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COMPETITION COMMITTEE**

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**Working Party No. 3 on Co-operation and Enforcement**

**ANTITRUST ISSUES INVOLVING MINORITY SHAREHOLDING AND INTERLOCKING  
DIRECTORATES**

-- United States --

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## MINORITY SHAREHOLDING AND INTERLOCKING DIRECTORATES

1. A firm's partial ownership of a competitor, or its sharing member(s) of their respective boards of directors, can sometimes pose competitive concerns. In the United States, minority shareholding and interlocking directorates can implicate three areas of antitrust law: Section 1 of the Sherman Act, which covers agreements between companies; Section 7 of the Clayton Act, which governs mergers and acquisitions (along with the Hart-Scott-Rodino Premerger Notification Act, which provides the antitrust enforcement agencies time and tools to investigate mergers before they are consummated); and Section 8 of the Clayton Act, which deals with interlocking directorates. This paper discusses each of these statutory provisions and provides recent related case examples.

### 1. Section 1 of the Sherman Act, and common ownership issues

2. In exploring the array of indirect shareholding connections that may link two corporations, the threshold question that must be answered before Section 1 can be applied is whether the firms are, within the meaning of the Sherman Act, two separate entities, such that they are legally capable of entering an agreement, or whether they are instead a single business entity.

3. In the United States, the Supreme Court established the basic framework for this analysis in its 1984 decision in the *Copperweld* case.<sup>1</sup> The Court held that "the coordinated activity of a parent and its wholly-owned subsidiary must be viewed as that of a single enterprise for purposes of § 1 of the Sherman Act."<sup>2</sup> If these two firms constitute a single functional entity, then, as a legal matter, "they are incapable of conspiring with each other...."<sup>3</sup>

4. The Court determined that this resolution reflected the underlying goals of antitrust enforcement: "A parent and its wholly owned subsidiary have a complete unity of interest.... [T]here is no sudden joining of economic resources that had previously served different interests...."<sup>4</sup> This conclusion was warranted even if the parent had previously permitted its subsidiary some scope for independent action. U.S. corporate law allows the parent in such a case to reassert full control over the subsidiary at any moment that the subsidiary fails to act consistently with the parent's interest. For these reasons, the *Copperweld* Court found that there was only a single entity for Section 1 purposes. By recognizing the parent's ownership rights in this way, Section 1 allows complex corporate organizations to utilize whichever form of internal communications they consider most efficient.<sup>5</sup>

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<sup>1</sup> *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984).

<sup>2</sup> 467 U.S. at 771.

<sup>3</sup> *Id.* at 777.

<sup>4</sup> *Id.* at 771. *See also id.* at 769.

<sup>5</sup> *Cf.* 467 U.S. at 771 ("Indeed, a rule that punished coordinated conduct [among company divisions] would serve no useful purpose but could well deprive consumers of the efficiencies that decentralized management may bring").

5. This issue becomes more complex when a subsidiary is not direct and wholly-owned. The question in such cases is whether the underlying economic reality remains one of common management and control. Thus, U.S. courts have found that Section 1 does not apply to agreements between two wholly-owned subsidiaries of a common parent,<sup>6</sup> or between two corporations owned by the same small group of individuals.<sup>7</sup> In neither of these circumstances would one normally expect the companies to be independent competitors.

6. When common control becomes less clear, however, the availability of the *Copperweld* defense becomes less certain. Thus one court has held that there was no longer a single enterprise once the alleged parent had only a minority, 20, or 30 percent interest in its subsidiaries.<sup>8</sup> Similarly, the *Copperweld* doctrine is more difficult to apply once the asserted unifying force is a common or shared purpose rather than actual or effective control through corporate ownership. For this reason, the courts have been divided as to whether hospitals and their medical staffs are, in their peer-review process, acting separately or as a single entity.<sup>9</sup> In cases in which the firms are eventually found to be separate entities, the enforcement agencies must turn to the antitrust merits, asking whether the particular connections among the firms will have anticompetitive consequences that should be condemned.

