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PRIVATE EQUITY PARTIAL ACQUISITIONS: TOWARDS A NEW ANTITRUST PARADIGM

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"On a going forward basis, there are . . . areas of some concern to us that may be of interest to you . . . we are seeing an increasing number of partial acquisitions, often in industries in which minority investments create a complex web of interrelated relationships. Traditionally, small minority equity purchases have not received much attention from antitrust enforcement agencies. That is likely to change . . . ."

-John M. Nannes, Fmr. Deputy Assistant Attorney General and Acting Assistant Attorney General, Antitrust Division of the U.S. Department of Justice

ABSTRACT

Considerable antitrust questions have arisen about the role of the control inquiry in merger review of partial acquisition cases subsequent to the recent Sixth Circuit decision in *United States v. Dairy Farmers of America.* Control, as this Article discusses, can be practically asserted through a variety of means including corporate governance rights or board seats even without a majority stake. But, the importance of control, as both a legal and business concept, is not so clearly explained. Thus this Article surveys the antitrust treatment of partial acquisitions of equity over the last half-century and shows that a "control paradox" for courts has emerged. This Article argues that partial acquisitions may violate Section 7 of the Clayton Act, but because courts have failed to explain the economics of the unilateral effects theory of harm as applied to partial acquisitions, a new paradigm that will bring more clarity and certainty to partial acquisitions of non-controlling interests of firms is needed especially during this global financial crisis when there will be widespread merger activity. This new paradigm entails four novel requirements. First, as described in Part I, the new paradigm will require more precision about what role "control" has in merger review. Second, as detailed in Part II, the new paradigm will entail the strengthening of the "solely for investment" exception of Section 7. Third, Part III describes the necessity of further integration of efficiencies in partial acquisition analysis. Finally, the new paradigm will require an assessment of the implications of a two-stage approach to merger review of partial acquisitions with an *ex ante* phase and an *ex post* consummation phase, as outlined in Part IV.

I. THE CONTROL PARADOX: A CONFUSING DOCTRINAL ANTITRUST FRAMEWORK

UNLIKE perhaps any other time in history, the current global financial recession is forcing firms to change, which could have a variety of implications from an antitrust standpoint. Organizational and structural changes in the form of transactions like partial acquisitions are one aspect of firms' general attempts to lessen competition and thereby maximize profit. It is generally accepted that even partial acquisitions that confer a minority ownership stake can substantially lessen competition, whether or not they convey control or influence over the acquired firm in terms of, for example, voting rights or board of directors seats to the acquiring firm. The general theories on how this might occur are the following: First, the acquiring firm, even if its interest confers no control or influence over the acquired firm's decisions, gains a unilateral incentive to compete less vigorously with the acquired firm, because if the acquiring firm bests its target firm, it reduces the value of its investment in that firm.[1] Second, the target may have a parallel incentive to compete less vigorously with the acquirer, regardless of control, because directors of the acquired company may seek to avoid antagonizing the acquiring company.[2] Third, the acquisition may weaken the acquired firm's ability to compete by forcing organizational change, uncertainty about the future, and decreased organizational morale, which is particularly problematic in private equity partial acquisitions in which private equity acquirers may insist on cost reductions.[3]

From another theoretical standpoint, a partial ownership interest may substantially lessen competition and raise antitrust concerns in two broad scenarios: (1) where the ability of the acquiring firm, "A," to raise prices or decrease output due to its control or influence over the target firm, "B," is

1. 5 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 1203c, at 320 (2003).
2. *Id.* ¶ 1205e, at 318, 320. *Cf.* United States v. Pennzoil Co., 252 F. Supp. 962, 984 (W.D. Pa. 1965) ("[W]e cannot believe that where one corporation acquires the assets of another corporation and has absolute control over who shall be the officials of the acquired corporation, that human tendency will not constrain the acquiring corporation to favor retention of officials in the subsidiary corporation, who are most compliant and acquiescent to the wishes of those who control them.").
3. *See, e.g.*, F. & M. Schaefer Corp. v. C. Schmidt & Sons, Inc., 597 F.2d 814, 818 (2d Cir. 1979); *see also* AREEDA & HOVENKAMP, *supra* note 1, ¶1205e, at 318–19.

