DOJ Penalty Warns: Do Not Jump the Gun

The Department of Justice's recent $4.95 million settlement of claims of illegal premerger coordination – also known as "gun jumping" – between two particleboard manufacturers reminds parties to exercise care over pre-closing activities to avoid running afoul of the federal antitrust laws.

On November 7, 2014, roughly 6 weeks after the manufacturers had abandoned their transaction, the DOJ announced a settlement with Flakeboard America Ltd., its parent companies, and SierraPine Ltd., which requires that the companies pay a combined civil penalty of $3.8 million for violations of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act") and that Flakeboard disgorge $1.15 million in profits allegedly illegally obtained under Section 1 of the Sherman Act while Flakeboard's deal to acquire three of SierraPine's paper mills was under review by the DOJ.

SierraPine operated paper mills in Springfield, Oregon and Martell, California that competed with Flakeboard's mill in Albany, Oregon. The DOJ complaint alleged that after announcement of the deal and before the expiration of the waiting period under the HSR Act, the parties coordinated the transfer of key customer accounts and salespersons from SierraPine's Springfield mill to the competing Flakeboard mill and proceeded to close the Springfield mill, resulting in violations of both the HSR Act and the Sherman Act.

Under the HSR Act, parties to a sufficiently large transaction (currently $75.9 million and adjusted annually) are required to notify the federal antitrust authorities and observe a waiting period while the agencies evaluate any potential anti-competitive impact of the transaction. During the waiting period, the parties are prohibited from transferring beneficial ownership of the subject assets or voting securities. Further, Section 1 of the Sherman Act prohibits agreements that unreasonably restrain trade.

In this case, Flakeboard's proposed acquisition triggered an HSR Act notification and the waiting period was still pending at the time parties jointly agreed to close the Springfield mill, conduct that constituted both an unlawful agreement between competitors in violation of Section 1 of the Sherman Act and a premature transfer of operational control of SierraPine's business to Flakeboard.

Both acquiring and acquired parties are subject to the HSR Act and violators of the HSR Act are liable for civil penalties of up to $16,000 for each day in violation. Here, the DOJ credited the parties for voluntarily producing evidence of their unlawful premerger conduct and did not seek the maximum civil penalty of $3.568 million per party for the 223 days during which the parties were in violation of the HSR Act. Instead, the DOJ sought and obtained a reduced penalty of $1.9 million from each party.

Violators of Section 1 of the Sherman Act may be subject to injunctions (e.g. reversing the illegal course of action) or legal damages, such as the disgorgement of illegally obtained profits. Here, the DOJ determined that a disgorgement of $1.15 million was preferable over injunctive relief because SierraPine's Springfield mill had already been closed for months and the majority of the employees had left or were terminated.

Even if the parties had not been competitors, the agreement to close the plant before the expiration of the HSR Act waiting period would have been a violation, resulting in penalties of up to $16,000 per day from the day of the offense. Because the parties were also competitors, however, the same agreement also resulted in a violation of Section 1 of the Sherman Act, leading to disgorgement of profits to the DOJ and potentially treble damages to direct purchasers. This serves as a reminder that the enforcement agencies take gun jumping seriously, particularly when it involves areas of overlap between competitors. Disgorgement, in addition to HSR Act penalties, may increase the economic risk that parties undertake when they cross or come close to the line of permissible premerger coordination and integration planning. And where, as here, the transaction itself raises significant issues resulting in close investigation by the DOJ or Federal Trade Commission, the length of the period between signing and close, and the scrutiny that the deal and parties

receive, substantially increase the probability both that gun jumping may occur and that the agencies will detect it. The only surprise here is that the DOJ did not act more quickly to compel the parties to keep open (or reopen) the plant they agreed to close.

For additional guidance regarding gun jumping as well as permitted activities for combining businesses, please contact a member of the antitrust practice group.