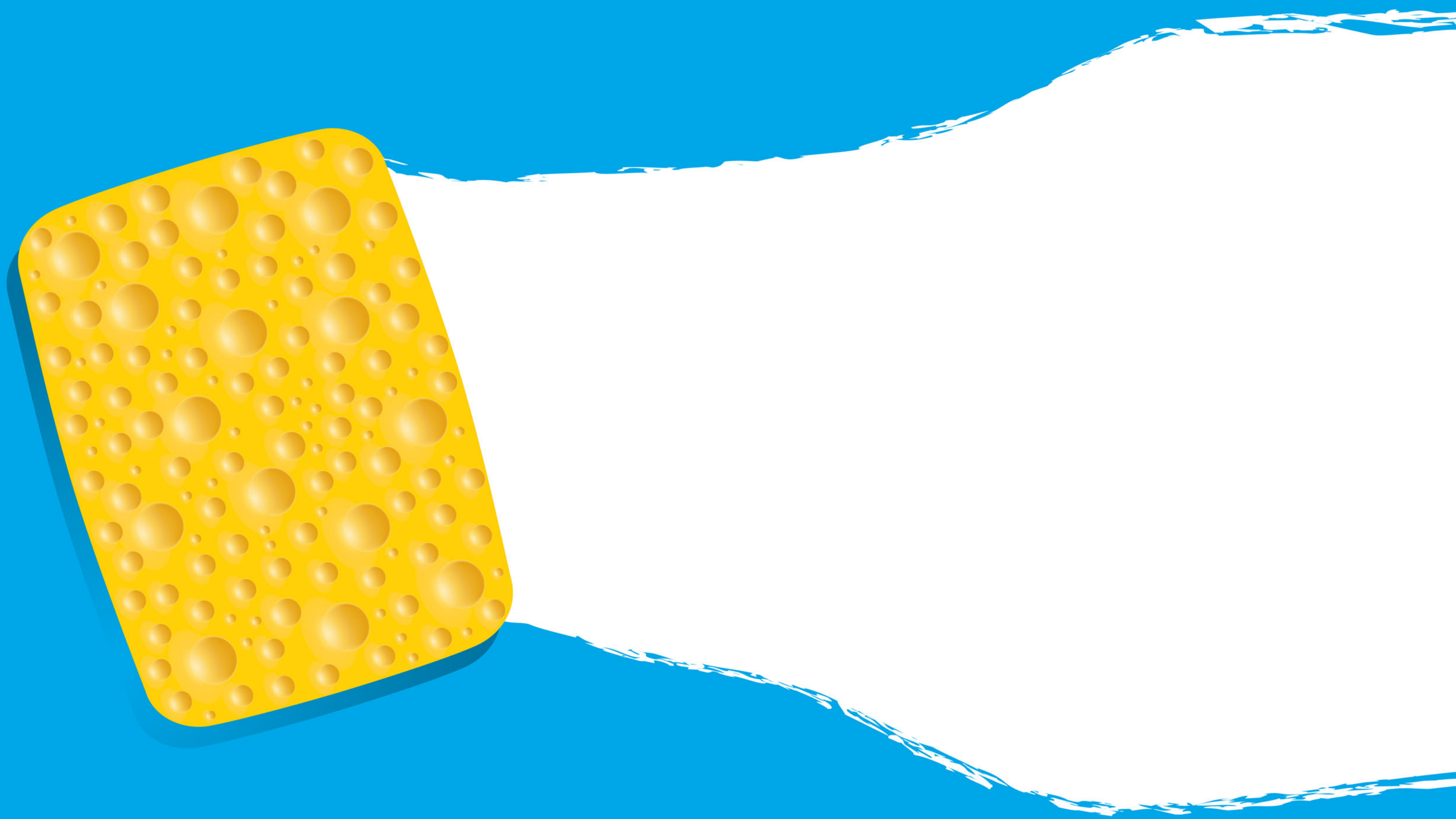
EFFECTING M&A DILIGENCE WHEN COMPETITORS ARE INVOLVED



