

Authored by Gino A. Maurelli and Stefani Thomas

January 29, 2010

ACQUIRING COMPANY FINED \$900,000 FOR EXERCISING EXCESSIVE CONTROL OVER TARGET PRIOR TO EXPIRATION OF HSR ACT WAITING PERIOD

Last week the U.S. Department of Justice (DOJ) announced that it reached a \$900,000 settlement with Smithfield Foods Inc. relating to Smithfield's alleged "gun-jumping" activities in connection with its 2007 acquisition of Premium Standard Farms LLC. "Gun-jumping" stands for the general proposition that an acquirer is prohibited from acquiring beneficial ownership of a target until the waiting period imposed under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act) has either expired or been terminated. As middle-market M&A starts to show signs of increased activity, the Smithfield settlement reminds us that parties need to be particularly mindful of their activities during the period between signing and closing of the transaction in order to avoid allegations of gun-jumping. Using the Smithfield settlement as a backdrop, this Alert provides a brief summary of the issue of gun-jumping in the M&A context (many people think of gun-jumping as limited to a securities law concept) and highlights a few considerations for interaction between acquirer and target prior to the expiration of the HSR Act waiting period.

HSR Act. If a transaction involves consideration and parties over certain thresholds (see HRO Alert "Federal Trade Commission Announces Decreases to Hart-Scott-Rodino Thresholds for 2010" at www.hro.com/publications/), then the HSR Act requires the parties to such transaction to file a Notification and Report Form with the DOJ and the Federal Trade Commission (FTC). Once these filings have been made, the parties are required to observe a waiting period (typically 30 days) before closing their deal. An acquirer may be found to be in violation of the HSR Act if it is deemed to have acquired beneficial ownership of the target prior to the expiration or termination of the waiting period. The DOJ takes the position that an acquirer obtains beneficial ownership of a target if the acquirer exercises "substantial operational control" over the target. Civil penalties for violation of the HSR Act are \$16,000 a day for each day in which the party is in violation.

Smithfield Facts. Prior to its acquisition of Premium Standard, Smithfield was the largest pork packer, processor and hog producer in the U.S. Premium Standard was the sixth-largest pork packer and processor and second largest hog producer. In September 2006, Smithfield and Premium Standard entered into an Agreement and Plan of Merger ("Merger Agreement") pursuant to which Smithfield agreed to acquire Premium Standard for total consideration of approximately \$810 million. On October 6, 2006, each side filed their Notification and Report Forms with the DOJ and FTC and the 30-day waiting period began to run. The waiting period was subsequently extended when the DOJ made a "second request" for additional information regarding the transaction. Ultimately, the waiting period expired on March 7, 2007 and the transaction was closed in May 2007.

Like most middle-market purchase agreements, the Merger Agreement contained a "conduct of the business" covenant that limited Premium Standard's conduct during the period between signing and closing. The conduct of the business covenant (1) included customary negative covenants (e.g., prohibitions on the incurrence of debt, issuance of additional securities and sale of assets), and (2) required Premium Standard to "carry on its business in the ordinary course consistent with past practice."

HRO CONTACTS Commercial Law & Securities

Hendrik F. Jordaan
hendrik.jordaan@hro.com
303-866-0456

Stephen E. Lee
stephen.lee@hro.com
213-572-4365

Charles D. Maguire Jr.
charles.maguire@hro.com
303-866-0550

Gino A. Maurelli
gino.maurelli@hro.com
303-866-0649

Sean R. Odendahl
sean.odendahl@hro.com
303-866-0267

Carol Osborne
carol.osborne@hro.com
213-572-4336

Richard R. Plumridge
rich.plumridge@hro.com
303-417-8504

W. Dean Salter
dean.salter@hro.com
303-866-0245

Thomas R. Taylor
tom.taylor@hro.com
801-323-3239

Cory A. Talbot
cory.talbot@hro.com
801-323-3215

B. Lawrence Theis
larry.theis@hro.com
303-866-0449

Emily J. Yukich
emily.yukich@hro.com
213-572-4334



Holme Roberts & Owen LLP
Attorneys at Law

The DOJ alleged in its complaint that Premium Standard stopped exercising independent business judgment when, shortly after the Merger Agreement was signed, Premium Standard, among other things, sought Smithfield's consent to the terms of three proposed hog procurement contracts being negotiated with independent hog producers. These contracts were multi-year obligations to purchase, on an annual basis, 400,000 to 475,000 hogs at a total cost of between \$57 and \$67 million. Premium Standard provided Smithfield with the proposed contract terms, including the purchase price, purchase quantity, and contract length, each time Premium Standard sought consent.

In its complaint, the DOJ took the position that the hog procurement contracts were in the ordinary course of Premium Standard's business and consistent with its past practice. Therefore, Smithfield's conduct of reviewing and consenting to the terms of the proposed contracts amounted to exercising operational control over Premium Standard, which in turn, meant that Smithfield had acquired beneficial ownership of Premium Standard prior to the expiration of the waiting period. The DOJ stopped short of asserting that the conduct of the business covenant contained in the Merger Agreement was a per se violation of the HSR Act, but instead seemed to focus on the fact that Smithfield was becoming involved with acts that were in the ordinary course of Premium Standard's business and consistent with its past practice.

Lessons from Smithfield. The Smithfield settlement operates as a timely reminder that once a deal has been signed and prior to the expiration or termination of the HSR Act waiting period, the parties to the transaction should be mindful of the following:

- While integration planning is allowed, it is not permissible for the acquirer to exercise operational control over the target. The target should continue to be operated in an independent, business-as-usual manner and should continue to compete with the acquirer during the waiting period.
- Parties to the transaction should consider distributing guidance to members of the deal and integration teams, providing specific examples of activities and actions that are or are not permissible during the waiting period.
- Inclusion of a "conduct of the business" covenant is not a per se violation of the HSR Act, but such a provision must be drafted and applied in a manner that does not prevent the target from taking action in the ordinary course of business consistent with past practice during the waiting period.

This article is a periodic publication of Holme Roberts & Owen LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances, nor is it intended to address specific disclosure or compliance issues that may arise in particular circumstances or provide an exhaustive discussion of the topics discussed herein. The contents are intended for general informational and educational purposes only, and you are urged to consult counsel concerning your particular situation and any specific legal questions you may have. For further information regarding the topics described herein, please contact the attorneys listed.