## 2. Section 7 of the Clayton Act

7. When enforcing Section 7 of the Clayton Act, antitrust authorities in the U.S. recognize that partial acquisitions of horizontal competitors can have anticompetitive effects analogous to the effects of horizontal mergers. In both types of transactions, an acquiring firm gains a financial interest and may gain some control over a target firm. The competitive concerns arising from partial acquisitions are qualitatively the same as in a complete merger, but (usually) quantitatively smaller.

8. When firm A acquires a financial interest in a competing firm B, firm A may have a unilateral incentive to compete less aggressively because it benefits through its ownership of firm B when firm B faces less competition. Firm A's incentive to compete less aggressively tends to be greater when it has a greater financial interest in Firm B and when firms A and B have higher market shares. If firm A's acquisition carries a degree of control or influence over firm B, there may be an additional unilateral effect arising from firm A's incentive to use its control to make firm B compete less aggressively. Firm A's control over firm B is more likely to lead to anticompetitive effects if the two firms have high market shares and if firm A has a greater degree of control over firm B. The same factors—financial interest and control—are relevant to an analysis of the unilateral effects of mergers.

9. Partial acquisitions can also raise the risk of coordination among competitors. If the partial acquisition confers control, the effective reduction in the number of independent competitors can make it

<sup>6</sup> See *Eichorn v. AT&T*, 248 F.3d 131, 139 (3<sup>rd</sup> Cir. 2001); *Greenwood Utilities Comm'n v. Mississippi Power Co.*, 751 F.2d 1484, 1497 n.8 (5<sup>th</sup> Cir. 1985).

<sup>7</sup> See *Century Oil Tool v. Production Specialties*, 737 F.2d 1316 (5<sup>th</sup> Cir. 1984) (common ownership by three individuals).

<sup>8</sup> See *Sonitrol of Fresno v. AT&T*, 1986-1 Trade Cas (CCH) ¶ 67,080, at 62,566-57 (D.D.C. 1986) (ownerships in two corporations of 23.9% and 32.6%). In this case a conspiracy was found possible even though the parent company was the largest single shareholder and exercised effective control over the subsidiaries. The court noted that the subsidiaries' directors still had an independent fiduciary obligation to act in the interests of the subsidiaries' shareholders.

<sup>9</sup> Compare *Oksanen v. Page Memorial Hospital*, 945 F.2d 696, 703 (4<sup>th</sup> Cir. 1991) (en banc) (hospital and medical staff could not conspire because staff acted as hospital's agent in peer review process), with *Bolt v. Halifax Hospital Medical Center*, 891 F.2d 810, 819 (11<sup>th</sup> Cir. 1990) (en banc) (hospital and individual staff doctors are legally separate entities and are capable of conspiring).

easier for firms to coordinate their strategies and alter the benefit-cost calculus of defecting from a cartel so as to make the cartel easier to sustain. It may also make it easier for firms to detect defections from a cartel. The methods for analyzing these issues are analogous to methods used to analyze the coordinated effects of mergers.

## **2.1 KMI/Carlyle/Riverstone**

10. In a recent case involving partial acquisition, the FTC challenged the acquisition of interests in Kinder Morgan, Inc. (KMI) by private equity funds managed by The Carlyle Group (Carlyle) and Riverstone Holdings LLC (Riverstone).<sup>10</sup> The case demonstrates that the antitrust agencies are willing to act against acquisitions of partial interests in competing firms in situations in which competition likely would be diminished. KMI was an energy transportation, storage, and distribution firm, and Carlyle and Riverstone held interests in Magellan Midstream, a competitor of KMI in the terminaling of gasoline and other light petroleum products in the United States.<sup>11</sup>

11. The Commission's complaint alleged that the proposed acquisition would violate Section 7 of the Clayton Act and Section 5 of the FTC Act because investment funds controlled by Carlyle and Riverstone would hold interests in both KMI and Magellan, leading to a reduction in competition in the terminaling of gasoline and other light petroleum products in eleven metropolitan areas in the United States.<sup>12</sup> In addition, the FTC alleged that the proposed acquisition would reduce competition because Carlyle and Riverstone would have the right to board representation at both firms, the right to exercise veto power over actions by Magellan, and access to non-public competitively sensitive information from or about KMI or Magellan. The Commission also stated that the transaction would make it easier for the acquirers to exercise unilateral market power because many of KMI's and Magellan's terminals were customers' first or second choices, and other terminals would be either unable or unwilling to replace the competition that would be lost through the transaction. Finally, the transaction would increase the likelihood of coordinated interaction between competitors in the eleven markets, as it would combine, through common partial ownership, two of the primary independent participants in these markets, the FTC stated.