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Increased scrutiny of the healthcare industry from antitrust agencies such as the FTC and DOJ, emphasize the necessity of compliance measures to mitigate antitrust risk that can negatively impact the closing of transactions. This article explores the critical role of clean team agreements ("CTAs") in managing antitrust risks during the due diligence process of healthcare transactions. The paper provides a comprehensive analysis of how CTAs can be structured to securely handle competitively sensitive information, ensuring that such documents are only accessed by designated personnel under strict guidelines. Through a variety of hypothetical scenarios, the article demonstrates the application of CTAs in situations involving direct competitors, labor competition, and different geographic markets. These examples underscore the importance of tailoring CTAs to the specific competitive dynamics and regulatory environments of each transaction, ensuring both legal compliance and transactional efficiency in the healthcare sector.

I. INTRODUCTION

It is no secret that antitrust enforcers are shining a spotlight on healthcare. Given the increased scrutiny of healthcare transactions, firms must take care to conduct due diligence without running afoul of the antitrust laws.

In the high-stakes world of mergers and acquisitions, the Federal Trade Commission ("FTC") and the Department of Justice ("DOJ") are using their investigations as an opportunity to root out any whiff of antitrust violations both in the ordinary course or during diligence itself. While their focus often centers on thwarting transactions that could stifle healthcare competition and lead to higher prices or reduced quality of care, these watchdog agencies are leaving no stone unturned. From scrutinizing potential gun-jumping offenses to investigating information-sharing breaches during diligence or pre-integration phases, the FTC and DOJ are on the lookout.[2] The agencies typically discover information-sharing concerns as part of their review of a transaction, though complaints can also come from customers or competitors.[3] The current regulatory landscape demands unwavering vigilance, as any hint of impropriety could trigger a thorough and distracting investigation; even if no violation is ultimately found, the repercussions of such investigations can extend timing on a transaction, distract agency staff and business personnel, increase costs substantially, and result in negative public perception of the transaction.[4]

II. CLEAN TEAM AGREEMENTS: ONE OF MANY TOOLS TO MITIGATE RISK

There are cost-effective tools that parties can implement with legal counsel to mitigate risks associated with sharing information during diligence. For example, when appropriately implemented, the following techniques can often sufficiently protect parties:

- Staging information to provide only what is necessary at a given time, including limiting the information exchanged during early phases of due diligence when several potential buyers may be in the running; information disclosed in diligence should serve a legitimate business purpose;
- Redacting competitively sensitive information from documents;
- Aggregating information such that highly sensitive information such as product or customer specific pricing, costs, margin are not discernable; or
- Summarizing competitively sensitive information such that the information cannot be operationalized.

In some cases, however, the amount of information that must be exchanged during diligence can be substantial or the desire of the buyer to have unfettered access is so great that sometimes the most cost-effective approach is to implement a formal clean team agreement ("CTA").

What is a clean team agreement? A CTA provides a contracted set of processes and procedures to allow competitors to share competitively sensitive information in full through a separate virtual data room (Clean Room) accessible only by approved, specifically designated personnel (clean team members). The personnel that are most-likely to be appropriate to serve on a clean team should not have a role in competitively sensitive aspects of the business (e.g. setting/negotiating prices, negotiating with customers, etc.) through which they could operationalize that competitively sensitive information in their day-to-day work on behalf of the buyer, competing against the seller.

2 See, e.g. *In the Matter of Bosley, Inc., Aderans America Holdings, Inc., and Aderans Co., Ltd.* (June 5, 2013) (FTC settlement involving exchange of competitively sensitive information discovered during merger investigation), available at: https://www.ftc.gov/legal-library/browse/cases-proceedings/1210184-bosley-inc-aderans-america-holdings-inc-aderans-co-ltd. Gun-jumping and violations of Section 1 (illegal coordination between competitors) can occur during diligence review.

3 See, e.g. Deputy Assistant Attorney General Andrew Forman, Antitrust Merger Enforcement: The Role of M&A Lawyers and Select Enforcement Priorities (September 17, 2022) ("Where the Division hears of potential gun-jumping or identifies evidence of it in documents, interviews, or depositions, we have and will continue to open a separate investigation and potentially pursue penalties."), available at: https://www.justice.gov/opa/speech/deputy-assistant-attorney-general-andrew-forman-antitrust-division-delivers-remarks-aba.

