Energy Sector Alert Series: Antitrust and Acquisition of Partial Ownership Interests—What Energy Companies Should Know

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In this eight-week alert series, we are providing a broad look at current and emerging issues facing the energy sector. Lawyers from across the firm are discussing issues ranging from cybersecurity, antitrust and intellectual property to the impact of both Brexit and the upcoming presidential election on the energy industry. Read our recent publications, including articles from a previous alert series published earlier this year.

Antitrust enforcers are increasingly scrutinizing transactions that result in partial ownership in competitors. This interest in partial acquisitions is particularly relevant in the energy sector, where the costs for developing large energy projects are high, and partial ownership can be used to spread risk and limit exposure.

In this alert, we explain why enforcers are concerned about partial acquisitions involving actual or potential competitors, how their concerns may be resolved, and what lessons can be learned from recent cases.

Antitrust Concerns With Partial Acquisitions: The "Three I's"

Acquisitions of partial ownership interests rarely eliminate all competition between the parties. They may, however, lessen competition in one or more of the following ways: the acquirer may be able to *influence* the business conduct of the target; have a reduced *incentive* to compete against the partially owned company; or obtain access to competitively sensitive *information*.[1] Parties to partial ownership transactions involving actual or potential competitors should be to sensitive these "three I's."

- **Influence.** The antitrust agencies will consider whether, post-transaction, the buyer would be able to control or otherwise influence the competitive decisions of the target. If the buyer will obtain effective control of the target, the agencies will analyze the transaction as though it were a full merger.[2] Even if the transaction does not result in effective control, the agencies may still be concerned that partial ownership will allow the buyer to change the competitive conduct of the target, or of competing companies in which either party holds partial interests.[3]

The Federal Trade Commission (FTC) recently raised this question in connection with the proposed merger of Williams and ETE. The FTC alleged that the transaction would have resulted in control over two natural gas pipeline systems in the Florida peninsula, each of which was partially owned by one of the parties.[4]

The FTC raised similar concerns in Kinder Morgan/Carlyle/Riverstone, where two investment firms, Carlyle and Riverstone, agreed to acquire a 22.6 percent interest in Kinder Morgan, Inc. (KMI), as part of an acquisition of KMI by a group of investors.[5] Both firms already held significant interests in Magellan Midstream, a competitor of KMI. KMI and Magellan operated gasoline terminals and—the FTC alleged—were their customers' first or second choices in many markets. Because Carlyle and Riverstone, through a jointly managed fund, were represented on Magellan's board and had “significant veto power over Magellan's activities,”[6] the FTC challenged the acquisition, arguing that “it w[ould] have the effect of combining [KMI and Magellan] through partial common ownership.”[7]

- **Incentive.** The agencies also may be concerned that the transaction reduces the buyer's incentive to compete with the target. The basic theory underpinning this concern is straightforward: once a firm obtains a financial interest in a competitor, it can recoup a portion of any lost sales through its financial interest in the rival firm. It may, therefore, have less incentive to beat its rival in the marketplace. This may be the case even if the buyer acquires a passive interest that conveys no right to influence the target.[8]

  Acquisitions of partial ownership also can raise other incentive concerns. For example, the target may have access to assets—such as pipelines—that enable competition between third parties and entities partially owned by the acquirer. The agencies may ask whether, post-transaction, the combined company would have an incentive to foreclose third-party access to those assets, to protect the partially-owned entity from increased competition by third parties.[9]
- **Information.** A partial acquisition in a competitor may also threaten competition by giving access to nonpublic, competitively sensitive information about the target, thereby diminishing the vigor of competition between the two parties and possibly harming overall competition in a relevant market. The FTC raised this concern in Kinder Morgan/Carlyle/Riverstone, noting that the transaction would result in (i) the right to board representation at KMI and Magellan and (ii) access to nonpublic competitively sensitive information from or about KMI or Magellan.[10]

How Can Partial Ownership Concerns Be Resolved?