12. Under the consent agreement, Carlyle and Riverstone were required to (1) remove all of their representatives from the Magellan Board of Managers and its boards of directors, (2) cede control of Magellan to its other principal investor, Madison Dearborn Partners, (3) not influence or attempt to influence the management or operation of Magellan, and (4) establish safeguards against the sharing of competitively sensitive information between KMI and Magellan.<sup>13</sup>

## **2.2 Dairy Farmers of America/Southern Belle**

13. The DOJ's lawsuit challenging Dairy Farmers of America's (DFA's) significant partial investment in two rival dairies (Flav-O-Rich and Southern Belle) also illustrates how partial ownership investments might reduce competition. DFA is a multi-billion dollar cooperative of thousands of dairy

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<sup>10</sup> In the Matter of TC Group, L.L.C., No. 061-0197 (Jan. 25, 2007) (decision and order), *available at* <http://www.ftc.gov/os/caselist/0610197/decisionorder.pdf>.

<sup>11</sup> See Federal Trade Comm'n, Press Release, FTC Challenges Acquisition of Interests in Kinder Morgan, Inc. by The Carlyle Group and Riverstone Holdings (Jan. 25, 2007), *available at* <http://www.ftc.gov/opa/2007/01/kindermorgan.shtm>.

<sup>12</sup> In the Matter of TC Group, L.L.C., No. 061-0197 (Jan. 25, 2007) (complaint), *available at* <http://www.ftc.gov/os/caselist/0610197/complaint.pdf>.

<sup>13</sup> In the Matter of TC Group, L.L.C., No. 061-0197 (Jan. 25, 2007) (decision and order), *available at* <http://www.ftc.gov/os/caselist/0610197/decisionorder.pdf>.

farmers. Its primary mission is to secure a steady sale of raw milk for its farmers at the highest price. To further that mission, DFA began vertically integrating and investing in dairies that process raw milk into fluid milk, ice cream, and other milk products. DFA preferred not to wholly acquire and manage the dairies, but to take 50% ownership and largely leave daily operations to business partners with more experience. DFA used its dairy investments both to secure a steady source of processing and distribution for its farmers' raw milk and to capture some of the profits of the dairy processing business.

14. Prior to February 2002, DFA held a 50% equity stake in the company that owned and operated the Flav-O-Rich dairy. The other 50% equity stake was held by the Allen Family Limited Partnership, a long-time business partner of DFA that maintained the day-to-day responsibilities for operating Flav-O-Rich. In February 2002, DFA acquired 50% of the voting stock of Flav-O-Rich's biggest competitor, the Southern Belle Dairy. The two dairies had a history of antitrust issues, including a decade-long bid-rigging conspiracy, in which they had agreed not to bid aggressively for each other's school milk customers.

15. For many school districts, Southern Belle and Flav-O-Rich were the only two school milk competitors. For school districts located farther away from the two dairies, often only one other dairy competed. Southern Belle and Flav-O-Rich price discriminated in their school milk bids to school districts based on the school districts' competitive options. The acquisition created no efficiencies; DFA actually argued that the two dairies would be operated independently. The critical issue was whether DFA's investment in both companies would result in either greater coordination between them or in a unilateral anticompetitive effect.

16. Because both dairies could raise prices to school districts by reducing competition against each other, DFA's 50% interest in each dairy's profits gave DFA a strong incentive to reduce competition. DFA also had an incentive to facilitate unilateral price increases, irrespective of coordination between the dairies. Because of DFA's half ownership of both dairies, it would not matter to DFA if customers of either dairy switched to the other dairy in response to a price increase. Through the governance provisions of the companies that operated the dairies and DFA's ownership interests, DFA also acquired the ability to influence its chosen dairy managers so that DFA could cause the dairies to act in DFA's interest to reduce competition.

