WILMERHALE

DOJ Obtains Fines and Disgorgement for Premerger Coordination in Flakeboard/SierraPine Transaction

MONDAY, NOVEMBER 10, 2014

In a stark reminder that the US antitrust agencies continue to take illegal premerger coordination—commonly known as "gun jumping"—very seriously, two producers of medium density fiberboard (MDF) agreed to pay nearly $5 million in civil penalties and disgorgement for violations of the Hart-Scott-Rodino (HSR) Act and Section 1 of the Sherman Act. The two defendants, Flakeboard America Limited and SierraPine, allegedly coordinated on the closure of a SierraPine MDF mill during the Department of Justice's (DOJ) review of the proposed transaction between the companies. The complaint filed on November 7, 2014 and the DOJ's accompanying papers are significant for other merging parties because they contain descriptions of pre-closing conduct that the DOJ is likely to view as prohibited and conduct that it is likely to view as permitted.

Legal Background

Merging parties are subject to two primary antitrust limitations on their ability to coordinate premerger conduct. First, the HSR Act requires parties to acquisitions of voting securities or assets that meet certain thresholds to remain independent economic actors while the government investigates the transaction's potential anticompetitive effects. Specifically, the act prohibits an acquiring person from obtaining beneficial ownership of the voting securities or assets before the end of the HSR waiting period. As a practical matter, this means that an acquirer cannot exercise any control over the ordinary course activities of the seller until the waiting period has expired. The HSR Act imposes civil penalties for violations of up to $16,000 per day.

Second, Section 1 of the Sherman Act prohibits agreements that unreasonably restrain trade. Certain types of agreements, including agreements between competitors to restrict output or allocate customers, are considered *per se* unreasonable, and therefore illegal under Section 1. Section 1 applies to merging parties prior to consummation of their transaction regardless of whether the transaction is reportable under the HSR Act.

Complaint and Settlement

This matter arose out of Flakeboard's agreement to acquire three mills from SierraPine, including an operating mill in Springfield, Oregon. Although Flakeboard wanted the Springfield mill, it did not want the mill to continue operating. That was presumably because Flakeboard could serve the mill's customers from Flakeboard's other facilities. However, Flakeboard did not want to manage the shutdown or absorb the reputational harm of announcing the Springfield mill shutdown itself. Thus, the parties agreed and put in the purchase agreement that SierraPine would shut down the mill before the transaction closed. The DOJ complaint alleges that, before the proposed acquisition, SierraPine had no plans to close the Springfield mill.

According to the complaint, the defendants originally expected that SierraPine would shut down the Springfield mill *after* the HSR waiting period expired, but *before* the transaction closed. However, a labor dispute at the mill shortly after the transaction was announced led Flakeboard and SierraPine to agree to an earlier closure, months before the expiration of the HSR waiting period. The parties also acted together to move customers from the Springfield mill to Flakeboard. SierraPine provided to Flakeboard detailed information about individual customers of the mill, which Flakeboard provided to its sales force. SierraPine delayed the closure announcement until Flakeboard's sales force was ready to contact the Springfield mill's customers. SierraPine did not use its remaining plant to compete for the Springfield mill's business, and instead directed those customers to Flakeboard.

Eventually, the defendants abandoned their transaction in light of DOJ concerns that it would substantially lessen MDF competition. The deal's abandonment, however, did not prevent the DOJ from bringing claims against the parties for their pre-closing conduct. The DOJ's complaint alleges that the coordination to close the Springfield plant, when there was no assurance that the transaction would be consummated, constituted an agreement between competitors to allocate customers and reduce output, and thus was *per se* illegal under Section 1 of the Sherman Act. Further, through its coordination on the closure of the plant and transfer of customers, Flakeboard exercised operational control and beneficial ownership over SierraPine, thus violating the HSR Act.

The $4.95 million settlement includes $3.8 million in civil fines under the HSR Act. The defendants avoided the maximum fine, which would have been more than $7 million, by cooperating with the DOJ's investigation of their premerger coordination. To remedy the Sherman Act Section 1 violation, the DOJ required Flakeboard to disgorge $1.15 million in profits it received from former Springfield mill customers. The settlement places certain restrictions on Flakeboard and SierraPine in future transactions, regardless of whether the transaction is subject to the HSR Act.

Lessons from the Case

The settlement's limitations on the defendants' future conduct provides helpful guidance regarding pre-closing conduct that the DOJ is likely to regard as permissible or prohibited.

Permissible Pre-Closing Conduct and Transaction Agreement Provision

- Agreement provisions requiring the seller to continue operating in the ordinary course of business.
- Agreement provisions prohibiting the seller from taking actions that would cause a material adverse change in the value of the to-be-acquired business or assets.
- Conducting "reasonable and customary due diligence" where the information sought is

"reasonably related to a party's understanding of future earnings and prospects." Information exchanges should occur under a non-disclosure agreement that limits the use of the information to due diligence purposes, and prohibits disclosure of the information to any person who is directly responsible for marketing, pricing or sales of any products in which the two companies compete.

- Entering into a buyer/seller relationship with each other if that relationship would be lawful in the absence of the planned acquisition.

Prohibited Pre-Closing Conduct

- Agreements that would affect product price or output, or allocate customers, while a transaction is pending.
- Disclosing competitively sensitive information without adequate protections against its improper use.

The DOJ did recognize that in certain circumstances an agreement to close a seller's production facility may be legal. However, this remains a gray area, particularly where the facility makes products that compete with those of the buyer.

The Flakeboard settlement is a reminder that parties involved in mergers and acquisitions must continue to compete independently while the government completes its investigation of the transaction. Merging parties should consider putting protective measures in place to ensure that any joint activity during the HSR waiting period does not cross the line into illegal gun jumping. This is not only good practice from a legal perspective, but is also a prudent business course because it recognizes the risk that the transaction might not close and the parties will continue to operate as separate companies.

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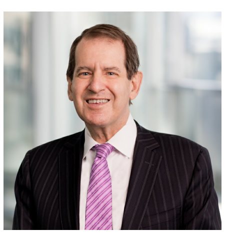

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