created or enhanced; or (2) where the partial acquisition changes the incentives of A to compete with B.[4]

This Article does not discuss in detail collusion or cooperation in the form of coordinated effects theories of harm relating to partial acquisitions. Indeed, unilateral effects theories of harm assume that A and B are not coordinating tacitly or expressly and are making decisions and setting their prices independently on the assumption, theorized by Cournot and Bertrand,[5] that a firm's pricing decision will have no effect on the prices charged by competitors.[6]

Ultimately, this section demonstrates that the cases prove nothing further than that the courts consider the ability to control or influence in a partial acquisition scenario as but one indicia in assessing whether competitive harm may (or did) occur.

A. The Firm's Motivation for Structural Change Is Profit Maximization

It is assumed for the purposes of this Article that a firm's fundamental motivation for structural change is profit maximization.[7] As Farrell and Shapiro have argued, current merger policy rests on the assumption that

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4. It is the second theory that the Sixth Circuit relies on in *United States v. Dairy Farmers of America*, 426 F.3d 850, 862 (6th Cir. 2005), by discussing the closely aligned interests of an acquirer and target to maximize profits via anticompetitive behavior, and describing how an acquirer, as the holder of nonvoting stock, could assert control or influence over the target as its financier. *See also* Complaint at 8–9, United States v. Univision Commc'ns. Inc., No. 1:03CV00758, 2003 WL 23781621 (D.D.C. Mar. 26, 2003); United States v. AT&T Corp., No. CIV.98 CV03170, 1999 WL 1211462, at *10 (D.D.C. Aug. 23, 1999); Clear Channel Commc'ns., 66 Fed. Reg. 12,544, at 12,561–62 (Feb. 27, 2001) (proposed final judgment and competitive impact statement).

5. This assumption of unilateral pricing decisions dates back to Cournot and Bertrand, but was not present in the 1982 and 1984 Merger Guidelines. This assumption was made explicit in the 1992 guidelines in horizontal merger cases. *See, e.g.*, ANTOINE AUGUSTIN COURNOT, RESEARCH INTO THE MATHEMATICAL PRINCIPLES OF THE THEORY OF WEALTH 80 (Nathaniel T. Bacon trans., The Macmillan Co. 1897) (1838); Joseph Louis Francois Bertrand, *Theorie Mathematique de la Richesse Sociale*, 67 JOURNAL DES SAVANTS 499 (1838) (Fr.). *See also* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 2.2 (1992) [hereinafter HORIZONTAL MERGER GUIDELINES]; Janusz A. Ordover & Robert D. Willig, *Economics and the 1992 Merger Guidelines: A Brief Survey*, 8 REV. OF INDUS. ORG. 139 (1993) (Neth.).

6. Daniel P. O'Brien & Steven C. Salop, *Competitive Effects of Partial Ownership: Financial Interest and Corporate Control*, 67 ANTITRUST L.J. 559, 568–69, 571–73, 575–76 (2000). *Cf.* David Gilo, *The Anticompetitive Effect of Passive Investment*, 99 MICH. L. REV. 1, 8–9 (2000).

7. *See* Ronald Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 390–95 (1937).

merging firms operate in this fashion.[8] The 2002 President's Council of Economic Advisers Report characterizes profit maximization as compelling firms to constantly minimize costs and maximize value.[9] Put simply, organizational structure will change when a firm finds that the relative costs of an internal transaction are greater than an external one, or vice versa.[10]

A firm may change its organizational structure by a variety of methods, including a full merger, a joint venture, or a partial acquisition. Indeed, as Smitherman argues, globalization provided more options for profit maximization than the Coase Theorem originally contemplated.[11] Any change in organizational structure may affect the parties' control, incentives, and information sharing, not to mention efficiency and social value created.[12] This Article considers the interlocking implications for merger review of control or influence, incentives, and efficiency in partial acquisition analysis.