There is no “one size fits all” solution. The overarching goal of any attempt to address agency concerns is to design a remedy that restores competition to the pre-acquisition state, is practicable to implement and is consistent with business objectives. In practice, the antitrust agencies have accepted a variety of remedies, including divestitures and other relief.

- **Divestitures.** In cases involving overlapping assets, the agencies prefer divestiture remedies, including in partial ownership cases. By selling a set of assets that will allow a purchaser to compete effectively, the parties can replace the competition that the transaction otherwise would eliminate. In ETE/Williams, for example, the combined company agreed to divest its stake in a pipeline partially owned by Williams within 180 days, to an FTC approved buyer.
- **Conversion of partial ownership into passive interest.** The agencies have sometimes accepted conversion of partial ownership interests with governance and information rights into passive financial shareholdings. This may be particularly suitable in cases involving private equity firms: in Kinder Morgan, Carlyle and Riverstone agreed to turn their interest in Magellan into a purely passive one by (i) removing their representatives from the Magellan boards and (ii) ceding control of Magellan to its other principal investor.
- **Firewalls.** To address concerns about access to nonpublic, competitively sensitive information, the agencies have accepted firewalls designed to protect confidential information as a remedy. In Kinder Morgan, for example, the parties agreed to establish safeguards against the sharing of competitively sensitive information between KMI and Magellan and appointed an implementation monitor to ensure that the firewall was consistent with the consent order.[11]
- **Other remedies.** Other nondivestiture remedies have also been used to address concerns from partial ownership acquisitions, including in the energy sector. In addition to firewalls against information sharing, such relief may include supply or other business agreements, employee obligations, confidentiality protections, or a requirement not to favor certain entities.

Takeaways

- Antitrust enforcers are concerned about the potential competitive effects of partial ownership acquisitions, and are likely to increase their efforts in the coming years.[12]
- Recent FTC enforcement actions have shown that this heightened interest in partial ownership acquisitions includes the energy sector.
- To date, enforcement actions have focused on transactions among alleged close competitors in highly concentrated markets. Parties engaged in transaction planning should not limit their analysis to highly concentrated markets, however. For every transaction involving potential partial ownership interests, it is prudent to:
  - understand whether the entities in which the partial interests exist are actual or potential competitors;
  - analyze whether the transaction arguably reduces competition through one of the three I's: influence, changed incentives or access to information;
  - to mitigate risk, consider whether the parties' goals could be achieved by eliminating or reducing rights to influence or information; and
  - as in every other transaction with potential concerns, develop a “Plan B” for remedies that may satisfy the antitrust agencies.

[1] US Department of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (August 19, 2010) ¶ 13.

[2] *Id*.

[3] Parties engaged in partial ownership transactions that convey rights to board representation should also be mindful of Section 8 of the Clayton Act, which prohibits certain interlocking directorates.

[4] *In the Matter of Energy Transfer Equity, L.P. and The Williams Companies, Inc.*, No. C-4577 (June 9, 2016).

[5] *In the Matter of TC Group, LLC., Riverstone Holdings LLC, Carlyle/Riverstone Global Energy and Power Fund II, LP, and Carlyle/Riverstone Global Energy and Power Fund III, LP*, No. 061-0197 (Jan. 25, 2007).

[6] Analysis to Aid Public Comment at 1, *In re TC Group*, No. 061-0197.

[7] *Id*. at 4.

[8] *See* Comment of the Fed. Trade Comm'n to the Fed. Energy Reg. Comm'n, No. RM09-16-000 (Mar. 29, 2010).

[9] Analysis to Aid Public Comment at 3, *In re Energy Transfer Equity*, No. 151-0172.

[10] Complaint at 6, *In re TC Group*, No. 061-0197.

[11] Decision and Order at 7, *In re TC Group*, No. 061-0197.

[12] In May, the FTC published a blog entry on partial ownership acquisitions, listing examples of cases from various industries. *See* Fed. Trade Comm'n, What's the Interest in Partial Interests? (May 9, 2016).

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