4 As an example of how aggressively the agencies are pursuing potential violations in this arena, the DOJ recently withdrew three policy statements that provided 'safety zones' for information exchanges. See, Principal Deputy Assistant Attorney General Doha Mekki of the Antitrust Division, Remarks at GCR Live: Law Leaders Global 2023 (February 2, 2023) ("[W]e believe the health care industry has evolved considerably since the statements were issued and that they no longer serve their intended purposes to provide encompassing guidance to the public on relevant health care competition issues. Accordingly, the Division will withdraw these three statements concerning the health care industry. At this time, the Division does not have immediate plans to replace them."), available at: https://www.justice.gov/opa/speech/principal-deputy-assistant-attorney-general-doha-mekki-antitrust-division-delivers-0.

III. TAILORING CTAS TO A SPECIFIC TRANSACTION

When setting up a CTA, parties and legal counsel should consider several factors to set appropriate parameters tailored to the transaction at-hand. Understanding competition between the parties — overlapping products or services, geographic overlap, closeness of competition, and planned or potential entry, among other factors — will heavily influence the overall tenor of the agreement. Additionally, parties should consider what kind of information is highly sensitive in the particular industry, the dynamism of the information (that is, how quickly does it go stale), and whether the information is already in the public sphere.

Other considerations when drafting a CTA include:

- How is competitively sensitive information defined?

This can depend on the nature of the overlap between the parties. Competitively sensitive information typically includes customer or product-specific pricing, cost, or output information; current or future business plans, strategic plans or marketing plans; R&D plans, customer or product-specific strategies; and comprehensive job-specific employee compensation data. Competitively sensitive information may also include confidential product designs and other nonpublic information relevant to competition. Competitively sensitive information typically does not include sufficiently historical (stale) information, aggregated information, non-customer specific information, and public information or information gleaned from sources outside diligence. It is also important to be mindful of interrelated information across documents — that is, could a potential buyer use information disclosed in disparate documents that might inadvertently reveal competitively sensitive information?

- Will diligence be directed in one direction or will both parties need to review competitively sensitive information?

Typically, a buyer will need to review the seller's competitively sensitive information, but there are scenarios in which a seller may need to diligence the buyer and its competitively sensitive information. For example, sellers that receive rollover stock in a buyer entity as partial payment for a transaction retain an interest in the merged company and would thus want to have insight into the merged company's prospects. In these situations, a bilateral or mutual CTA can allow for diligence in both directions.

- Who are the clean team members? What restrictions are placed on them?

Clean team members often include external advisors such as outside counsel and other third-party advisors such as bankers, accountants, and consultants. Clean teams may also include business development personnel and, in some cases, business personnel. Assuming the parties compete[5] and absent special circumstances, clean team members generally should not have direct or day-to-day responsibility for marketing, pricing, or sales of competing products/services (keep in mind other roles could be implicated depending on the industry). For this reason, business personnel are often not appropriate clean team members if engaged in those activities. The CTA should explicitly list the business roles that clean team members are restricted from engaging in throughout the duration of the CTA and for a "cooling off period" from engaging in those roles after the CTA terminates. All clean team members should be identified in the CTA (usually in an appendix or exhibit that may be added to with the approval of the disclosing party as the matter extends).

- How long is the cooling off period?

The competitive situation in the relevant industry should dictate the length of the cooling off period. The cooling off period is often set to coincide with the amount of time it might take for the actionability of the competitively sensitive information to go stale (and thus diminish the risk of information being operationalized or even recalled). Typically, most industry information goes stale in 3-24 months, but every industry is different.

- What are clean team reports and who approves clean team external reports?

