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Justice Department Fines Unsuccessful Merger Parties for "Gun Jumping"

Posted by Kobi Kastiel, Co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Wednesday November 19, 2014

Editor's Note: The following post comes to us from Nelson O. Fitts, partner in the Antitrust Department at Wachtell, Lipton, Rosen & Katz, and is based on a Wachtell Lipton memorandum by Mr. Fitts and Nathaniel L. Asker.

On November 7, 2014, the Antitrust Division of the U.S. Department of Justice brought a lawsuit against Flakeboard America Limited, its foreign parents, and SierraPine, charging that Flakeboard exercised operational control over SierraPine prior to expiration of the statutory pre-merger waiting period, prematurely assuming beneficial ownership of the target assets in violation of the Hart-Scott-Rodino Act and conspiring in violation of Section 1 of the Sherman Act. Flakeboard and SierraPine settled the case, with each agreeing to pay $1.9 million in HSR fines and Flakeboard disgorging an additional $1.15 million in unlawful profits.

The HSR Act requires that parties to certain mergers and acquisitions notify the federal antitrust agencies and observe a statutory waiting period, during which time the parties may not consummate the proposed transaction or transfer beneficial ownership of the target. The HSR Act is intended to allow the antitrust agencies an opportunity to review notifiable acquisitions and evaluate their potential competitive effects before the parties integrate the underlying businesses. Section 1 of the Sherman Act prohibits conspiracies in restraint of trade, and merging parties remain independent actors capable of conspiring until they close a transaction.

On January 13, 2014, Flakeboard agreed to acquire three SierraPine wood product mills for $107 million. The DOJ opened an investigation of the proposed transaction and issued "second requests" for documents and information, extending its review until the HSR Act waiting period expired on August 27, 2014. The parties abandoned the transaction a month later in response to DOJ concerns about the deal's potential anticompetitive effects in the production of medium-density fiberboard. Notwithstanding their abandoning the transaction, the DOJ continued a parallel "gun jumping" investigation based on information discovered during the merger review. The DOJ's complaint alleged that SierraPine and Flakeboard agreed to close one of the three

target mills—and then cooperated to transition SierraPine customers to Flakeboard's competing mill—all while the transaction was under active federal antitrust review.

The settlement serves as a reminder that merging parties must exercise care not to engage in conduct that the antitrust agencies perceive as a premature transfer of beneficial ownership or a conspiracy in restraint of trade. Investigations into potential "gun jumping" present costly and delaying distractions during substantive merger review, and even though Flakeboard and SierraPine abandoned their transaction, the DOJ's investigation led to significant penalties. While the agencies will clearly challenge egregious conduct, the DOJ's *Flakeboard* settlement also makes clear that reasonable interim operating covenants "intended to protect a transaction's value and prevent a to-be-acquired firm from wasting assets" remain both common and lawful. With appropriate controls on due diligence and integration planning, such investigations can be avoided, and pre-merger conduct will not run afoul of antitrust laws.