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DOJ Antitrust Action Condemns Pre-Merger Coordination Requiring Target Company to Sell Factory

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On November 7, 2014, the United States Department of Justice, Antitrust Division (DOJ) announced a $5 million agreement to settle charges that Flakeboard and SierraPine had engaged in unlawful pre-merger coordination.[1] The DOJ's complaint alleged that the parties' conduct constituted both a *per se* unlawful agreement between competitors to reduce output and allocate customers in violation of Section 1 of the Sherman Act and a premature transfer of beneficial ownership (commonly referred to as "gun jumping") in violation of the HSR Act.[2] While the DOJ's action underscores that merging parties must remain separate and independent competitors during the HSR review period, it is especially noteworthy in that it condemns, as *per se* illegal under the Sherman Act, the actions of the companies pursuant to a provision in the merger agreement that required the target company to close one of the facilities being sold prior to the consummation of the acquisition.

Background

Flakeboard and SierraPine were competitors in the production of particleboard and medium density fiberboard (MDF). In January 2014, Flakeboard agreed to acquire three competing mills from SierraPine — particleboard mills in Springfield, Oregon, and Martell, California, and an MDF mill in Medford, Oregon. The asset purchase agreement expressly required SierraPine to close its Springfield particleboard mill after the expiration of the HSR waiting period and five days prior to closing the deal. However, shortly after the proposed acquisition was announced, SierraPine, in consultation with Flakeboard, decided to close the mill earlier than anticipated by the merger agreement (seemingly due to a labor dispute at the plant).

The DOJ's Action

The DOJ's complaint alleges that during the HSR review period: (i) Flakeboard and SierraPine agreed to transition customers to Flakeboard's competing mill following the closing of the Springfield mill, (ii) SierraPine provided competitively sensitive information about the Springfield mill's customers to Flakeboard, which Flakeboard distributed to its sales force, (iii) SierraPine delayed the issuance of the press release to allow Flakeboard to better position its sales personnel to contact the Springfield mill's customers, (iv) SierraPine instructed its sales force to direct the Springfield mill's customers to Flakeboard, and (v) SierraPine relayed assurances of future employment at Flakeboard as an incentive to shift customers to Flakeboard. The parties ultimately abandoned the proposed acquisition due to significant DOJ competitive concerns in light of the parties' high combined shares for MDF in California, Washington and Oregon.

The DOJ's complaint and consent materials make it clear that merging parties can be charged with violating the Sherman Act if they coordinate on price, output or other competitively

1 Press Release, U.S. Department of Justice, "Justice Department Reaches $5 Million Settlement with Flakeboard, Arauco, Inversiones Angelini and SierraPine for Illegal Pre-merger Coordination" (Nov. 7, 2014), http://www.justice.gov/atr/public/press_releases/2014/309786.htm.

2 Complaint, *United States v. Flakeboard America Ltd.*, 3:14-CV-04949 (N.D.Cal. 2014).

significant matters prior to the consummation of the transaction.[3] While the DOJ expressly acknowledges in its court papers that customary conduct of business covenants are "common provisions intended to protect a transaction's value and prevent a to-be-acquired firm from wasting assets" and that "a prospective acquirer may need information about pending contracts to properly value a business during the due-diligence process," the DOJ cautions that "[a]s a general rule, competitors should not obtain prospective, customer-specific pricing information before consummating a transaction because it could be used to harm competition if the transaction is abandoned."[4]

Under the HSR Act, each party (buyer and seller) that engages in gun-jumping is subject to a maximum civil penalty of $16,000 per day for each day that they are in violation — potentially subjecting Flakeboard and SierraPine to fines of $3.5 million each. The DOJ reduced the fine as a result of the parties' voluntary cooperation in the investigation and ultimately settled for each party paying $1.9 million.[5] The DOJ further required Flakeboard to disgorge $1.15 million in profits for violating the Sherman Act, which represented the value of diverted sales Flakeboard earned from the premature closing of the Springfield mill.[6] The DOJ said that the disgorgement of profits was necessary so that future parties would be deterred from engaging in pre-merger anticompetitive behavior prior to completion of the acquisition (and even after the expiration of any applicable HSR waiting periods).[7]

The Flakeboard settlement demonstrates that the DOJ (and probably the FTC, the other U.S. antitrust enforcement agency) may challenge provisions in transaction agreements that go beyond normal operating covenants and possibly impact pricing and output decisions of the target. In fact, the parties to that transaction are prohibited by the consent decree for 10 years from entering into an agreement with an acquiring or a to-be-acquired party that, among other things, sets prices, reduces output through a plant shut-down, allocates customers or involves sharing of pricing information.[8]

Companies should note that pre-merger coordination rules (whether under the HSR Act or the Sherman Act) apply regardless of whether a transaction raises serious competitive concerns or not.[9] However, when firms are competitors, they not only face the gun-jumping rules but also the potentially serious consequences of a Sherman Act case. Because there can be many gray areas (including in the type of provisions that restrict or dictate the target's behavior prior to closing), it is imperative to work with antitrust counsel to ensure that the merging parties do not run afoul of either the HSR Act or the Sherman Act prior to closing.

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3 The DOJ, however, also recognized in the Competitive Impact Statement that there may be "certain circumstances" in which an agreement to close a production facility before a transaction is consummated may be permissible. The settlement materials do not elaborate on what constitutes "certain circumstances," but presumably it may contemplate a situation where the parties have cleared the HSR process, there are no remaining bars on closing and closing is imminent. Competitive Impact Statement at 12, *United States v. Flakeboard America Ltd.*, 3:14-CV-04949 (N.D.Cal. 2014).

4 *Id.*

5 Flakeboard Competitive Impact Statement at 13.

6 *Id.* at 3.

7 *Id.* at 11.

8 Final Judgment at 6, *United States v. Flakeboard America Ltd.*, 3:14-CV-04949 (N.D.Cal. 2014).

9 Notably, the last gun-jumping case brought by the DOJ, *United States v. Smithfield Foods and Premium Standard Farms*, 1:10-CV-00120, (D.D.C. Jan. 21, 2010), resulted in Smithfield agreeing to a $900,000 settlement for exercising beneficial ownership before closing, even though the DOJ ultimately decided that the transaction did not implicate anticompetitive concerns.

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