A Harsh Reminder About the Danger of Pre-Closing Activities in M&A Transactions

BY BERNARD "BARRY" A. NIGRO JR. AND MARIA CIRINCIONE

Barry Nigro is a partner and chair of the Antitrust Department at Fried, Frank, Harris, Shriver & Jacobson LLP, working in the firm's Washington, D.C. and New York offices. Maria Cirincione is an associate in Fried Frank's Washington, D.C. office.[1] *Contact:barry.nigro@friedfrank.com or maria.cirincione@friedfrank.com.*

On November 7, 2014, the Department of Justice (DOJ) required particleboard competitors Flakeboard America Limited (Flakeboard) and SierraPine to pay $5 million in penalties and to institute a ten-year antitrust compliance program because of inappropriate pre-closing conduct.[2] DOJ's allegations centered on three things: (1) the parties' discussions and conduct relating to the planned closure of SierraPine's mill in Springfield, Oregon; (2) the movement of customers from the Springfield mill to Flakeboard; and (3) the sharing of SierraPine's customer and pricing information.

The Alleged "Gun Jumping"

The Hart-Scott-Rodino Act of 1976 (HSR Act),[3] if applicable, requires that transacting parties obey a mandatory pre-closing waiting period. This waiting period seeks to preserve competition between the parties while the antitrust enforcement agencies review the proposed transaction. If the merging parties prematurely transfer "operational control" of the target, they are subject to a fine of $16,000 for each day they are in violation of the HSR Act. In addition, the Sherman Act prohibits pre-closing coordination between competitors regarding price, output, or other restraints of trade.[4] Pre-closing violations of the HSR Act and Sherman Act are known as "gun jumping."

On January 13, 2014, Flakeboard and SierraPine signed an asset purchase agreement (APA) for the acquisition of three SierraPine mills. The APA included a provision that required SierraPine to close its Springfield mill shortly before closing the deal, but after receiving HSR approval. However, an unexpected labor issue at the Springfield mill that arose days after announcing the proposed transaction caused SierraPine to discuss with Flakeboard the implications of the labor issue on the mill's closure. Following that discussion, SierraPine announced the closure of the mill on February 2, eleven days into the HSR waiting period.

Because the mill was closing, the parties decided to refer SierraPine's Springfield mill customers to Flakeboard. To do so, SierraPine shared its customer list, including products and volume purchased by customer, with Flakeboard's sales team and directed its sales employees to notify the Springfield mill's customers that Flakeboard wanted their business and would match SierraPine's prices. Flakeboard requested that SierraPine delay the mill closure announcement until Flakeboard could better position its sales team to contact SierraPine's Springfield mill customers. Finally, at the request of Flakeboard, SierraPine assured certain sales representatives employment at Flakeboard.

Months later, in September 2014, Flakeboard and SierraPine abandoned the transaction after DOJ expressed antitrust concerns regarding the acquisition's potential anticompetitive effects on medium-density fiberboard production.

Matters grew worse, however, when DOJ initiated a gun jumping investigation and enforcement action, which resulted in a settlement that included $5 million in total penalties. DOJ required Flakeboard to disgorge $1.15 million in profits earned from the inappropriate pre-closing coordination with SierraPine,[5] declaring that "disgorgement will deter Flakeboard and others from participating in anticompetitive conduct in the context of a pending transaction, regardless of whether the transaction is subject to the HSR Act."[6] The settlement also imposed $3.8 million ($1.9 million for each company) in civil penalties for violating the HSR Act. Finally, DOJ required both companies to, for a period of ten years, adhere to certain conduct restrictions, institute an antitrust compliance program, and appoint an Antitrust Compliance Officer.

Until Closing, Merging Parties Must Operate Independently

Transaction agreements typically contain provisions governing both parties' conduct between signing and closing.[7] Where the antitrust laws draw the line on pre-closing coordination is not always clear. Here, DOJ's Proposed Final Judgment prohibits the defendants from engaging in two categories of pre-closing activities:

- First, the parties may not include provisions in transaction agreements, or coordinate in ways, that affect price or output, or that allocate markets or customers for competing products.

- Second, the parties may not disclose or seek the disclosure of information about customers, prices, or output for any competing products *unless* the information is publicly available or being shared in due diligence. Even in the context of due diligence, the information shared must be reasonably related to facilitating the transaction and covered by a non-disclosure agreement that (1) limits the information's use to due diligence and (2) prohibits disclosure to those responsible for the marketing, pricing, or sales of competing products.

DOJ's Proposed Final Judgment also identified pre-closing conduct in which the parties are permitted to engage. Specifically, the Proposed Final Judgment permits the parties to include provisions in transaction agreements that require the parties to (1) continue operating in the ordinary course of business and (2) forego conduct that would cause a material adverse change to the value of the target assets.

The period between signing and closing, by necessity, involves regular communication and coordination between the buyer and the target. But, as demonstrated in this case, certain conduct will be judged to run afoul of the antitrust laws. Preclosing communication and conduct as well as agreement provisions should be carefully scrutinized for potential antitrust implications. As DOJ made clear for Flakeboard and SierraPine, parties that cross the line will suffer harsh penalties.

NOTES

1. Special thanks to Matthew Joseph, Antitrust and Competition Law Clerk, for his valuable assistance in the research and drafting of this article.
2. *United States v. Flakeboard Am. Ltd.*, No. 3:14-cv-4949 (N.D. Cal., Nov. 7, 2014).
3. 15 U.S.C. § 18a.
4. *See Palmer v. BRG of Ga., Inc.*, 498 U.S. 46, 49 (1990) (applying the Sherman Act's per se rule to horizontal market allocations between competitors); *National Collegiate Athletic Ass'n v. Board of Regents*, 468 U.S. 85, 100 (1984) (holding that agreements to reduce output will normally violate the Sherman Act's per se rule).
5. The last use of disgorgement by DOJ in a Sherman Act case occurred in *United States v. Keyspan Corp.*, 763 F. Supp. 2d 633, 638–41 (S.D.N.Y. 2011) (holding the government may seek disgorgement in antitrust suits under the Sherman Act). *See* Barry Nigro and Maria Cirincione, "DOJ Orders Financial Services Firm to Disgorge Profits From Derivative Contract."
6. Competitive Impact Statement at 11, *United States v. Flakeboard Am*. DOJ added that "no other remedy would be as effective to fulfill the goal of the Sherman Act to 'prevent and restrain' antitrust violations." Id. (quoting 15 U.S.C. § 4).
7. Provisions affecting how the parties operate the business between signing and closing typically appear in the interim covenants, although they sometimes are also found in the provisions governing the definition of a material adverse effect, representations and warranties, and closing conditions.