

Client Alert

FTC Signals More Stringent Antitrust Review of Private Equity Investments with Challenge of Kinder Morgan Acquisition

On January 24, 2007, the Federal Trade Commission (FTC) filed a complaint challenging a proposed acquisition in which The Carlyle Group (Carlyle) and Riverstone Holdings LLC (Riverstone) would acquire an equity interest in Kinder Morgan, Inc. (KMI). The FTC challenged the acquisition, valued at approximately \$22 billion, because Carlyle and Riverstone currently maintain significant holdings in Magellan Midstream (Magellan), a major competitor of KMI. The FTC alleged that the proposed acquisition violated Section 7 of the Clayton Act and Section 5 of the FTC Act because it would allow Carlyle and Riverstone to use their board representation rights in KMI and Magellan to exercise unilateral market power, threatening competition in the gasoline-terminating markets of eleven metropolitan areas in the Southeast. The proposed acquisition would provide Carlyle and Riverstone with board representation at both firms, the right to exercise veto power over Magellan's actions, and access to competitively sensitive business information regarding KMI or Magellan.

The FTC entered into a consent order with Carlyle and Riverstone that was tailored to remedy the competitive harm resulting from the transaction. Representatives of Carlyle and Riverstone are prohibited from serving on any Magellan board, and from exerting any form of control over the business operations of Magellan. In addition, the consent order requires that the parties implement internal controls to ensure that sensitive information is not transmitted between KMI and Magellan. The FTC stated that these safeguards are necessary to preserve competition in the gas-storage market.

The Implications of the Kinder Morgan Case

In 2006, private equity funds accounted for nearly 27 percent of all merger and acquisition activity. As analysts forecast continued expansion of private equity involvement in mergers and acquisitions, more stringent antitrust review of private equity investments is likely. The KMI case signals that the FTC is taking notice of private equity's increasing merger and acquisition activity, and is likely going to focus more attention on the competitive impact of private equity investments. As the private equity sector continues to grow, private equity companies will continue to acquire equity positions in a diverse range of companies, some of which may be competitors. Where an acquisition of interests in competitors may facilitate coordinated market activity or promote the exercise of unilateral market power, private equity firms that are contemplating an investment must take into consideration the antitrust implications of that merger or acquisition. The KMI case demonstrates that the FTC will closely review private equity investments that create equity positions in competitors, especially in cases in which the private equity firm has assumed positions in major competitors in a concentrated market. If the FTC determines that the investment threatens competition, then the agency is likely to challenge the acquisition and pursue remedial measures. Although the FTC may be hesitant to require divestitures in the private equity context, divestiture remains an available remedy for the competitive harm of an acquisition.

In the majority of cases involving private equity, it seems more likely that the FTC will attempt to negotiate a settlement agreement in which the private equity firm cedes control in one or more of the competitive companies. In negotiating such an agreement, the FTC is also likely to require that the parties implement conduct-oriented controls to prevent coordinated interaction between the competing companies, such as requiring that procedural safeguards be implemented to prevent the competitors from sharing non-public competitively sensitive business information. The FTC may also insist on other controls to address competitive issues that are particular to the acquisition. Ultimately, private equity firms must evaluate the antitrust implications of equity investments and develop an awareness of the types of acquisitions that are likely to trigger the agency's antitrust review.

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