

Antitrust Alert

DOJ Fines Parties to Abandoned Purchase Agreement for “Gun Jumping”

The Department of Justice has reached a \$4.95 million settlement with companies it had sued for engaging in anticompetitive preclosing activities in violation of the Sherman and Hart-Scott-Rodino Acts. The DOJ's lawsuit and subsequent settlement highlight the need for companies contemplating a merger or purchase agreement to continue to act as separate entities until after the legally required waiting period has ended.

The DOJ's lawsuit stemmed from a proposed purchase agreement under which Flakeboard America Ltd. would have acquired three particleboard and medium-density fiberboard mills owned by SierraPine, one of Flakeboard's competitors. Although the parties abandoned the agreement after the DOJ expressed concerns about its potential anticompetitive effects, the DOJ nonetheless sued them for conduct they engaged in while the deal was pending. The DOJ alleged that Flakeboard and SierraPine violated the federal antitrust laws by allowing Flakeboard to exercise operational control of one of SierraPine's mills before the statutory waiting period had expired. The terms of the settlement require SierraPine and Flakeboard, along with its parent companies, to each pay a \$1.9 million civil fine for violations of the Hart-Scott-Rodino Act. Additionally, Flakeboard must disgorge \$1.15 million in illegal profits obtained in violation of the Sherman Act.

Under the Hart-Scott-Rodino Act, parties to mergers and acquisitions must notify the federal antitrust agencies and observe a statutory waiting period if the value of the transaction exceeds certain monetary thresholds. The current basic threshold amount is \$75.9 million, but the Federal Trade Commission adjusts this figure annually based on changes in the gross national product. The purpose of the statutory waiting period is to preserve the parties as independent entities until the antitrust agency reviewing the proposed agreement has completed its investigation and decided whether or not to challenge the transaction. During the waiting

period, the purchasing party is prohibited by the Premerger Notification Rules from obtaining “beneficial ownership” of the seller’s assets, known as “gun jumping.” As long as the waiting period continues, parties to a purchase agreement are still competitors and are required under the antitrust laws to continue to behave as competitors until the waiting period ends and the deal closes. If the parties begin to share competitively sensitive information and coordinate the transfer of customers or employees from one company to another while the transaction is still under review, they can violate the antitrust laws by behaving as though they are a single business entity with united interests rather than competitors. A violation of the waiting period can also constitute a violation of the Sherman Act if the parties engage in a conspiracy or agreement in restraint of trade.

One method of obtaining beneficial ownership in violation of these rules is to begin exercising operational control of the seller’s business before the waiting period has ended. According to the DOJ’s lawsuit, that is precisely what Flakeboard did. The DOJ’s complaint alleged that Flakeboard prematurely assumed operational control of one of SierraPine’s mills during the statutory waiting period while the transaction was still under review by the DOJ.

On January 13, 2014, Flakeboard and SierraPine executed a purchase agreement under which Flakeboard would acquire three of SierraPine’s particleboard and medium-density fiberboard mills. The agreement included a provision that five days prior to closing, SierraPine would shut down all business operations at one of the mills, located in Springfield, Oregon. However, shortly after the agreement was signed, an issue arose that required SierraPine to publicly disclose the shutdown of the Springfield mill much sooner than expected, before the end of the Hart-Scott-Rodino waiting period. The parties discussed the ramifications of this development and decided that SierraPine would announce the closure of the mill during the waiting period and would shut down the mill a few weeks later.

According to the DOJ’s complaint, the companies took several steps during the statutory waiting period to ensure that the early closure of the Springfield mill would not adversely affect Flakeboard. These measures were aimed at facilitating the transfer of SierraPine’s Springfield mill customers to Flakeboard’s competing mill in Albany, Oregon. SierraPine provided Flakeboard with names, contact information and sales data for its Springfield customers, and Flakeboard disseminated this information to its sales employees. SierraPine also instructed its sales employees to tell customers that Flakeboard wanted their business and would match SierraPine’s prices, and made promises to certain of those employees that Flakeboard would employ them after the mill closed. Finally, SierraPine delayed its announcement of the Springfield mill closure by one day in order to put Flakeboard in a better position to reach out to the Springfield mill’s customers. These efforts were successful, and after the Springfield mill closed on March 13, Flakeboard secured a significant amount of the mill’s old business, including several customers that were new to Flakeboard. Meanwhile, the statutory waiting period was extended when the DOJ issued a second request, indicating that it required more documents, more information and more time to complete its review of the transaction. All of the alleged coordination in connection with the Springfield mill closure occurred well before the statutory waiting period finally expired on August 27.

The two parties abandoned the proposed purchase agreement on September 30 because of concerns raised by the DOJ about the agreement's anticompetitive effects on sales of medium-density fiberboard. Nevertheless, on November 7, the DOJ sued the companies in connection with their alleged coordination and agreements surrounding the closure of the Springfield mill. The complaint alleged that the conduct constituted both a premature transfer of beneficial ownership in violation of the Hart-Scott-Rodino Act and an agreement to restrain trade in violation of the Sherman Act.

The companies' settlement with the DOJ illustrates the importance of exercising caution during interactions between parties to a merger or acquisition while the transaction is under review by the antitrust authorities. Employees of both parties need to understand that the other party must remain a separate entity and should be treated as such until the waiting period has ended and the deal has closed. The penalties for failing to do so can be severe, as companies who engage in gun-jumping conduct can face both civil fines under the Hart-Scott-Rodino Act and disgorgement of unlawful profits under the Sherman Act. Because the maximum civil fine for violations of the Hart-Scott-Rodino Act is \$16,000 per day for each day that the antitrust violation was ongoing, these penalties can be quite costly. Indeed, Flakeboard and SierraPine could have faced a significantly harsher penalty of \$3,568,000 per company for their 223-day-long violation had they not earned a reduced fine by voluntarily producing evidence to the DOJ. Both companies devoted significant resources to facilitating their proposed purchase agreement, and they now face substantial costs because of the manner in which they did so. These costs can only be prevented by careful adherence to the antitrust laws throughout the negotiation, signing and agency review of a merger or purchase agreement.

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