17. DOJ sued DFA, alleging that DFA's partial acquisition of the Southern Belle dairy gave it both the economic incentive and the ability to reduce competition between the dairies. The complaint alleged that the dairies were the only two competitors for a significant number of customers, that entry or expansion would not prevent increased prices and a reduction in service, and that the transaction yielded no efficiencies to outweigh the likely competitive harm. Prior to trial, DFA decided to improve its litigation position by changing its governance rights. DFA turned its common voting stock in the companies that operated both dairies into non-voting stock. As a result, it lost its rights to set salaries or to veto corporate decisions such as capital expenditures. DFA then filed a motion stating that it had no control over the dairies and therefore its ownership interests could not reduce competition. The trial court agreed with DFA and granted DFA's motion for summary judgment, ruling that DFA did not have the ability to control the dairies.

18. DOJ appealed. In response to DFA's alteration of the original agreement, DOJ argued that DFA violated the law when it first acquired its interest in Southern Belle under the original governance agreement. DOJ argued that the trial court was wrong to ignore DFA's violation of the antitrust laws during the period of the original agreement, and that in doing so the trial court had effectively permitted DFA to evade review and impose an inadequate remedy of its own choosing. In contrast to DFA's self-selected relief, DOJ sought complete divestiture of DFA's interest in Southern Belle.

19. The Court of Appeals ruled that, assuming DOJ ultimately proved its factual allegations, DFA's original investment in the Southern Belle dairy would violate the antitrust laws.<sup>14</sup> The court ruled that it was error for the trial court to ignore the original agreement. Under the original terms, DFA could use its ownership interests and governance rights to reduce competition between the two dairies. More important, the appellate court also held that DFA's voluntary relinquishment of its voting rights did not remedy the violation. The court explained that DFA could still reduce competition because it had installed managers in the companies who would be loyal to DFA's interests. Additionally, Southern Belle was beholden to DFA for additional capital (given that DFA held all the debt in the company). Further, DFA maintained control over Southern Belle's and Flav-O-Rich's raw milk supply – each dairy plant's most vital input – and could use that control to further influence the dairies to reduce competition. The appellate court held that the appropriate remedy for DFA's overlapping partial ownership interests was DFA's complete divestiture of its interests in one of the two dairy plants. After the appellate court's decision and before trial, DFA and the Allen Family Limited Partnership agreed to sell the Southern Belle dairy plant to another firm.

### 2.3 *Premerger Notification*

20. In the U.S. merger control regime, the Hart-Scott-Rodino Act<sup>15</sup> generally requires that any acquisition of voting securities (and/or assets) that meets the size of transaction threshold (and the size of person threshold, if applicable) must be reported to the antitrust enforcement agencies – and a waiting period be observed – prior to consummation.<sup>16</sup> The HSR Act and the implementing rules, however, exempt several categories of acquisitions from HSR notification and waiting requirements. Many of these exemptions are based on the view that transactions of certain types are extremely unlikely to raise antitrust concerns; indeed, in addition to the HSR exemptions contained in the statute, the antitrust enforcement agencies are authorized to exempt from HSR requirements classes of transactions that “are not likely to violate the antitrust laws.”<sup>17</sup>

21. Section (c)(9) of the HSR Act exempts from HSR requirements the acquisition of 10 percent or less of an issuer's voting securities if such acquisition is made “solely for the purpose of investment.” HSR Rule 801.1(i)(1) provides that voting securities are acquired “solely for the purpose of investment” if the acquirer “has no intention of participating in the formulation, determination or direction of the basic business decisions of the issuer.”<sup>18</sup> The U.S. agencies are considering whether it would be appropriate to

<sup>14</sup> *United States v. Dairy Farmers of America, Inc.*, 426 F.3d 850 (6<sup>th</sup> Cir. 2005).

<sup>15</sup> 15 USC 18a.

<sup>16</sup> The size of transaction test measures the value of the voting securities or assets that the acquiring person will hold as a result of the acquisition. The size of person test considers the size of the parties to the transaction.

<sup>17</sup> 15 USC 18a(d)(2)(B).