A feature of clean team agreements is to provide the clean team members the ability to report out on the learnings from the information reviewed in the clean team. The reports or summaries can be shared outside of the clean team with other personnel subject to the non-disclosure agreement if the report effectively removes, aggregates, anonymizes, summarizes, redacts, or otherwise masks the relevant competitively sensitive information. Often, the disclosing party will want its counsel to be the *final* gatekeeper controlling review of those reports before they are shared outside of the clean room to ensure that the report appropriately addresses the handling of any sensitive information. In some situations, it is appropriate for the receiving party's counsel to review and approve clean team reports, particularly where the standard of what is competitively sensitive is well understood by buyer's antitrust counsel (e.g. sometimes sellers seek to protect through the clean team process sharing with buyer certain sensitive information that would not be a violation of antitrust law to share — in such situations, the standard of review may not be easily understood by buyer counsel). If the disclosing party's counsel controls approval, the CTA can require counsel respond to requests to disclose a clean team report within a certain period of time (e.g. 24 or 48 hours) to provide for efficient flow of

5 Keep in mind that information sharing protocols may be needed in situations outside of direct competition. For example, in situations in which, the seller diligence necessitates sharing competitively sensitive information of competitors with a buyer or the seller is a customer of a buyer (or *vice versa*). Generally, it is a good idea to work with counsel on information sharing considerations whenever a buyer and seller are competitors or there is a potential customer/supplier nexus.

information. It is also prudent for counsel to advise clean team members to implement a consistent labeling system to keep proposed and final external reports appropriately segregated and avoid confusion of which materials remain clean team only.

- <u>If the transaction is an auction process, will all bidders use the same clean room or will the clean room be tailored for each prospective buyer?</u>

A primary consideration is whether bidders have different competitive overlaps. For example, if there are financial and strategic bidders, financial bidders may not compete with the seller though care should be taken when financial bidders partner with strategic bidders. Some strategic bidders may compete more directly or across a wider swath of products than others. The seller should weigh the increased complexity and risk of inadvertent disclosure of competitively sensitive information that comes with running multiple clean rooms against the efficiency of creating a more streamlined clean room for bidders with no or limited competitive overlaps.

IV. HYPOTHETICAL SITUATIONS AND CTA CONSIDERATIONS TO MITIGATE RISK

Although CTAs for direct competitors may be relatively clear-cut, there are many nuanced circumstances that require careful consideration. Below we discuss some of these hypothetical scenarios along with considerations for the clean team process.

A. Direct Competition

If the parties are competitors, typically the CTA should implement certain best practices to minimize antitrust risk. Counsel should discuss the diligence information request list before information is made available in the clean room. An effective practice is to use a staging folder (or sandbox) in the virtual data room so counsel can review diligence materials and direct material, as needed, to the clean room prior to commencing diligence. Thereafter, counsel should similarly review materials as uploaded to the staging folder. Counsel should consider, in conjunction with the business team, what information is needed for each stage of diligence and only provide the level of detail for that stage; if information is so sensitive that even sharing it in the clean team is problematic, it may be that limiting the clean team to outside advisors (assuming the outside advisors are not otherwise involved in advising the business on a day-to-day level) is an appropriate safeguard. Outside advisors could then blind, aggregate or otherwise mask the competitively sensitive information to share with deal decision makers.

B. Indirect Competition

Consider, for example, a situation where the parties are not direct competitors but either (i) could enter the same product or geographic market, (ii) serve the same customers in an adjacent product, service, or geographic market, or (iii) otherwise could potentially operationalize competitively sensitive information obtained during diligence. In these situations, both parties should have sensitivity to disclosing information, though it is likely the disclosing party will perceive greater competitive risk. When a disclosing party is reluctant to share information with a potential competitor, that reluctance may indicate the information in question is often competitively sensitive, but the concerns could have more to do with business risk for the seller rather than mitigating the risk the information sharing contravenes antitrust law. In these situations, assessing the level of competition and discussing between outside counsel is essential to setting up proper guardrails. As a corollary, a situation where a buyer is not in the same business as the seller but is evaluating two separate acquisitions in parallel could have a similar analysis.

Using clean teams in these situations can be helpful tool to mitigate seller concerns. In these situations, an appropriate workaround could be to modulate appropriateness for clean team membership depending on the nature of the competition or potential competition (perhaps restricting membership only if they have direct oversight of relevant decisions rather than a broader exclusion of anyone involved in the relevant roles).

