

'Gun jumping' in Israeli Merger Law

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Controlling 'Gun jumping' is one hurdle that antitrust authorities are currently struggling to overcome. This challenge has not bypassed the Israeli Antitrust Authority (IAA), which lacks clear guidelines defining which actions constitute 'gun jumping' and qualify as 'merger de facto'. In this paper we elaborate on some of the questions arising with respect to this unresolved matter.

The basic legal framework

Merger of companies

In the view of the Restrictive Business Practices Law, 1988, Israel's anti-trust law, (the 'Law'), certain practices engaged in by the parties in the pre-closing period of an acquisition, could be deemed to finalise the transaction without the requisite approval of the General Director of the IAA (the 'General Director'), rendering such practices illegal.

The term 'Merger of Companies' is broadly defined in the Law through a non-exhaustive list that includes the full or partial unification of two or more companies in one of the following ways: an acquisition of the principal assets of a company, an acquisition of more than one quarter of the company's issued capital stock or of the voting power, or the right to appoint more than one quarter of the directors, or receive more than one quarter of the company's profits.

Upon a merger in which the market share or turnover of the merging companies exceeds thresholds set out in regulations promulgated under the Law, the merging companies are required to submit a pre-merger 'notification' (in essence, a request for approval of the transaction) to the General Director. Consummation of a merger without such approval is deemed an illegal action by the companies, constituting both a criminal offence and a civil wrong. Moreover, the General Director can request that Israel's Antitrust Tribunal separate companies that merged in such circumstances. Any active director, partner (other than a limited partner) or a senior administrative employee responsible in this field is potentially subject to prosecution.

Restrictive arrangements

Certain practices in the pre-closing period, especially when engaged in by competitors, may constitute a 'Restrictive Arrangement'. A Restrictive Arrangement is prohibited by the Law, unless specifically approved or otherwise exempted. The Law defines the term as

an arrangement between parties conducting business in which at least one of the parties restricts itself 'in a manner liable to eliminate or reduce competition between it and the other parties to the arrangement, or any of them, or between it and a person not party to the arrangement' (Section 2(a) of the Law). Violation of this provision constitutes a criminal offence, as well as a civil wrong.

The black, the white and the grey

The IAA has authority to investigate violations of the Law, including practices that purport to consummate a merger without the requisite approval. To date, however, the IAA has filed only one indictment in such circumstances; the IAA has been motivated by the extreme circumstances of the case and was confident in its claim that the parties flagrantly breached the Law, however, the case concluded in a plea bargain. In another case raising similar issues, the IAA settled for a consent decree without an admission of liability by the investigated parties; here the IAA explained its settlement by virtue of lack of precedent in this 'grey area'. Moreover, the General Director has offered scarce direction in this field. Thus neither the Law nor the IAA has provided clear guidelines concerning acceptable practices in the pre - closing period of a transaction.

Nevertheless, it is clear that certain pre-closing actions would be illegal without the General Director's approval. These actions would include: payment, transfer of shares, transfer of rights (including voting rights, the right to determine who will vote, or profit rights), transfer of economic risk, and the acquirer's appointment of executives or directors.

On the other hand, certain practices would not raise 'gun jumping' concerns. This category would include agreement as to the consideration, and the effectiveness of covenants protecting the value of the acquired business (including covenants under

which the acquired entity commits not to act during the pre-closing period in a manner that will substantively change its business status, or not to incur expenses exceeding those incurred in the ordinary course of business). The parties must take care, however, that such covenants do not afford the acquirer with control over the acquired entity.

Certain pre-consummation business practices, however, are not so easily placed, and fall within a grey area in which companies may be exposed to claims that they have merged de facto, in breach of the Law.

Due diligence

Due diligence is a legitimate tool commonly employed by parties in order to assess the value of a target business. Where parties, especially competitors, perform due diligence pre-closing, they face the following questions among others: First, in a commercial context, to what extent is a company willing to disclose its confidential business information? Second, in a legal context, under the anti-trust laws, to what extent is it permissible for a company to disclose its confidential business information to a competitor? Disclosure of sensitive information between competitors might, under

certain circumstances create Restrictive Arrangements, since during the interim pre-closing period such disclosure could potentially reduce competition in a relevant market. In addition, under extreme circumstances, the due diligence process may involve disclosure of confidential information in a manner that enables the parties to coordinate their practices, thereby effecting a merger de facto. Commercial concerns may deter parties from excessive disclosure and pre-consummation coordination, and lead them to employ alternative solutions such as engaging a third party to conduct the due diligence. Nevertheless, the question remains: on a practical level what, if any, restrictions does the Law impose on merging parties at the due diligence stage?

Transition planning

Early attention to the plans for, and the goals of, a merged entity is vital to the success of a merger. As such planning at a transitional stage could potentially involve exchanges of information at a detailed and confidential level, not typically divulged between independent entities; the same concerns as expressed above arise.

Operating covenants

Covenants imposing restrictions on the sellers' activities during the interim period, in order to protect the buyer's benefit of the bargain, are legitimate under the Law. On the other hand, such covenants may run afoul of the Law if they affect transfer operational control, by restricting the ordinary business activities of the target company or by limiting its ability to compete during that period. The challenge facing all parties is how to gage, whether a covenant falls within the first or the second category. For example, when the prospective acquirer's approval is acquired for substantial long term contracts, what, if any, restrictions does the Law impose on such approval process by the acquirer?

Pre-merger coordination activities

Preliminary steps taken with respect to decisions that will come to fruition post-closing are often necessary for efficiency and the avoidance of unnecessary waste. For example, steps to establish or preserve the post closing team, negotiations relating to future suppliers or customer contracts, and decisions as to whether to proceed with a significant capital project may fall into this category. However, such activities should be considered carefully as they may, in effect transfer operational

control to the prospective buyer, finalising the merger without the necessary approval.

Conclusion

Merging companies are confronted with a complex question: Does a certain pre-closing practice fall within the black, the white, or the grey area of the Law? The questions posed above are examples of complex situations that the IAA and the Israeli legislature have been hesitant to address. The solution to the uncertainty of the 'grey area' is the promulgation of clear agency guidelines, for in their absence there is a real fear that the current uncertainty will lead the business community to steer clear of transactions that otherwise would be socially beneficial, or worse, to engage in practices that may be considered socially harmful.

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