<sup>18</sup> Rule 802.64 (16 CFR 802.64) exempts certain acquisitions of 15 percent or less of an issuer's voting securities by institutional investors “made solely for the purpose of investment.” For purposes of this rule, an institutional investor includes: a bank as defined by the US Code; a savings bank; a savings and loan or building and loan company or association; a trust company; an insurance company; an investment company registered with the SEC under the Investment Company Act of 1940; a finance company; a broker-dealer as defined by the US Code; certain companies regulated by the Small Business Administration; a stock bonus, pension or profit-sharing trust as defined by the Internal Revenue Code; a bank holding company as defined by the US Code; an entity controlled by the institutional investor; an entity that holds only controlling interests in institutional investors; and a non-profit entity as defined by the Internal Revenue Code. For this exemption to apply, the acquisition of 15 percent or less of an issuer's voting securities must be made directly by an institutional investor in the ordinary course of business solely for the purposes of investment. This exemption does not apply when the acquisition involves institutional

expand the exemption from HSR notification and waiting requirements in the future, by exempting small-percentage acquisitions without regard to the acquiror's intent.<sup>19</sup>

### 3. Section 8 of the Clayton Act

22. Section 8 of the Clayton Act,<sup>20</sup> as amended by the Antitrust Amendments Act of 1990, prohibits certain director and officer interlocks between competing business corporations. Additionally, the FTC has applied Section 5 of the FTC Act,<sup>21</sup> which prohibits unfair methods of competition, to enforce the "spirit and policy" of Section 8.<sup>22</sup>

23. Subject to certain minimum thresholds, Section 8 prohibits a person from serving as a director or an officer, elected or chosen by the board, of two or more corporations if the corporations are "by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws."<sup>23</sup> Competitor corporations are covered by Section 8 if the combined capital, surplus, and undivided profits of each of the corporations exceeds an inflation-adjusted multiple of \$10 million.<sup>24</sup> Exempted from Section 8's prohibitions are interlocks for which (1) the competitive sales of either corporation are less than an inflation-adjusted multiple of \$1 million,<sup>25</sup> (2) the competitive sales of either corporation are less than 2 percent of that corporation's total sales,<sup>26</sup> or (3) the competitive sales of each corporation are less than 4 percent of that corporation's total sales.<sup>27</sup> This removes from the coverage of interlock prohibitions arrangements that pose little risk of significant antitrust injury.

24. Section 8 requires the existence of a horizontal market relationship.<sup>28</sup> In a recent case described below, CommScope Inc.'s acquisition of Andrew Corporation raised both Section 7 and Section 8 issues.

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investors of the same type or when an entity that is not an institutional investor within the institutional investor already holds shares of the target.

<sup>19</sup> The antitrust enforcement agencies have brought civil penalty actions under the HSR Act for failures to observe the Act's notification and waiting requirements in instances in which parties acquired ten percent or less of an issuer's voting securities and did not make the acquisition "solely for the purpose of investment." See, e.g., *United States v. Smithfield Foods*, 2004-2 Trade Cas. (CCH) Par. 74,614 (D.D.C. 2004); *United States v. Pennzoil Co.*, 1994-2 Trade Cas. (CCH) Par. 70,760 (D.D.C. 1994); *United States of America (for the Federal Trade Commission), Plaintiff, v. James D. Dondero, c/o Highland Capital Management, L.P., Defendant*, (D.D.C. FTC File No.: 051-0184); *United States of America (for the Federal Trade Commission), Plaintiff, v. ValueAct Capital Partners, L.P., Defendants*, (D.D.C. File No. 051 0204).

<sup>20</sup> 15 U.S.C. § 19.

<sup>21</sup> 15 U.S.C. § 45.

<sup>22</sup> See *Kraftco Corp.*, 89 F.T.C. 46, remanded on other grounds sub nom. *SCM Corp. v. FTC*, 565 F.2d 807 (2d Cir. 1977), appeal after remand, 612 F.2d 707 (2d Cir.), cert. denied, 449 U.S. 821 (1980).

<sup>23</sup> 15 U.S.C. § 19(a)(1)(B).

<sup>24</sup> As of January 2008, the threshold was set at \$25,319,000.

<sup>25</sup> The threshold was set at \$2,531,900 as of January 2008.

