

Department of Justice Imposes \$900,000 Fine on Smithfield Foods, Inc. and Premium Standard Farms, LLC for Gun Jumping

On January 21, 2010, the Antitrust Division of the Department of Justice (“DOJ”) announced a \$900,000 settlement with Smithfield Foods, Inc. (“Smithfield”) and Premium Standard Farms, LLC (“Premium Standard”) concerning allegations that the two meat-processing companies failed to observe statutory waiting periods required by the Hart-Scott-Rodino (“HSR”) Act in connection with their August 2007 merger. *United States v. Smithfield Foods, Inc.*, No. 1:10-cv-00120 (D.D.C. Jan. 21, 2010). The case serves as a reminder that parties to transactions need to take care to avoid charges of “gun jumping.”

In October 2006, Smithfield and Premium Standard filed premerger notification forms with the U.S. antitrust agencies in connection with their \$810 million transaction. This commenced a statutory 30-day waiting period, which was extended when DOJ issued a “second request.” Ultimately, DOJ did not seek to block the transaction and the waiting period expired on March 7, 2007. The parties closed their deal that same day.

According to DOJ’s complaint, Smithfield began to exercise operational control over a “significant segment” of Premium Standard’s business operations before expiration of the HSR waiting period. Between late September 2006 and consummation of the transaction five months thereafter, Premium Standard allegedly submitted to Smithfield, for its approval, each of the three contracts for hog purchases from independent producers that arose during the HSR waiting period, and Smithfield consented to terms relating to prices, quantities and contract duration. The complaint asserts that Premium Standard needed to continue to purchase hogs from independent hog producers in order to carry on its business in the ordinary course consistent with its past practice. Together, these contracts represented a total cost of between \$57 and \$67 million.

The complaint charges that, by approving contracts that would otherwise have been entered into in the ordinary course and that represent a value in excess of the HSR Act reporting threshold in effect at the time, Smithfield had acquired beneficial ownership of a significant segment of Premium Standard’s business. DOJ does not appear to be restricting the ability of buyers to restrict sellers from engaging in transactions outside the ordinary course of business during the period between signing a deal and closing.

Section 7A of the HSR Act requires parties to certain transactions to provide premerger notification materials to the U.S. antitrust agencies, and to observe mandatory waiting periods before closing their transactions. During the waiting period, the parties must maintain their respective independence in case the proposed acquisition is blocked or not consummated. The antitrust agencies do, however, recognize that merger agreements customarily and appropriately include provisions designed to protect the buyer’s interests in maintaining the value of the company it intends to purchase.

In its complaint, DOJ charged that Smithfield and Premium Standard had been in continuous violation of Section 7A of the HSR Act beginning on or about September 20, 2006, through their closing date, March 7, 2007. Under the law, the parties were liable for a civil penalty of up to \$11,000 per day for violation of

Section 7A, which could have amounted to a fine in excess of \$1.8 million. They ultimately settled with DOJ for \$900,000.

The *Smithfield* settlement once again calls attention to the federal government's insistence that parties may not transfer ownership rights prior to closing a transaction. Premature exercise of beneficial ownership, by allowing the buyer in a transaction to make decisions for the seller that represent significant portions of the business, can be costly. Importantly, gun-jumping charges such as these may be brought against companies even when the government does not find reason to challenge the transaction itself on competitive grounds. Transaction partners are well advised to seek antitrust counsel in connection with integration planning to ensure that they remain within appropriate boundaries.

See: <http://www.justice.gov/atr/cases/smith2.htm>

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