

Client Alert

November 2014

Justice Department Imposes \$5 Million Fines and Profit Disgorgement for Improper Premerger Coordination in Abandoned Deal

On November 7, 2014, the US Department of Justice Antitrust Division (DOJ) announced that it entered into a nearly \$5 million settlement agreement with two particleboard manufacturers for unlawful premerger coordination. The would-be merging parties each received civil penalties of \$1.9 million for violating the waiting period imposed by the HSR Act (HSR) and the would-be buyer was forced to disgorge \$1.15 million in profits obtained in violation of Section 1 of the Sherman Act. This is the first instance in which the US antitrust agencies have used profit disgorgement as a sanction for “gun jumping” by merging parties.

The Alleged Premerger Coordination

Earlier this year, Flakeboard America Limited (Flakeboard) signed an asset purchase agreement (APA) to acquire three particleboard mills owned by a competitor, SierraPine. (The two are reportedly among only four suppliers on the West Coast.) At the time, both operated mills in Oregon. As part of the APA, SierraPine was required to shut down its Springfield, Oregon particleboard mill prior to conveying it to Flakeboard, provided that it was not to do so until “required waiting periods and approvals ...under applicable Antitrust Law shall have expired or been terminated.”

Because of a labor issue, Flakeboard decided that SierraPine should close its Springfield mill during the HSR waiting period and transfer as many customers as possible to Flakeboard. According to the DOJ complaint, SierraPine closed its mill on March 13, 2014, and helped Flakeboard to secure a large number of customers that formerly purchased from the closed mill. In furtherance of the customer transfer, the complaint also alleges that the parties’ sales teams coordinated and that SierraPine shared competitively sensitive customer information with Flakeboard.

The parties received a request for additional information (“Second Request”) and substantially complied in July. The HSR waiting expired August 27, 2014. However, the parties abandoned the sale soon thereafter in response to the DOJ’s concerns and presumed threats to challenge the acquisition in court.

HSR Act Waiting Periods

The HSR Act requires that companies planning acquisitions exceeding certain thresholds file a notification with the FTC and DOJ and observe a statutory waiting period, ordinarily 30 days, to allow the agencies to review the transaction for potential anticompetitive effects. During the waiting period, the filing parties must continue to compete and operate independently. Failure to maintain separate operations prior to closing is known as “gun jumping.”

Failure to observe the HSR waiting period may result in civil penalties of up to \$16,000 per day. In addition, if the pre-merger coordination constitutes a conspiracy in restraint of trade, it may also violate the Sherman Act, and result in treble damages, criminal penalties, and injunctive relief.

Lessons Learned

The Flakeboard enforcement action illustrates that the agencies take compliance with the HSR Act seriously and are willing to impose significant fines in response to violations, particularly when they threaten competition. This case provides several lessons for parties considering a merger or acquisition:

- It is generally a bad idea to require a seller to close a competing facility prior to acquisition, and perhaps a worse idea to include such a requirement in deal documents filed with the FTC and DOJ as part of an HSR notification. Such a provision waves a red flag that the buyer may want to use the acquisition to take capacity out of the market. Indeed, such an agreement can, as shown here, constitute a *per se* violation of Section 1 of the Sherman Act.
- HSR civil penalties are not just a concern for buyers to worry about. Sellers need to carefully consider antitrust risks and the potential implications of a broken deal. Here, both seller and buyer received a fairly significant \$1.9 million civil penalty. Given the deal was abandoned, the would-be seller was left without a sale, a shuttered plant it would have otherwise desired to operate, and a substantial HSR fine. (It is not known if the APA provided for the payment of an adequate termination fee to the seller, but such terms are often advisable for sellers where a buyer presents significant antitrust risk.)
- The agencies may seek disgorgement in the absence of equitable remedies. The DOJ indicates that it chose to impose a disgorgement of \$1.15 million because there was no equitable remedy available. The DOJ claimed that it would have been impractical to order SierraPine to reopen the closed plant given that all of the employees had left.
- Customary pre-closing cooperation by merging parties does not violate the HSR or Sherman Acts. In the Flakeboard Competitive Impact Statement, the DOJ indicated that the following customary pre-closing terms do not violate the antitrust laws:
 - Agreements that require a seller to operate its business on the ordinary course;
 - Material adverse change provisions that give the acquiring firm certain rights to prevent a to-be-acquired firm from materially changing how it conducts its business; and
 - Allowing a prospective acquirer to access information about pending contracts to properly value a business during the due-diligence process.

Conclusion

The DOJ's enforcement action serves as a powerful reminder to merging parties that the antitrust agencies can seek significant penalties against parties that fail to observe the HSR and Sherman Act gun jumping prohibitions.

Hunton & Williams has significant experience navigating the complexities of the merger review process, including the HSR Act waiting period and related gun jumping rules, and can assist with any merger-related antitrust matters. Lawyers in the group include former senior management and staff attorneys from both of the US antitrust enforcement agencies. The group serves domestic and international companies in merger review, competition litigation, and criminal antitrust defense and related price-fixing litigation.

Contacts

D. Bruce Hoffman
bhoffman@hunton.com

Amanda L. Wait
await@hunton.com

Gregory L. Kinzelman
gkinzelman@hunton.com