B. "The Control Paradox": The Muddled Characteristics of Partial Acquisition Analysis

Partial acquisition permits a target's shareholders to maintain a continuing equity stake in the target itself or in a combined entity, consisting of a portion, but not all, of the acquirer.[13] In this scenario, the acquiring firm retains legal independence. By contrast, in a full merger of equals or stock-for-stock acquisition, a successor corporation is established or one hundred percent of shares in one of the corporations are consumed.[14]

The scope of section 7 of the Clayton Act, as expanded in 1950 and 1980, covers a broad category of asset acquisitions,[15] as it explicitly prohibits

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8. Joseph Farrell & Carl Shapiro, *Horizontal Mergers: Reply*, 81 AM. ECON. REV. 1007, 1007 (1991) (citing Joseph Farrell & Carl Shapiro, *Horizontal Mergers: An Equilibrium Analysis*, 80 AM. ECON. REV. 107, 107–126 (1990)).
9. Randall S. Kroszner et al., *Economic Organization and Competition Policy: President's Council of Economic Advisers*, 19 YALE J. ON REG. 541, 546 (2002) [hereinafter *PCEA Report*].
10. *See id.* at 541, 546–547.
11. Charles W. Smitherman III, *The Future of Global Competition Governance: Lessons from the Transatlantic*, 19 AM. U. INT'L L. REV. 769, 776 (2004).
12. *See PCEA Report*, *supra* note 9, at 547–548.
13. *See* 2 LOU R. KLING & EILEEN R. NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 22.02 (1992).
14. *See PCEA Report*, *supra* note 9, at 554.
15. Antitrust Procedural Improvements Act of 1980, Pub. L. No. 96-349, § 6(a), 94 Stat. 1154, 1157–58 (1980) (codified as amended at 15 U.S.C. § 18); An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes, of Dec. 29, 1950, Pub. L No. 81-899, 64 Stat. 1125, 1125–26 (1950) (codified as amended at 15 U.S.C. § 18). It is worth noting that challenges under Section 7 have frequently been

acquisitions of "the whole *or any part* of the stock or other share capital."[16] A survey of the case law evinces that Section 7 can apply to acquisitions of a part of the stock of another corporation, whether the acquisition is sufficient to control or influence the target or whether it appears to be a step toward such control.[17] However, the role control or influence plays in theories of harm continues to haunt partial acquisitions analysis. Agencies continue to emphasize their heightened interest in scrutiny of partial acquisitions,[18] while testing for control or steps toward control or toward total ownership in order to "arrest restraints of trade in their incipiency,"[19] and to predict whether there is a reasonable probability of substantial lessening of competition.

Agencies'[20] and courts' analyses of control and anti-competitiveness of partial acquisitions has been inconsistent, sometimes indicating that any control will suffice,[21] and sometimes indicating that no control is necessary.[22]

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accompanied by claims of violations of Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2 (2004). This Article only touches upon Section 1 and merely references the role of section 8.

16. Section 7 of the Clayton Act prohibits acquisitions of "the whole *or any part* of the stock or other share capital . . . of one or more persons engaged in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition, of such stock or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18 (2006) (emphasis added). *See also* 1 ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 329 (Jonathan M. Jacobson et al. eds., 6th ed. 2007) (citing McTamney v. Stolt Tankers & Terminals, 678 F. Supp. 118, 120 (E.D. Pa. 1987) (holding that even if stock ownership is not transferred, section 7 may apply where a firm has "achieved significant control over the decision making processes or the property of" another firm)).

