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U.S. Premerger Coordination Allegations Settled for $5 Million in Civil Penalties, Disgorgement

Jeffrey May (Wolters Kluwer) · Saturday, November 8th, 2014

The dangers of prematurely exercising operational control over an acquisition target, or at least appearing to operate organizational control, are highlighted by a Department of Justice Antitrust Division action announced yesterday against two particleboard suppliers that recently dropped their planned combination. Just five weeks ago, Flakeboard America Ltd. abandoned its proposed acquisition of rival SierraPine in the face of the government's antitrust concerns. Now, the companies have agreed to pay millions to settle allegations that they engaged in premerger coordination, also known as "gun jumping," in violation of both Sec. 7A of the Clayton Act and Sec. 1 of the Sherman Act.

According to the government's complaint, Flakeboard and its parent companies during the premerger waiting period coordinated with SierraPine on the closing of a particleboard mill and moving the mill's customers to Flakeboard. This alleged conduct constituted a *per se* unlawful agreement between competitors to reduce output and allocate customers in violation of Sec. 1 of the Sherman Act. In addition, the government alleged that this and other premerger coordination demonstrated Flakeboard's exercise of operational control over SierraPine's business before the premerger waiting period expired. Therefore, it was alleged, Flakeboard and its parent companies, as well as SierraPine, violated Sec. 7A of the Clayton Act, commonly known as the Hart–Scott–Rodino Antitrust Improvements Act or HSR Act.

The Justice Department contended that SierraPine had no plans to shut down the mill in question, located in Springfield, Oregon, before negotiating the proposed acquisition. Apparently, under the parties asset purchase agreement (APA), SierraPine agreed to take action to shut down the mill prior to the transaction's closing but after the expiration or termination of the HSR waiting period. The Springfield mill competed directly with Flakeboard's particleboard mill in Albany, Oregon.

According to the complaint, despite the defendants' intentions under the APA, the parties subsequently entered into a series of agreements and took other actions during the HSR waiting period to close the mill and move the mill's customers to Flakeboard months before the HSR waiting period expired. The acquisition was abandoned on September 30 in light of Justice Department concerns about the transaction's likely anticompetitive effects in the sale of medium-density fiberboard (MDF)—which is used in furniture, kitchen cabinets, and decorative moldings—sold to customers in California, Oregon, and Washington. Flakeboard and SierraPine are two of only four significant suppliers of MDF to the West Coast. The Springfield mill remains closed.

Settlement. Under the terms of a proposed consent decree, the defendants have agreed to pay a combined $3.8 million in civil penalties ($1.9 million each) for violating the HSR Act. The government noted that a maximum penalty for the alleged 223-day violation was $3.568 million for each party to the transaction. However, the lower penalty was deemed appropriate in light of the parties' cooperation with the government's investigation.

In addition, to resolve the Sherman Act, Sec. 1 allegations, Flakeboard has agreed to disgorge $1.15 million in illegally obtained profits. The proposed consent decree requires both Flakeboard and SierraPine to establish antitrust compliance programs, name antitrust compliance officers, and agree to other restrictions. Injunctive relief prohibits premerger coordination in the future.

Disgorgement remedy. In its competitive impact statement, the government suggests that the disgorgement of ill-gotten gains, approximating the amount of profits that Flakeboard illegally obtained by coordinating with SierraPine to close the Springfield mill and move the mill's customers to Flakeboard, is an appropriate remedy. The government estimates that Flakeboard earned approximately $1.15 million in illegally obtained profits during the six-month period leading up to the settlement. Moreover, injunctive relief in the form of requiring the reopening of the Springfield mill, which has been shuttered for several months, would be impractical, in the Justice Department's view.

Other gun-jumping actions. Enforcement actions alleging gun-jumping are relatively rare. In 2010, Smithfield Foods, Inc. was ordered to pay $900,000 in civil penalties under the terms of a U.S. consent decree to settle Antitrust Division charges that it exercised operational control over a significant segment of the target's business during the premerger waiting period ((CCH) 2010-1 Trade Cases ¶76,880). Four years earlier, technology companies Qualcomm Inc. and Flarion Technologies Inc. were required to pay a total of $1.8 million in civil penalties for premerger coordination in violation of the HSR Act ((CCH) 2006-1 Trade Cases ¶75,195). The government had alleged that Flarion Technologies ceded operational control to Qualcomm prior to the expiration of the HSR Act waiting period.

Both of these cases alleged only violations of the HSR Act. Despite the paucity of gun-jumping actions, the significant civil penalties and disgorgement in the action against the particleboard makers should serve as a warning for merging parties to avoid premerger coordination.

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