



US companies fined for 'gun jumping' before expiration of the HSR Act waiting period

UNITED STATES V SMITHFIELD FOODS, INC. AND PREMIUM STANDARD FARMS, LLC

This briefing examines the civil fine of \$900,000 that Smithfield Foods has agreed to pay to settle charges that by exercising operational control over Premium Standard Farms it acquired beneficial ownership of Premium Standard Farms before obtaining clearance. By engaging in this conduct, also known as 'gun jumping', the parties violated premerger waiting period requirements as required under US antitrust laws.

On 22 January 2010, the US Department of Justice (DOJ) announced that Smithfield Foods and its Premium Standard Farms subsidiary have agreed to pay a \$900,000 civil penalty for violating the premerger waiting period requirements of the Hart-Scott-Rodino Act (HSR Act). The DOJ alleged that, in exercising operational control over Premium Standard and acquiring and holding assets from the target's hog procurement contracts, Smithfield prematurely acquired beneficial ownership of a significant segment of Premium Standard's business operations.

This case is a strong reminder of the limits of permissible conduct in the period between signing an acquisition agreement and obtaining antitrust authority clearance. It is the first gun-jumping action brought by the agencies since 2006, and, therefore, the first such action brought by the Obama antitrust team.

HSR requirements: premerger waiting period

Under the HSR Act, parties to certain transactions are required to notify the transaction to the DOJ and Federal Trade Commission (FTC) and observe a designated waiting period before consummating the acquisition. The waiting period provides the FTC and DOJ an opportunity before the merger is consummated to investigate the proposed transaction and determine whether it may violate the federal antitrust laws, and also helps to preserve the companies as independent competitors until closing.

The US antitrust authorities consider the HSR Act violated when the acquiring party acquires 'beneficial ownership' of the target company or any of its significant assets before clearance. The DOJ and FTC analyse various factors on a case-by-case basis to determine whether an unlawful transfer of beneficial ownership has occurred. These factors include, among others, the assumption of control through management contacts, integration of the parties' operations or joint decision making.

Details of the case

In September 2006, Smithfield Foods, the largest pork producer and processor in the US, announced the acquisition of Premium Standard (at the time, the second-largest US hog producer and sixth-largest processor) in a cash and stock deal totalling approximately \$810m. The DOJ investigation went into a second phase through the issuance of a so-called 'Second Request', but ultimately the DOJ did not challenge the merger on substantive grounds; in May 2007 Smithfield completed its acquisition of Premium Standard.

The merger agreement contained various customary interim 'conduct of business' provisions that limited Premium Standard's hog procurement operations during the HSR waiting period. These provisions, in part, restricted Premium Standard's right to issue new voting securities or sell assets and assume new debt or financing, and required the target to 'carry on its business in the ordinary course consistent with past practice'. The DOJ did not object to the terms of the

merger agreement, noting that these provisions limited Premium Standard's operations to protect Smithfield's legitimate interests in maintaining the value of the target.

Soon after the merger agreement was signed, Premium Standard submitted three multi-year contracts to Smithfield for its consent. These contracts accounted for approximately \$57m to \$67m of Premium Standard's annual hog purchases, and the information submitted to Smithfield for consent related to payment price, quantity of hogs for purchase and the contract lengths. By interacting in this manner, the DOJ alleged that Premium Standard had ceased to exercise independent business judgement in its hog purchases and prematurely transferred operational control. The DOJ considered Premium Standard's hog procurement contracts necessary to the company's ongoing and ordinary course business activities.

The DOJ alleged the parties engaged in a continuing violation over a 169-day period between September 2006 (when they signed the merger agreement) and March 2007 (when the HSR Act waiting period expired). At \$11,000 for each day of the violation, the maximum fine would have totalled \$1,848,000 for each party.¹ The court filings do not indicate why the DOJ accepted a lesser fine of \$900,000, but it may reflect a compromise to avoid litigation.

Conclusion

The US antitrust authorities regard gun jumping as a serious issue, but also have acknowledged that the buyer does have legitimate commercial interests in protecting the target's value. The DOJ has expressly recognised that parties may impose customary interim 'conduct of business' covenants in their merger agreement, similar to the provisions included here, or co-ordinate reasonable activities when the buyer has a legitimate reason to protect the benefit of its bargain, to ensure against material adverse events or to guarantee business is operated in the ordinary course. Nonetheless, certain buyer conduct exceeds what is permissible, such as the acquirer actively influencing key contracts, or unilaterally requiring or jointly providing pre-clearance

for routine business practices of the target company. Companies must maintain their independence in ordinary business operations, including purchasing decisions, until the premerger waiting period has ended. As was the case here, it does not matter if the transaction itself does not pose any risk of competitive harm; conduct can still be viewed as illegal gun jumping. Thus, merging parties must consider carefully the risks of HSR enforcement when negotiating and interpreting the merger agreement's pre-closing conduct of business terms and should closely monitor their conduct under those terms.

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¹ The maximum daily penalty has since increased to \$16,000 for any violations occurring on or after 10 February 2009. The US antitrust authorities may also seek injunctive relief in addition to monetary penalties.