For example, if a buyer could readily enter the same geographic or product market as the seller, consider whether any concrete steps have been taken toward entry. In a scenario in which a buyer in California is conducting diligence on a seller in Nevada where the buyer has been aggressively expanding across state lines, has conducted studies or analysis of entering in Nevada, and has recently applied for licenses to permit expansion into Nevada should likely be treated as a direct competitor of the seller. But a buyer in California that has not taken any of those steps and is conducting diligence on a seller in Maine may warrant different treatment since the likelihood of competition is lower.

Further, consider a scenario in which a physician practice is for sale with multiple bidders conducting diligence. One of the bidders is a private-equity backed healthcare provider considering whether to acquire the physician practice to expand into a new geographic area or organically grow by standing up its own providers and practice group in that area (i.e. a “make-buy” scenario). Here, the bidder has the resources to rapidly expand to serve customers in this adjacent market and compete against the selling physician practice. It would be important for any clean team to exclude any of bidder’s personnel involved in strategic growth, including assessing bidder’s organic growth expansion opportunities to mitigate the risk of the bidder learning competitively sensitive information about reimbursement rates, facility contracts, or provider compensation it could operationalize to compete against the selling physician practice in the event it lost the bid to acquire the practice.

C. Labor Competition

While CTAs are primarily used for situations where the parties compete to provide a product or service, there can be situations where parties do not compete with each other for customers but do compete for employees. For example, employees with specialized skills like nurses might work in a variety of settings ranging from infusion centers to hospitals to providing home health care. Infusion centers and home health companies do not compete to provide the same service, but nurses may move between the two care settings. Thus, sharing detailed job-specific compensation, information regarding recruitment and retention plans, or similar employee information could be problematic. Parties have several options in this kind of situation. Often redacting certain employee information (e.g. wages tied to specific job functions) can be sufficient, but if implementing a CTA, the definition of competitively sensitive information can be limited to labor information.

D. Different Geographies

There can also be situations where parties provide similar or the same products or services, but in different geographic markets. While the parties may not consider themselves direct competitors (and may emphasize they do not compete for the same customers, respond to the same RFPs, etc.), careful construction of the CTA and consideration of clean team members is warranted.

Typically, it is reasonable to designate employees from operations in another geographic area as clean team members, but counsel should consider whether there is potential entry, competition for labor, or customer overlaps that could allow for operationalizing competitively sensitive information across geographic markets. Also consider whether sales, marketing, or pricing information in one geography is substantially similar to that in another geography. For example, if one party were to find out what a competitor is charging a customer in California, could they use that information to alter pricing in New York? If the parties operate in different geographies and there are not special circumstances warranting more careful treatment, CTAs in this situation can reasonably include more limited definitions for competitively sensitive information and what functions are precluded for clean team members or can be dispensed with altogether.

E. Alternative Transaction Structures Under Consideration

Finally, consider the situation where parties are conducting mutual diligence and considering alternative permutations of a transaction structure. For example, a buyer could offer a narrower transaction perimeter than the seller initially offers; a seller could offer alternative deal perimeter carveout sales; or a buyer could include a larger deal perimeter than what is presented in the primary bid. The different parts of the business for sale might implicate different scopes of competitive overlap (or lack thereof). Handling a CTA in this situation could therefore get complicated. One option would be to use separate CTAs for each permutation, ensuring each is tailored to the specific competitive concerns of that potential transaction structure. Alternatively, a single CTA could be adopted with different personnel permitted to view information relating to various permutations. A simpler option would be to set up a CTA to encompass the largest possible perimeter, although this could frustrate a buyer seeking to have certain clean team members or trying to review specific information related to transaction structures that pose little or no competitive issues.

V. CONCLUSION

Every healthcare transaction has unique factors that can alter what kind of information can be shared and in what manner and parties have differing incentives for information sharing. Involving counsel early in the process can not only help navigate these intricacies, but also ensures processes can be put in place to mitigate risk from antitrust enforcers who are shining a light on the healthcare industry and aggressively investigating all potential infractions.

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