Freeborn

Your Future Is Our Purpose

Gun Jumping in Mergers and Acquisition

by Jeffery M. Cross

A FREEBORN & PETERS CLIENT ALERT

ABOUT THIS CLIENT ALERT:

A recently filed complaint by the Department of Justice alleging violations of the Sherman Act and the Hart Scott Rodino Act for gun-jumping in a merger and acquisition illustrates the onerous conduct remedies that may be imposed in addition to fines in an area of M&A law where there are no bright lines that distinguish proper from improper conduct.

The latest example of the government's prosecution of gun-jumping in conjunction with mergers and acquisitions can be seen in a case filed in federal court in California on November 7th, *United States v. Flakeboard America Ltd. and SierraPine*.

There are several notable aspects regarding the penalties and future conduct remedies being sought by the DOJ in this case:

- In addition to fines of $3.8 million, the acquiring company would be required to disgorge profits of $1.15 million.
- The proposed final judgment prohibits either company for 10 years from engaging in certain conduct in M&A transactions, including what can and cannot be included in a purchase agreement and what data and information can be exchanged during due diligence.
- The proposed final judgment requires the companies to institute antitrust compliance programs and to appoint antitrust compliance officers.
- The proposed final judgment requires officers, directors, sales managers, and employees who have responsibility for or authority over mergers and acquisitions to certify annually for 10 years to the DOJ that there are no violations of the final judgment.
- The proposed final judgment requires the defendants for a period of 10 years to provide a copy of the final judgment to any potential partner to an acquisition or merger before the initial exchange of a letter of intent,

definitive agreement, or other agreement of merger.
- The proposed final judgment requires any officer, director, or antitrust compliance officer who, during a period of 10 years, learns of any violation of the final judgment, to take action to terminate or modify the activity and to report the violation to the DOJ.
- The Department of Justice is allowed a 10-year period to inspect the defendants' books and records, interview employees, and to propound written interrogatories.

The value of the transaction was only $107 million, plus a variable amount for inventory. The fines and disgorgement penalty therefore only amounted to approximately 4.62 percent of the base transaction price. However, for many companies and their executives, the imposition of conduct remedies and government supervision requirements may be more onerous than the fines and penalties. Violations of any of the conduct remedies could result in a finding of contempt of court.

The facts alleged in the complaint place in context the requested penalties, particularly the unusual penalty of the disgorgement of profits.

The parties wrote into the asset purchase agreement that the to-be-acquired company would close one of its plants after the expiration of the HSR waiting period but before the closure of the deal. This plant shut-down was required despite the fact that, before the negotiations for the deal, the to-be-acquired company had no plans to shut down the plant.

Shortly after the acquisition was publicly announced, labor issues arose that required the to-be-acquired company to reveal that it would be shutting the plant. The to-be-acquired company asked the acquiring company if it would waive the requirement that the plant be closed, but the parent of the acquiring company refused. This forced the to-be-acquired company to announce the expected closing prior to the expiration of the HSR waiting period.

The parties collaborated on a joint press release announcing the closing. They also agreed that they would transition customers from the closed plant to the acquiring company's neighboring plant. The acquiring company requested that the to-be-acquired company delay the announcement of the closing so that it could get its sales force in place to handle the transition. The to-be-acquired company gave the acquiring company competitively sensitive information about the customers of the closed plant, including the types and volumes of products purchased by each customer, and the acquiring company distributed the information to its sales force. At the acquiring company's request, the to-be-acquired company instructed its sales force to tell customers that the acquiring company wanted to service their business and would match the to-be-acquired company's prices. Also, at the request of the acquiring company, key employees were given assurances of future employment at the acquiring company so that they would have an incentive to steer customers to the acquiring company's competing plant.

ABOUT THE AUTHOR

Jeffery M. Cross
Partner, Litigation Practice Group
Chicago Office
(312) 360-6430

jcross@freeborn.com

Jeff has nearly 40 years of extensive trial experience representing a variety of corporations and businesses throughout the country on antitrust and trade regulation issues. Jeff also has experience in mergers and acquisitions, including counseling clients in the area, working with economists to develop economic support for mergers and acquisitions, responding to government requests for documents and negotiating with the government.

After the announcement of the plant closure, the to-be-acquired company did not compete for the plant's business, but rather directed customers to the acquiring company. This resulted in increased profits for the acquiring company and hence, the request in the proposed final judgment that the acquiring company disgorge these profits.

The Department of Justice charged the parties with a violation of Section 1 of the Sherman Act, which prohibits naked collusion among competitors to fix prices, reduce output, or allocate customers. It also charged the parties with violations of the Hart Scott Rodino Act for the effective transfer of beneficial control of the to-be-acquired company to the acquiring company before the expiration of the statutory waiting period. The penalty for such a violation of the HSR Act is $16,000 for every day that a party is in violation of the Act, which accounts for the fine being sought by the government.

ABOUT FREEBORN & PETERS LLP

Freeborn & Peters LLP is a full-service law firm headquartered in Chicago, with international capabilities. Freeborn is always looking ahead and seeking to find better ways to serve its clients. It takes a proactive approach to ensure its clients are more informed, prepared and able to achieve greater success—not just now, but also in the future. Although Freeborn serves clients across a broad range of sectors, it has also pioneered an interdisciplinary approach that serves the specific needs of targeted industries, including credit unions, food, private equity and venture capital, transportation, and insurance and reinsurance. Freeborn is a firm that genuinely lives up to its core values of integrity, caring, effectiveness, teamwork and commitment, and embodies them through high standards of client service and responsive action. Its lawyers build close and lasting relationships with clients and are driven to help them achieve their legal and business objectives.

Call us at **(312) 360-6000** to discuss your specific needs. For more information visit: **www.freeborn.com**

CHICAGO
311 South Wacker Drive
Suite 3000
Chicago, IL 60606
(312) 360-6000
(312) 360-6520 fax

SPRINGFIELD
217 East Monroe Street
Suite 202
Springfield, IL 62701
(217) 535-1060
(217) 535-1069 fax