Major Pork Producers Fined $900,000 in Latest Antitrust "Gun Jumping" Case

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In its latest "gun jumping" case, the Antitrust Division of the Department of Justice (the Division) announced a $900,000 civil penalty settlement with Smithfield Foods, Inc. and Premium Standard Farms LLC. The complaint alleges that the buyer, Smithfield, prematurely exercised operational control over a significant portion of Premium Standard's business in violation of the Hart-Scott-Rodino Act (HSR) waiting period requirements. The Division found Premium Standard stopped exercising independent business judgment when it allowed Smithfield to approve its hog purchase contracts and that this conduct constituted illegal gun jumping.

Prior Approval of Significant Supply Agreements by Purchaser is Gun Jumping

Smithfield Foods, Inc. and Premium Standard Farms LLC were two of the largest pork producers in the United States prior to their merger, both purchasing and raising hogs for slaughter as well as selling fresh and processed pork. In connection with a September 2006 merger agreement, the companies filed HSR Notification and Report Forms, which began the statutory 30-day waiting period. Following compliance with a request for additional information (known as a "second request"), the transaction was not challenged by the Division, and the parties closed the transaction in May 2007.

The merger agreement contained a number of customary "conduct of business" provisions concerning Premium Standard's operations during the HSR waiting period and required Premium Standard to "carry on its business in the ordinary course consistent with past practice." The Division noted that as a general proposition such provisions protect a buyer's legitimate interest in protecting the value of the target business as long as they do not impair the target company's independence. Prior to signing the merger agreement, Premium Standard had routinely purchased hogs from independent hog suppliers under contracts that lasted from one to five years. After the agreement to merge, however, Premium Standard began providing Smithfield the proposed contractual terms, including price, quantity and duration, for prior approval.

The Division found that by allowing prior approval of its purchase contracts, Premium Standard was no longer exercising independent business judgment, which gave Smithfield operational control over a significant segment of Premium Standard's business before the end of the HSR waiting period. In the Division's view, this conduct was classic gun jumping. The Division announced the settlement on January 21, 2010, and the settlement can be found at http://www.justice.gov/atr/cases/smith2.htm.

Suggested Do's and Don'ts to Avoid Gun Jumping

Companies negotiating a merger, or conducting pre-closing due diligence and planning activities, should be aware that the antitrust agencies may view certain activities as gun jumping or even a violation of the Sherman Act's Section 1 prohibition of agreements in restraint of trade. While normal covenants in an acquisition agreement are permissible, they should not be used to allow integration or control of a target company prior to the expiration of the HSR waiting period. The following do's and don'ts should assist parties to a transaction to guard against gun jumping allegations:

Purchasers should not:

1. Direct the business of the seller prior to the consummation of the transaction;
2. Implement post-transaction integration plans prior to the expiration of the HSR waiting period;
3. Negotiate with the seller's customers on seller's behalf;
4. Act with the seller as one firm before the HSR waiting period has expired and the transaction has closed;
5. Make day-to-day decisions for items normally entered into in the ordinary course of business;
6. Negotiate with the seller's suppliers on its behalf or approve the terms of significant purchase contracts; and
7. Draft overly detailed material adverse change clauses, particularly with regard to prices for sales or input purchases, as this could draw antitrust scrutiny.

Sellers who are competitors with the purchaser should:

1. Provide only the information that is necessary for appropriate due diligence and valuation;
2. Be particularly vigilant when disclosing information about prices, costs, contracts, and customers and in general not disclose specific customer information such as pricing, rebates, discounts, and other terms of sale; costs; profitability; marketing plans; or product development plans;
3. Provide information only to those with a need to know and take precautions to limit the distribution of confidential information (e.g., use appropriate confidentiality agreements and limit distribution to non-line personnel);
4. Not provide current (less than three months old) and future non-public pricing or bid data unless approved by counsel; and

5. To the extent practicable, make non-public historical pricing and current or recent cost data available on an aggregate basis only.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work, or the authors of this advisory.

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