

KIRKLAND ALERT

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U.S. Department of Justice Fines Firms \$900,000 for Illegal HSR “Gun Jumping”

In September 2006, Smithfield Foods and Premium Standard Farms agreed to merge, with Smithfield acquiring Premium Standard for approximately \$810 million. The parties, competing meat processors, filed HSR notification forms and, after going through a lengthy Second Request investigation, were permitted to close the transaction in mid 2007.

Last week, the U.S. Department of Justice (“DOJ”) brought a federal antitrust lawsuit against both Smithfield and Premium, challenging not the 2007 combination itself but rather the *parties’ conduct prior to receiving HSR clearance*. The case was simultaneously settled, with the companies agreeing to pay a total of \$900,000 in fines. According to Assistant Attorney General Christine Varney: “Merging companies must remain independent in their ordinary business operations, including purchasing decisions, until the end of the premerger waiting period.”

The suit alleges that “after executing the Merger Agreement, Premium Standard stopped exercising independent business judgment in its hog purchases.” Market concentration in hog purchases was a key focus of the DOJ’s 2006/2007 investigation of the proposed merger. Prior to HSR clearance, Premium allegedly sought Smithfield’s consent for three contracts to purchase hogs from an independent producer. Premium provided Smithfield with the contract terms, including price, quantity and duration. The DOJ alleged these contracts were “necessary to Premium Standard’s ongoing business and entered into in the ordinary course,” and suggested at least one of these contracts was not material. Per the DOJ, Smithfield used this contract approval process to exercise operational control, and thereby acquire beneficial ownership, of Premium Standard before obtaining HSR approval for the merger.

The complaint references customary interim “conduct of business” provisions in the merger agreement, which limited Premium’s pre-closing operations. Those provisions included limitations on Premium Standard’s right to assume new debt or financing, issue new voting securities, or sell assets. They also required Premium Standard to “carry on its business in the ordinary course consistent with past practice” and obtain Smithfield’s consent before entering into or amending certain material contracts.

The DOJ’s complaint and settlement do not identify any specific provisions in the parties’ merger agreement as being objectionable. Instead, the complaint bases the challenge on Premium Standard seeking Smithfield’s consent to enter into the hog purchase contracts. Because the misconduct allegations do not refer back to the merger agreement, it is unclear whether the DOJ was objecting to a contractual covenant in the merger agreement or to voluntary actions by Premium Standard and Smithfield.

While gun-jumping rules are not, strictly speaking, limited to direct competitors (*i.e.*, they can be triggered by improper coordination before HSR clearance even in deals raising no antitrust concerns at all), in practice the agencies tend to be more concerned about gun-jumping in deals between direct competitors. The government brings gun-jumping cases to send a message that competitors must act like competitors until their deal closes, and that HSR waiting periods must be taken seriously. The *Smithfield* case also involves agri-business, which has been a high priority focus of the DOJ Antitrust Division.

Gun-jumping violations can carry a stiff penalty. Each merging party can be fined \$16,000 per day for an HSR Act violation occurring after February 10, 2009 (\$11,000 per day for pre-February 10, 2009 violations). The meter starts running when the buyer exercises beneficial ownership, which can occur even before the companies file their HSR notifications, and continues until HSR waiting period expiration.

Despite gun-jumping rules, deal partners can start integration planning without violating the law. Here are some basic guidelines and “*do’s and don’t’s*” that will help minimize antitrust risk in transactions between competitors.

Key Principles

- Transaction parties remain subject to the antitrust laws during deal negotiations and due diligence. They may not coordinate their ongoing business activities — especially in pricing, marketing, or selling competing products or services — until their transaction closes, and must strictly limit the exchange of competitively sensitive information.
- Buyer and Seller *may* engage in thorough due diligence and integration planning, both unilaterally and cooperatively, with minimal legal risk, as long as certain basic guidelines are followed.
- Buyer may prohibit Seller from taking actions outside the ordinary course of business prior to closing. However, Buyer should not limit Seller’s ordinary course of business activities. The distinction between actions within and outside of the ordinary course is not always clear.

Specific Pre-Closing “Do’s and Don’t’s”

- Transaction partners may not hold themselves out as a combined business until closing. They should not coordinate bidding, pricing, sales activities (including new customer contracts) or, based on *Smithfield*, purchasing arrangements, or establish joint product development teams, or co-mingle personnel. Buyer may not tell Seller how to price its products or who to sell to.
- Transaction parties may take internal steps to

prepare for, and can jointly plan for, the consolidation, but those plans should not be ***implemented*** until after closing.

- Transaction partners must be careful when sharing competitively-sensitive information in due diligence and when discussing integration planning. ***Competitively-sensitive information (1) should not be used for any purpose other than evaluating the deal and planning for post-closing integration and (2) should be shared only where there is a self-evident, deal-related reason for doing so.*** Extremely sensitive information (e.g., information on pending bids on competing products and future pricing strategies in areas where the two parties compete) should not be shared with anyone at the deal partner who is engaged in day-to-day competitive operations or is responsible for setting prices. If feasible and efficient, an independent third party (auditor, investment bank, consultant, etc.) can be used to collect, aggregate, and analyze very sensitive data from the merging parties.
- What information is “competitively sensitive” varies industry by industry and deal by deal. One litmus test is how concerned business people would be about sharing such information with a competitor other than its deal partner.

The Following Data Are Usually Deemed “Competitively Sensitive,” Warranting Special Caution

- Information about pending or future bids/RFP responses or future pricing;
- Customer-specific prices and confidential sales terms in markets where Buyer and Seller compete, including key supplier contracts, and customer-specific rebates, discounts, or other terms of sale (***but***, providing form contracts and contracts with pricing and other competitively-sensitive terms redacted is generally not sensitive);
- Current or future non-public business plans, marketing plans, bidding strategies, or product-specific production estimates;

- Detailed information about ongoing R&D efforts (unless such plans have already been disclosed to the public);
- Sales figures by customer if this information is generally not known to competitors (*but*, providing no-name customer lists (“customer A, customer B”, etc.) and aggregated sales figures (*e.g.*, by type of product or geography) is generally not sensitive);
- Cost information on an individual product/SKU basis (*but*, providing aggregated, historical cost information is generally not sensitive); and,
- Current profit margins on an individual product/SKU basis (*but*, providing aggregated, historical profit data is generally not sensitive).
- Lists and descriptions of current products, manufacturing operations, distribution assets, real estate and leases, and general business activities;
- Information regarding IT and data processing systems;
- General information regarding existing joint ventures or similar relationships with third parties (giving due consideration to confidentiality obligations to third parties);
- Human resources information;
- Information regarding pending legal claims against the company (with due regard for the attorney-client privilege);
- Information regarding environmental risks; and
- Information in the public domain or of a type regularly disclosed to third parties such as stock analysts.

The Following Data Can Generally Be Shared With Little Legal Risk

- Balance sheets, income statements, and tax returns;
- Current and projected sales revenues, costs, and profits by broad product categories;

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