

# Fried Frank Antitrust & Competition Law Alert<sup>®</sup>



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## Department of Justice Antitrust Division Challenges Pre-Merger Gun Jumping

On January 21, 2010, the Antitrust Division of the Department of Justice (the "DOJ") announced that it had brought suit against pork processors Smithfield Foods, Inc. ("Smithfield") and Premium Standard Farms, LLC ("PSF") alleging that the parties' conduct during the statutory pre-merger waiting period violated the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act"). According to the DOJ complaint, following the announcement of their proposed merger in September 2006, but prior to the expiration of the HSR Act waiting period, PSF sought consent and approval from Smithfield with respect to the terms of three contracts for the procurement of hogs. The DOJ alleged that through this conduct Smithfield had acquired beneficial ownership over PSF prior to the expiration of the HSR Act waiting period. For transactions subject to the HSR Act, the acquiring party is prohibited from assuming "beneficial ownership" over the target until the expiration of the relevant HSR Act waiting period. In order to settle the DOJ's claims of unlawful "gun jumping," Smithfield agreed to pay a civil penalty of \$900,000. This case is an important reminder of the antitrust limitations imposed upon parties prior to closing their transaction.

### Background

On September 17, 2006, Smithfield and PSF, two competing pork processing companies, announced that they had entered into a merger agreement. The DOJ opened an investigation of the transaction and issued discovery requests ("Second Requests") that effectively extended the HSR Act waiting period until March 7, 2007. The DOJ ultimately approved the transaction, which closed on May 7, 2007.

In its complaint, the DOJ alleged that three days after the merger agreement was signed, PSF stopped exercising independent business judgment for its hog purchases by submitting purchasing contracts to Smithfield for approval of certain contract terms, including the price to be paid, quantity to be purchased, and length of the contract. These three contracts were for hog purchases at a cost ranging from around \$57 million to \$67 million. According to the DOJ, such conduct amounted to Smithfield exercising "operational control over a significant segment of [PSF's] business" and, therefore, Smithfield had acquired beneficial ownership of PSF prior to the expiration of the HSR Act waiting period.

Notably, the DOJ's claims related to the parties' conduct prior to closing and did not challenge specific provisions in the merger agreement. As the complaint notes, the merger agreement

“contained certain customary interim ‘conduct of business’ provisions limiting Premium Standard’s operations . . . to protect Smithfield’s legitimate interests in maintaining Premium Standard’s value without impairing Premium Standard’s independence,” such as requirements that PSF “carry on its business in the ordinary course consistent with past practice.”

### Implications

This case serves as an important reminder that the antitrust authorities (the DOJ and the Federal Trade Commission (“FTC”)) will investigate and prosecute gun jumping conduct by merging parties, even in transactions that ultimately are permitted to close. In recent years, the DOJ and FTC have brought a number of gun jumping actions resulting in substantial fines. Although it is appropriate to engage in planning for post-merger integration, integration plans should not be implemented prior to closing. The parties must remain separate and independent economic actors until the deal is consummated. Further, while typical ordinary course covenants are often reasonable and generally do not raise gun jumping concerns, any restrictions on the pre-closing conduct of the target should be reviewed by antitrust counsel. Parties must be careful (and should consult antitrust counsel) with respect to any conduct that could be construed as influencing the target’s independent judgment or ordinary course operations, particularly when the parties are competitors.

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