clean team structure, commercially sensitive information is typically placed in a separate data room (physical or virtual) with access limited to members of the clean team. Subsequently, this information can be reviewed and summarized in a manner that buyer executives outside the clean team could use such a summary without any sensitive information exchanging hands.

However, it must be understood that not all information exchange is problematic and competition authorities also understand that a certain amount of information exchange is necessary for the purpose of negotiating a potential M&A. These forms of coordination and information sharing are assessed to see if they are reasonable and necessary to implement the legitimate objectives of the merger agreement without causing any competition law concerns in respect of prohibitory decree of the competition legislation. That is the relevant balance that must be obtained in any M&A transaction.

It is important to note that information sharing between competitors can also potentially raise significant concerns under Section 3(3) of the Competition Act. While Section 3 of the Competition Act does not specifically mention information exchanges between competitors, the fact that an agreement under the Competition Act is defined to include “any arrangement or action taken in concert, even if it is not formal or in writing” implies that an arrangement for exchanging information would also be covered. Thus, an exchange of commercially sensitive information that facilitates an action in concert would likely be (and has in practice been) seen as a violation of Section 3(3).

The What, Why & How

While exchanging information in a pre-merger due diligence, the following points may be borne in mind by the parties:

- Only information that is relevant to the negotiation process should be exchanged;
- Dissemination of such information is protected by a non-disclosure arrangement limiting its use to the purpose of due diligence; and
- Limited access to any commercially sensitive information is provided to those individuals not involved in pricing, marketing, or sales.

Further, certain categories of the sensitive information, such as current and future customer-specific pricing, detailed cost information, and forward-looking business plans, should be exchanged only under more restricted conditions. In most instances, information flow must be unidirectional i.e., from the seller to the buyer. As a general matter, these must not involve current or future prices, fee schedules, pricing policies, pricing formulas, plans or other competitive terms of sale (such as, financing, rebates or installations), current or future profit margins, profitability targets on specific products or projects, cost information, strategies or policies relating to marketing, customers or competition, information concerning future operations or strategies and more.

Lending An Ear to Caution

Similar to other antitrust regulators, the CCI has also examined gun jumping cases in the past five years since merger control went into effect in India and the highest penalty imposed by it in such cases is Rs. 5 crore. However, under the Competition Act, the CCI has the power to impose penalties up to 1 per cent of the total turnover or assets, whichever is higher, of the combination. As mentioned above, even where transactions are not notifiable under the merger control regime in India, the potential exchange of commercially sensitive information can raise significant issues under Section 3(3) of the Competition Act.

Given the enormous consequences of gun jumping on companies and the potential issues under Section 3(3) of the Competition Act, it is mission critical to ensure that no exchange of sensitive commercial information between competitors occurs and there is no inadvertent violation of competition law i.e. the parties remain competitors until merger clearance is granted by the relevant antitrust authorities in global transactions. Such risks are easily avoidable by putting in place a clean team, arrangement described above.