WSGR ALERT

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DEPARTMENT OF JUSTICE SETTLES HART-SCOTT-RODINO GUN-JUMPING CASE AGAINST SMITHFIELD FOODS AND PREMIUM STANDARD FARMS

Smithfield Foods, Inc. (Smithfield), the largest pork packer and processor in the United States, and Premium Standard Farms, LLC (Premium), the sixth-largest pork packer and processor, agreed to pay a $900,000 civil penalty to settle a "gun-jumping" suit filed by the Department of Justice (DOJ). The suit alleged that the parties violated the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the HSR Act) in connection with Smithfield's 2007 acquisition of Premium. DOJ alleged that Smithfield acquired "beneficial ownership" of Premium prior to expiration of the HSR waiting period by taking control of Premium's hog purchasing contracts. Although DOJ did not challenge the terms of the merger agreement governing Premium's interim operations, it alleged that Premium's practice of submitting its hog purchasing contracts for Smithfield's approval amounted to an abdication of its independent business judgment in respect of a key element of its business.[1] What sets this case apart from previous gun-jumping challenges is the lack of specificity as to what conduct triggered the transfer of beneficial ownership. As drafted, the allegations in the complaint could cover conduct that has never been the basis for a gun-jumping challenge.

The merger agreement contained customary interim "conduct-of-business" provisions limiting Premium's operations during the HSR waiting period to protect Smithfield's interests in maintaining Premium's value without impairing Premium's independence. These included provisions regarding Premium's rights to assume new debt or financing, issue new voting securities, and sell assets, as well as requirements that Premium "carry on its business in the ordinary course consistent with past practice." The merger agreement also conditioned the closing of the transaction on the absence of any material adverse effect, as such agreements customarily do.

DOJ did not object to these conduct-of-business provisions as facially problematic, but rather challenged the manner in which Smithfield and Premium dealt with Premium's hog purchasing, which was the subject of the Second Request DOJ issued in connection with the transaction. In particular, the complaint alleges that Premium submitted for Smithfield's approval each of the hog purchase agreements that arose during the waiting period (there were three), regardless of whether the individual contract was material to Premium's business. In each case, Premium provided Smithfield with the contract terms, price, purchase quantity, and contract length.

An acquirer "taking over" a key component of a seller's business (such as hog purchasing in this case), especially where competitive concerns exist, has supported gun-jumping charges against both the buyer and the seller. What is unusual about this case is that the complaint seems to equate Premium providing its hog procurement contracts to Smithfield for approval with Premium abdicating its independent business judgment, without elaborating on the circumstances in which Premium sought Smithfield's consent. The complaint gives no detail as to the nature of the approval process, including, for example, whether Smithfield ever participated in the negotiation of the contracts or whether its approval was based solely on Premium's compliance with its past practices. There is no precedent to suggest that the mere submission of contracts to an acquirer, without more, constitutes an HSR violation. Yet, as drafted, the complaint does not provide clear guidance as to what an acquirer can do to ensure that a seller is complying with standard conduct-of-business provisions.

In contrast, DOJ has given far more detail as to the pre-closing conduct that they found to constitute transfer of beneficial ownership in other cases. For instance, in *U.S. v. Qualcomm-Flarion Tech., Inc.*, the complaint identified several potentially problematic clauses in the merger agreement, and explained how the purchaser used the contract provisions to exercise beneficial ownership over the seller.[2] There, although the merger agreement required the approval of material contracts, a standard contract clause that is also present in the Smithfield/Premium merger agreement, DOJ

[1] The complaint filed by DOJ is available at http://www.justice.gov/atr/cases/f254300/254369.htm.

[2] See "Gun-Jumping Sanctions Highlight Continued Antitrust Scrutiny of Pre-closing Activities," WSGR Alert, April 25, 2006, available at http://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/clientalert_qualcomm.htm.

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further alleged several examples of how the purchaser exercised more day-to-day control over the seller's pre-closing decisions, including decisions not to commercialize a product that the purchaser did not want on the market and a decision not to pursue a specific customer.

In addition, in *U.S. v. Gemstar-TV Guide International, Inc.*, DOJ's complaint extensively detailed how the defendants had entered into non-compete agreements so as to garner better contract terms with common customers. The parties further agreed on specific prices and other terms that they would offer to third parties, and in some cases acted as the other's agent in both legal and business negotiations. The parties were accordingly asserted to have further "substantially scrambled their assets."

Here, DOJ did not challenge the terms of the merger agreement, and did not spell out how the challenged conduct went beyond the parties' efforts to monitor the seller's compliance with otherwise acceptable contract clauses.

Thus, the Smithfield/Premium case could indicate that DOJ (and the Federal Trade Commission) may become more interventionist in regulating parties' pre-closing conduct. Although not specifically alleged, we suspect that Smithfield was exerting more control over Premium's business than merely receiving and rubber-stamping three of Premium's hog procurement contracts. Nevertheless, this case makes no effort to elucidate a bright line between legitimate and illegitimate pre-closing restrictions on the seller's operations. The facts—as alleged in this complaint—suggest that any efforts to oversee the obligations of a seller to conduct its business "in the ordinary course consistent with past practices" must be carefully supervised so as to not imply that the seller has "stopped exercising its independent judgment."

For more information on the Smithfield/Premium case, please contact Charles Biggio, Chris Compton, Scott Sher, or another member of Wilson Sonsini Goodrich & Rosati's antitrust practice.

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