<sup>26</sup> 15 U.S.C. § 19(a)(2).

<sup>27</sup> *Id.*

<sup>28</sup> See *Borg-Warner Corp.*, 101 F.T.C. 863, 932 ("[T]he relevant inquiry . . . is whether the parent company should be regarded as a 'competitor' of the subsidiary's competitors, and whether an interlocked director is . . . able to exercise control or even to substantially influence decisionmaking . . . so as to dampen

### 3.1 *CommScope/Andrew*

25. In June 2007, CommScope Inc. (CommScope) entered into an agreement to acquire Andrew Corporation (Andrew). CommScope is a major manufacturer of wire and cable products, including drop cable and hardware products used in drop cable installations.<sup>29</sup> Andrew is a major producer of antenna and cable products and products for wireless communications systems; it manufactured drop cable until it sold this business to Andes Industries, Inc. (Andes), shortly before its agreement with CommScope. Andrew held 30% of Andes' equity, a warrant to acquire additional Andes stock, and several notes of indebtedness from Andes. It also held numerous governance rights over Andes, including rights to designate members of Andes' board of directors. When Andrew sold its drop cable business to Andes, Andrew licensed Andes to use the intellectual property associated with a special dry anti-corrosion feature of drop cable.

26. The Department of Justice's competitive concerns centered on the drop cable market. The relevant geographic market was the United States. The market was highly concentrated, with only four companies supplying cable TV companies. CommScope had a market share of between 60 and 70 percent. Andes was the third largest manufacturer, with only a 4% market share, but was making a significant market impact because of its lower pricing and ability to offer drop cable with dry anti-corrosion protection.

27. The full line of products offered by CommScope and Andes made them each other's closest competitors for many customers. Of the four manufacturers of drop cable, only CommScope and Andes offered it with the dry anti-corrosion protection, a feature of particular importance to some cable TV customers. Andes and CommScope competed with each other in product innovation, such as development of the dry anti-corrosion feature. The prices charged by Andrew and Andes generally had been 5 to 10% lower than those charged by CommScope and other producers.

28. The DOJ found that if CommScope were allowed to acquire Andrew's minority holdings in Andes, Andes would no longer be an independent drop cable competitor. Successful entry into the drop cable market would not be timely, likely, or sufficient to offset the substantial lessening of competition. The DOJ concluded that

CommScope's substantial ownership in Andes would reduce its incentive to compete with Andes. In addition, ... CommScope would obtain substantial governance rights over Andes. Once CommScope completes its acquisition of Andrew, Andes' board of directors will have seven members. CommScope will then have rights to appoint two members of that board, and jointly with another Andes' shareholder, to appoint two more. In addition, CommScope's consent will be required ... for a range of corporate actions by Andes, and CommScope will hold extensive rights to access Andes' confidential business information. These governance rights, combined with its 30 percent ownership stake and other interests in Andes, would give CommScope both the incentive and the ability to coordinate its activities with those of Andes, and/or to undermine Andes' ability to compete on price and innovation.<sup>30</sup>

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competitive relationships") (citation omitted), *modified*, 102 F.T.C. 1164 (1983), *rev'd on other grounds*, 742 F.2d 108 (2d Cir. 1984).

<sup>29</sup> Drop cable is coaxial cable used by cable television companies to connect their transmission systems with customers' premises and equipment inside the customers' premises.

<sup>30</sup> Competitive Impact Statement, *United States v. CommScope, Inc.*, at 7, available at <http://www.usdoj.gov/atr/cases/f228300/228364.htm>.



29. On December 6, 2007, DOJ filed a complaint and proposed consent decree in federal district court that would require the parties to divest Andrew's entire ownership interest in Andes, the intellectual property concerning the dry anti-corrosion product, and all notes of Andes' indebtedness held by Andrew and warrants to acquire additional Andes stock.<sup>31</sup> With regard to the alleged interlocking directorates, the parties were required to renounce their contractual governance rights, including the rights of CommScope to appoint members of Andes' board.

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<sup>31</sup> *United States v. Commscope, Inc.*, No. 1:07-CV-02200, (D.D.C. filed Dec. 6, 2007).