DOJ Requires Disgorgement for Gun-Jumping Violations in Abandoned Flakeboard/SierraPine Transaction

On November 7, 2014, the U.S. Department of Justice, Antitrust Division ("DOJ") announced that it had entered into a settlement with Flakeboard and SierraPine resolving allegations that the two parties had engaged in illegal premerger coordination in connection with their now-abandoned transaction.[1] Flakeboard and SierraPine both operate in the forest products industry, which has long experienced heightened scrutiny from antitrust regulators. The settlement requires (1) the companies to pay a $3.8 million civil penalty for violating the Hart-Scott-Rodino ("HSR") Act by coordinating the closing of a SierraPine manufacturing facility before the HSR Act waiting period had ended, and (2) Flakeboard to disgorge the $1.15 million in profits it obtained from acquiring the customers of the closed facility. The settlement is notable because it is only the second time the DOJ has imposed disgorgement as a remedy.

The DOJ's settlement arises out of allegations that Flakeboard and SierraPine engaged in illegal premerger coordination in violation of Sherman Act Section 1 and the HSR Act.

Flakeboard and SierraPine own and operate mills that produce medium density fiberboard ("MDF") and particle board ("PBO"), which are manufactured wood products used in furniture, kitchen cabinets and decorative moldings. Flakeboard agreed to acquire three PBO and MDF mills from SierraPine in Medford, OR, Martell, CA, and Springfield, OR. Prior to the transaction, Flakeboard owned and operated competing MDF and PBO mills in Eugene, OR and Albany, OR. The parties announced their deal on January 14, 2014, but abandoned the transaction on September 30, 2014 in the face of DOJ objections that the transaction would substantially lessen competition in the market for the manufacture and sale of MDF in certain West Coast states, including California, Oregon and Washington.[2] According to the DOJ, the transaction would have reduced the number of MDF manufacturers in the relevant geographic market from four to three, and would have given the merged entity a 58% market share in the thicker and denser grades of MDF.

The DOJ's November 7 settlement arises out of allegations that Flakeboard and SierraPine engaged in illegal premerger coordination in violation of Sherman Act Section 1 and the HSR Act. More specifically, the DOJ alleged that the parties reached an illegal agreement to close SierraPine's PBO mill in Springfield, OR — a mill which competed with Flakeboard's PBO mill in Albany, OR — and to transfer the mill's customers to Flakeboard. SierraPine subsequently shut down the Springfield mill on March 13, 2014, and Flakeboard captured many of the closed mill's customers, allegedly with SierraPine's assistance. All of this activity occurred before the HSR Act waiting period had expired and while the DOJ investigation was ongoing. Under the HSR Act, a purchaser may not take "beneficial ownership" of the target — e.g., begin to coordinate the day-to-day business decisions of its target —

until the HSR waiting period has expired or been terminated. Further, Sherman Act Section 1 precludes competitors from agreeing to coordinate their competitive activity or to allocate customers.

The settlement provides a reminder that parties should take care during premerger negotiation and diligence and post-signing integration planning to ensure that illegal premerger coordination or gun-jumping does not occur.

The maximum penalty for violation of the HSR Act is $16,000 per day for each day of violation. The DOJ alleged that the parties' violation continued for 223 days from January 17, 2014, when Flakeboard and SierraPine began discussing the closure of the Springfield mill, until the HSR Act waiting period for the transaction expired on August 27, 2014. The DOJ could have levied a maximum fine of $3.5 million on each of the parties, but instead required each party to pay only $1.9 million. The DOJ explained that it reduced the penalty in acknowledgement of the parties' voluntary cooperation in the government's investigation. The DOJ also required that Flakeboard disgorge the $1.15 million in profits it generated from sales to the customers it diverted from SierraPines' closed mill in violation of Sherman Act Section 1. Combined, the parties paid approximately $5 million in penalties.

