Beware the Tolling Agreement, It May Toll for Thee: New Gun-Jumping Action Targets Certain Tolling Agreements

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Late last week, with only hours left for the Obama Administration, the Antitrust Division of the Department of Justice (DOJ) released one of the most remarkable gun-jumping enforcement actions in the more than 40-year history of the Hart-Scott-Rodino (HSR) Act.[1] In *United States v. Duke Energy Corp.*, the government alleged that Duke's entry into a plant tolling agreement with a failing electricity generator pending acquisition of that generator without obtaining clearance for the acquisition under the HSR Act violated the Act. Standing alone, tolling agreements are usually not reportable under the Act. Here, however, the government alleged that the use of such an agreement in conjunction with an acquisition was illegal. With the filing of the complaint, the government simultaneously filed a proposed settlement with Duke in which Duke agreed to pay a civil penalty of $600,000 to resolve the allegations.[2]

HSR and "Gun-Jumping:" The Basics. The HSR Act requires that the DOJ and the Federal Trade Commission (FTC) must be notified of acquisitions of assets or voting securities that meet certain size thresholds. The parties to reportable transactions must observe certain waiting periods under the Act before they can consummate their transaction. During the applicable waiting periods, the parties are required to continue to operate independently. It is a violation of the Act for the buyer to obtain operational or financial control—described as "beneficial ownership"—before expiration of the applicable waiting period.[3] Pre-closing coordination among parties to a reportable transaction that results in conferring control over all or a portion of one of the parties' operations is referred to as "gun-jumping."[4]

Why *Duke Energy* Is Relevant. Before the *Duke Energy* case, gun-jumping enforcement actions were limited to cases where, after the signing of the merger or acquisition agreement, the acquiring party effectively took control of all or a significant portion of the target's operations or interfered with its independent competitive decision-making before expiration of the waiting periods.[5] *Duke Energy* appears to expand the scope of activities that the US antitrust agencies view as constituting gun-jumping in violation of the HSR Act.

- Duke, among other activities, generates and sells electric power in a number of locations

in the United States, including in Florida. In August 2014, Duke agreed to purchase from Calpine Corporation the Osprey Energy Center, an electric power generating plant in Florida. Apparently Osprey had been selling its output to an electric cooperative, but the contract to do so expired earlier in 2014; Calpine had difficulty finding another customer for the output and chose instead to sell the plant to Duke.[6] At the same time, Duke entered into a tolling agreement with Calpine under which Duke assumed control of all fuel purchases, arrangements for fuel delivery, the amount of energy to be generated by the plant and transmission of the energy generated. In addition, Duke also retained any profit or absorbed any loss from the operation of the plant.

- Tolling agreements are common arrangements in the electric power generation industry. However, they are usually temporary in nature with the understanding that the plant will, at some point, return to the control of its underlying owner. What is different in this case is that the tolling agreement was entered into as a bridge between the signing of the parties' agreement that Duke would purchase the plant and Duke actually obtaining ownership. This period was somewhat indeterminate due to multiple required regulatory clearances (including HSR review) before consummation of the transaction. Thus, the parties never intended for the plant to return to Calpine's control at some future date.[7]
- Effectively, the government alleges that because the tolling agreement was inexorably tied to the acquisition agreement, that tolling agreement became subject to the strictures of the HSR Act. Critically, the government made clear that it did not find the tolling agreement, standing alone, to be a violation of the Act or any other antitrust law; it found only that its use in conjunction with an acquisition agreement was illegal. In essence, the government viewed the facts here as similar to those in prior enforcement actions where the acquiring party effectively took control of the target's operations after signing but before closing. While that analogy is not unfounded, this is the first time the government has asserted that a corporate arrangement common in the relevant industry that does not, standing alone, trigger the reporting requirements of the HSR Act and is not otherwise illegal becomes subject to the waiting period requirements under the HSR Act because of its association with a merger or acquisition.

More than 20 years ago, a deputy assistant attorney general gave a speech in which he asserted that a similar practice, then common in the radio industry, could violate the HSR Act if employed as part of a merger agreement.[8] However, until now neither DOJ nor the FTC has ever brought an action under these circumstances. Indeed, DOJ seemed to acknowledge the novelty of its position by agreeing to a penalty that was significantly below the maximum available under the statute.

Takeaways. The agencies provide little guidance on what constitutes illegal gun-jumping except through enforcement actions. Indeed, the last comprehensive agency statement on gun-jumping is now more than a decade old.[9] Thus, one must divine the agencies' views from their enforcement actions. In this case, we think the lesson is narrow but important: actions that cause an acquiring party to gain a material level of control over any significant part or activity of a target may violate the HSR Act if done in concert with a reportable transaction, *even if* those actions would not raise any legal issues—and would not be HSR reportable standing alone—absent the transaction. That an

action may be common in the industry absent a transaction does not provide any immunity.

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[1] 15 U.S.C §18a.

[2] The complaint, proposed final judgment, and competitive impact statement can be found at: www.justice.gov/atr/case/us-v-duke-energy-coporation.

[3] Where parties to a transaction are also competitors, coordination prior to closing can also constitute a violation of Section 1 of the Sherman Act, 15 U.S.C. §1.

[4] Until recently, outside the United States gun-jumping was generally understood to involve closing a reportable transaction before expiration of the applicable waiting periods or simply failing to file at all. Other jurisdictions rarely, if ever, challenged conduct short of close during the waiting periods. In the past few years, however, more jurisdictions are focusing on post-filing, pre-consummation conduct.

[5] *See, e.g., United States v. Flakeboard Am. Ltd.*, No. 3:14-cv-4949 (N.D. Cal. Nov. 7. 2014); *United States v. Gemstar-TV Guide International, Inc.*, 2003-2 Trade Cas. (CCH) ¶74,802 (D.D.C. 2003); *United States v. Input/Output, Inc.*, 1999-1 Trade Cas. (CCH) ¶72,528 (D.D.C. 1999); *United States v. Titan Wheel International, Inc.*, 1996-1 Trade Cas. (CCH) ¶71,406 (D.D.C. 1996).

[6] "Duke Energy Gets Slap on Wrist for Deceiving Federal Regulators," Forbes, Jan. 19, 2017.

[7] The government's complaint alleges that, in fact, Duke testified in regulatory proceedings that it would not have entered into the tolling agreement absent the agreement to purchase Osprey from Calpine.

[8] Lawrence R. Fullerton, Deputy Assistant Attorney General, Antitrust Division, Dep't of Justice, *Current Issues in Radio Station Merger Analysis*, Address at Business Development Associates Antitrust 1997 Conference (Oct. 21, 1996). The government cited this speech in its competitive impact statement in the instant matter.

[9] William Blumenthal, General Counsel, Federal Trade Commission, *The Rhetoric of Gun-Jumping*, Remarks Before the Association of Corporate Counsel (Nov. 10, 2005).

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