FTC CHALLENGES PRIVATE-EQUITY FIRMS' INVESTMENTS IN COMPETING COMPANIES

On January 25, 2007, the Federal Trade Commission (the "FTC") announced a complaint challenging the acquisition of a 22.6 percent equity interest in Kinder Morgan, Inc. ("KMI") by The Carlyle Group ("Carlyle") and Riverstone Holdings ("Riverstone"). Simultaneously, the FTC made public an order settling the complaint and allowing the transaction to proceed if Carlyle and Riverstone convert their interests in a competitor of KMI into a passive investment. As discussed below, the FTC's actions signal both increased antitrust scrutiny of private-equity firms and a willingness by the FTC to agree to remedies other than divestiture in the private-equity arena.

In August 2006, KMI announced that it had entered into a definitive merger agreement pursuant to which a group of investors, including one private-equity fund managed and controlled by Carlyle and another private-equity fund jointly managed and controlled by both Carlyle and Riverstone, would acquire all outstanding shares of KMI for approximately $22 billion. As a result of the proposed merger, the two equity funds controlled by Carlyle and/or Riverstone would hold a combined 22.6 percent of the equity of KMI, with the remaining equity held by other investors. However, yet another private-equity fund jointly managed and controlled by Carlyle and Riverstone already held a 50 percent equity interest in the entity that controls Magellan Midstream Partners, L.P. ("Magellan"). Magellan and KMI are competitors. They are both midstream energy firms the business of which includes the "terminaling" of gasoline and other light petroleum products.

The FTC's Complaint

The FTC identified 11 metropolitan areas in the southeastern United States in which KMI and Magellan own competing terminals. The FTC determined that barriers to entry are high and that following the acquisition the market for the terminaling of gasoline and other light petroleum products in each identified geographic area would be either highly or moderately concentrated.

The FTC alleged that the proposed acquisition would result in Carlyle and Riverstone having (1) significant interests in competitors KMI and Magellan; (2) the right to board representation at both KMI and Magellan; (3) the right to exercise veto power over actions by Magellan; and (4) the ability to receive, use, or share nonpublic, competitively sensitive information from or about KMI or Magellan. Consequently, the FTC determined that the acquisition may substantially lessen competition in the market for the terminaling of gasoline and other light petroleum products in each of the identified sections of the United States. The FTC's complaint thus challenged the proposed acquisition as violating Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

The Consent Order

The consent order will allow the transaction to proceed if Carlyle and Riverstone convert their interests in Magellan into passive investments to ensure that KMI and Magellan operate independently and in competition with each other.

The consent order requires Carlyle and Riverstone to remove all of their respective representatives from all Magellan boards and give up the right to elect or appoint representatives to such boards. For as long as Carlyle and Riverstone (1) hold any interest in KMI, either directly or indirectly; (2) have the ability to elect any KMI director; or (3) have access to nonpublic information relating to KMI, Carlyle and Riverstone may not (1) elect a Magellan director; (2) have any representative on any Magellan board; (3) influence or attempt to influence Magellan or the management or operation of Magellan; or (4) receive or attempt to receive nonpublic information relating to Magellan. Similarly, Carlyle and Riverstone are prohibited from providing to Magellan nonpublic information relating to KMI. The order also requires Carlyle and Riverstone to institute procedures and requirements ("firewalls") throughout their various entities to ensure that all nonpublic information is protected from disclosure and, for a period of ten years, to submit to the FTC as well as to an appointed outside monitor an annual verified written report setting forth the manner in which they are complying with the order.

Implications

The KMI consent order signals more intense scrutiny of private-equity transactions. The FTC confirmed its resolve to act against acquisitions of partial interests in competing firms where competition would likely be diminished. The private-equity community thus may expect closer scrutiny of investments, especially where firms or groups of firms acquire interests in multiple firms that compete with one another. At the same time, the FTC also appears willing to consider flexible remedies, such as the passive-investment and firewall requirements imposed on Carlyle and Riverstone, rather than the more traditional divestiture remedy. Preparatory consideration of potential competitive overlaps in ownership interests might facilitate obtaining HSR clearance and avoiding regulatory investigations.

Private-equity firms (and others) might face additional risks with respect to interlocking directorates. Section 8 of the Clayton Act prohibits, with limited exceptions, a person (or an entity by way of its agents, depending on how certain statutory terms are interpreted) from sitting on the board or acting as an officer of two or more firms that compete with one another. At least one court has indicated that Section 8 might apply where a company attempts to place on the boards of competitors different individuals who are its agents and with whom it has an employment or business relationship. Further to that broad interpretation of Section 8, in October of 2003, the U.S. Department of Justice (the "DOJ") filed an amicus brief in a private case that affirmed the DOJ's position that a corporation or other business entity may violate Section 8 of the Clayton Act if its "deputies" serve as directors or officers of competing corporations barred from sharing directors or officers under the statute. Although Section 8 was not discussed in the KMI consent order, firms should be aware of the potential for issues arising pursuant to Section 8 in future transactions.

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