This is the second time the DOJ has ordered disgorgement of illegally obtained profits resulting from a Sherman Act violation. The first time occurred in 2011, when DOJ required KeySpan Corporation and Morgan Stanley to disgorge profits acquired through a swap agreement that reduced competition in the New York City electricity market.[3] There, the DOJ alleged that KeySpan, an electricity generator, manipulated New York City electricity prices via a swap agreement with Morgan Stanley in violation of Sherman Act Section 1. The swap gave KeySpan an indirect financial interest in the sale of the electricity generating capacity of Astoria Generating Company, its biggest competitor. That interest reduced KeySpan's incentive to bid competitively at auction during the sale of its own electricity generating capacity. The DOJ required KeySpan to disgorge $12 million for the violation. The U.S. District Court for the Southern District of New York approved the settlement, noting that because (1) the anti-competitive conduct in question — the swap — had expired, (2) there were no assets to divest, and (3) restitution was likely unavailable, disgorgement was an appropriate remedy.[4] Following issuance of the Southern District's opinion, Morgan Stanley agreed to disgorge an additional $4.8 million.[5]

Flakeboard/SierraPine provides a reminder that parties should take care during premerger negotiation and diligence and post-signing integration planning to ensure that illegal premerger coordination or gun-jumping does not occur. As Bill Baer, Assistant Attorney General of the DOJ's Antitrust Division, noted following the settlement: "Companies proposing to merge must remain separate and independent during the government's investigation. These two competitors did not." In addition, the DOJ's enforcement action makes clear that the agency will seek disgorgement in Sherman Act cases, particularly where the alleged anticompetitive acts have stopped, where there are no structural or behavioral remedies to impose, and where restitution is impossible or impracticable. Finally, this case is further evidence of the DOJ's aggressive enforcement posture in forest products mergers, especially those that impact what the DOJ considers to be a highly concentrated Pacific Northwest marketplace.[6]

1 DOJ Press Release, "Justice Department Reaches $5 Million Settlement with Flakeboard, Arauco, Inversiones Angeline and SierraPine for Illegal Premerger Coordination" (Nov. 7, 2014), *available at* http://www.justice.gov/atr/public/press_releases/2014/309786.pdf.

2 DOJ Press Release, "Flakeboard Abandons its Proposed Acquisition of SierraPine" (Oct. 1, 2014), *available at* http://www.justice.gov/atr/public/press_releases/2014/309005.pdf.

3 DOJ Press Release, "Justice Department Requires KeySpan to Disgorge $12 Million in Profits from Anticompetitive Agreement" (Feb. 22, 2010), *available at* http://www.justice.gov/atr/public/press_releases/2010/255503.pdf.

4 *See generally*, *U.S. v. KeySpan Corp.*, No. 10 Civ. 1415 (WHP), 2011 WL 338037 (S.D.N.Y. Feb. 2, 2011).

5 DOJ Press Release, "Justice Department Requires Morgan Stanley to Disgorge $4.8 Million in Profits from Anticompetitive Agreement" (Sept. 30, 2011), *available at* http://www.justice.gov/atr/public/press_releases/2011/275740.pdf.

6 Flakeboard/SierraPine is the second forest products deal abandoned in 2014 in the face of DOJ objections. In May 2014, Louisiana-Pacific Corporation abandoned its proposed acquisition of Ainsworth Lumber Company. DOJ Press Release, "Louisiana-Pacific Corp. Abandons Its Proposed Acquisition of Ainsworth Lumber Co. Ltd." (May 14, 2014), *available at* http://www.justice.gov/opa/pr/louisiana-pacific-corp-abandons-its-proposed-acquisition-ainsworth-lumber-co-ltd. The DOJ also required divestitures before allowing the acquisition of Temple-Inland by International Paper Company to proceed in 2012. DOJ Press Release, "Justice Department Requires Mill Divestitures in International Paper's Acquisition of Temple-Inland" (Feb. 10, 2012), *available at* http://www.justice.gov/atr/public/press_releases/2012/280125.pdf.

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