Competition - Israel

Draft guidelines on information exchange in the course of due diligence

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Introduction

The Antitrust Authority recently published the draft Guidelines Regarding Information Exchange in the Course of Due Diligence Prior to a Transaction Between Competitors. The draft guidelines provide theoretical principles and a procedural framework for conducting due diligence in transactions that require the transfer of sensitive information. While the draft guidelines characterise certain types of competitively sensitive information and suggest ways to transfer such data legally, they confer the ultimate discretion regarding the due diligence process - and the potential liability that comes with it - on the merging parties.

Draft guidelines

The draft guidelines are not limited to a certain type of transaction. However, they do not apply to transactions that do not usually require a due diligence process (eg, a franchise agreement). Moreover, the draft guidelines do not apply when the parties do not actually intend to enter into a transaction and the due diligence process is being used as a cover for a 'naked' information exchange between competitors.

The draft guidelines apply only to transactions conducted between competitors. However, the guidelines define the term 'competitors' broadly, based on the definition proposed in the draft Antitrust Rules (Block Exemption for Non-horizontal Arrangements Without Price Restrictions) 2012. For example, the definition of 'competitors' also includes parties which are not *de facto* competitors, but which:

- have competed at some point during the five years preceding the transaction;
- are potential competitors; or
- provide products that have a similar use, even if they do not operate in the same relevant market.

The significance of the broad definition of 'competitors' is that the provisions of the draft guidelines and the attached limitations will apply to a wide variety of transactions, including in some cases, transactions in which the due diligence process raises no competitive issues.

The premise of the draft guidelines - which is economically and empirically controversial - is that, in general, parties' uncertainty about market conditions and their competitors' capabilities and plans contributes to competition; hence, any reduction in uncertainty could harm competition.

Accordingly, the draft guidelines define 'competitively sensitive information' as:

> "*Any information that is not public or cannot be identified or traced relatively easily, which, if found out by a business competitor of the owner of the information, including the other party to the transaction, will increase the ability of that competitor to anticipate the price and production strategy of the information owner and the information owner's expected response to price and quantity initiatives on that competitor's part.*"

Beyond the general definition, the draft guidelines list specific categories of information that are potentially sensitive, especially in the eyes of the antitrust commissioner, including:

- prices, pricing policies, discounts and terms of sale;
- profit margins;
- costs of a specific product;
- production capacity for a specific product;
- market share;
- competitive strategy;
- present and future business plans in different fields;
- the identity of existing and potential suppliers and customers;
- policies regarding customer negotiations, recruitment and retention;
- policies regarding tenders;
- information relating to a specific client;
- technologies owned;
- mergers, acquisitions or potential joint ventures; and
- other confidential business information that might be used to reduce competition, including historical information.

The commissioner does not establish a sweeping categorical rule regarding the exchange of such information, and there are presumably certain circumstances in which the exchange of such information would not pose a real competitive hazard.

The draft guidelines list a number of rules for due diligence that are aimed at minimising harm to competition in a manner that is consistent with the Restrictive Trade Practices Act 1988. Compliance with these rules is required only in transactions between competitors (as broadly defined in the draft guidelines) and only with respect to competitively sensitive information. These rules cover the following areas:

- The identification of competitively sensitive information.
- The evaluation of the necessity of the information disclosure - competitively sensitive information items may be disclosed only if they are essential for the purpose of the due diligence.
- The disclosure of information subject to an undertaking to maintain confidentiality - the agreement creating the undertaking must prohibit the use of the information for any purpose other than the due diligence process, and prohibit the delivery of the information to a third party which is not authorised to receive it.
- Preference for aggregate, outdated and non-concrete information - if possible, the exchanged information should be limited to aggregate information that does not allow the use of 'reverse engineering' to disclose the details of which it is composed. For example, information should be provided at the division level, rather than with regard to a specific product, or at the national or global level, rather than at the level of regional segmentation.
- External review - if possible, the information should be disclosed to an external evaluator (eg, a lawyer or accountant) who will review the information and organise it into a 'bottom-line' framework in the field of his or her expertise.
- Review by employees who are not involved in pricing, marketing and sales in the field in which there is a competitive overlap - when the information is not within an external evaluator's field of expertise, information can be filtered by employees who are not involved in pricing, marketing or sales of the competing products, or by former employees or those on the verge of retirement. These employees will review the information, subject to their confidentiality undertakings, and will provide the bottom-line information to the purchaser.
- Review by employees involved in pricing, marketing and sales in the field in which there is a competitive overlap - when there is a practical need to disclose information to employees who are involved in pricing, marketing and sales in the field in which there is competition, a 'clean team' should be formed, composed of as few employees as possible; these employees will exchange the information with the purchaser at the bottom-line level. Given their exposure to the information, these employees will be excluded from decisions regarding pricing, marketing and sales for a period of time as is sufficient under the circumstances. The draft guidelines do not define what constitutes a 'sufficient' period of time, but it is clear that the exclusion obligation ends when the acquisition is legally closed.
- Documentation - the due diligence process should be documented in detail and in real time. Among other things, the disclosed information should be documented, along with details regarding:
  - the practical need for disclosing each item and for its level of detail;
  - the identity of the people who reviewed the information, their roles and connection to the entity requesting the review; and
  - the date of the information review and the review procedure.

In addition, every information exchange between the direct reviewer and another party

should be documented, including exchanges of partial information or bottom lines. The documentation should also include the confidentiality statements and any work protocol governing the disclosure process. The draft guidelines state that the Antitrust Authority will view parties which fail to comply with the documentation requirements strictly as having failed to fulfil their obligations regarding the due diligence process.

Comment

The draft guidelines cover issues that have previously not been discussed in Antitrust Authority decisions and court rulings. They provide guidance for assessing whether information is sensitive and establish a procedure for handling such information. However, the draft guidelines allow parties to a transaction to exercise their own discretion - and leave them legally liable with respect to their exercise of such discretion - regarding the determination of the sensitivity of each item, as well as the determination of specific review arrangements within the framework and circumstances of each transaction. Such discretion, combined with a broad definition of the term 'competitors' and extensive documentation requirements, suggest that parties to a horizontal transaction should be especially cautious while conducting a due diligence process in order to achieve its legitimate ends without incurring significant antitrust liability.

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