17. *See* Denver & Rio Grande W. R.R. Co. v. United States, 387 U.S. 485, 501 (1967) (holding that a company need not acquire control of another company in order to violate the Clayton Act); United States v. E.I. duPont de Nemours Co., 353 U.S. 586, 592 (1957) ("[A]ny acquisition by one corporation of all or any part of the stock of another corporation . . . is within reach" of section 7); Gulf & W. Indus. Inc. v. Great Atl. & Pac. Tea Co., 476 F.2d 687, 694 (2d Cir. 1973) (stating the Second Circuit's finding that it is "not aware of any decision that requires numerical control in order to establish an antitrust violation"); *accord* Nat'l Supply Co. v. Hillman, 57 F. Supp. 4, 7 (W.D. Pa. 1944).

18. As far back as 2000, then-deputy assistant attorney general and acting assistant attorney general in the Antitrust Division of the U.S. Department of Justice, John M. Nannes pointed to the relationship between partial acquisition and control and the potential that this relationship would have an effect on competitive issues. John M. Nannes, Deputy Assistant Attorney Gen., U.S. Dep't of Justice, Last Year and This Year: The View from the Antitrust Trenches (Jan. 27, 2000).

19. Am. Crystal Sugar Co. v. Cuban-Am. Sugar Co., 152 F. Supp. 387, 395 (S.D.N.Y. 1957), *aff'd*, 259 F.2d 524 (2d Cir. 1958).

20. Many agency challenges focus on control aspects of partial ownership and resultant theories of harm including anticompetitive sensitive information sharing. *See, e.g.*, AT&T Corp., 65 Fed. Reg. 38,584, 38,590 (Dep't of Justice June 21, 2000) (proposed final

This is a challenging situation for parties to partial acquisitions. The courts have not crafted clear standards by which partial acquisitions are considered large enough to be anticompetitive threats;[23] although it is generally acknowledged that courts are wary of competitive concerns when a majority interest of stock is acquired.[24]

Further complicating the situation is the courts' failure to clarify what constitutes proper economic analysis[25] for the theoretical unilateral effects of

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judgment and competitive impact statement); Medtronic, Inc., 63 Fed. Reg. 53,919, 53,920 (Fed. Trade Comm'n Oct. 7, 1998) (analysis to aid public comment); Shell Oil Co., 62 Fed. Reg. 67,868, 67,869 (Fed. Trade Comm'n Dec. 30, 1997) (analysis to aid public comment); Time Warner, Inc., 61 Fed. Reg. 50,301, 50,309, 50,313 (Fed. Trade Comm'n Sept. 25, 1996) (proposed consent agreement with analysis to aid public comment); United States v. Gillette Co., No. 90-0053-TFH, 1990 WL 126485 (D.D.C. July 25, 1990) (final judgment); Gillette Co., 55 Fed. Reg. 12,567, 12,569–70 (Dep't of Justice Apr. 4, 1990) (proposed final judgment and competitive impact statement).

21. *See, e.g.*, E.I. duPont de Nemours Co., 353 U.S. at 592 ("[A]ny acquisition by one corporation of all or any part of the stock of another corporation . . . is within reach" of Section 7); Crane Co. v. Harsco Corp., 509 F. Supp. 115, 122 (D. Del. 1981) ("Section 7 prohibits acquisition by one corporation of part or all of another corporation's stock, 'where . . . the effect of such acquisition may be substantially to lessen competition.'") (quoting Clayton Act § 7, 15 U.S.C. § 18).
22. *See, e.g.*, Denver & Rio Grande W. R.R., 387 U.S. at 501; Gulf & W. Indus., 476 F.2d at 694; *accord* National Supply Co., 57 F. Supp. at 7.
23. Indeed, the Agencies have barely explained in their consent orders what factors may be critical in assessing the competitive theories of harm, besides discussing in general terms, concepts like incentives to compete after a partial acquisition. As Dubrow observes regarding the DOJ's Competitive Impact Statement for AT&T Corp., 64 Fed. Reg. 2506, 2511 (Dep't of Justice Jan. 14, 1999) (proposed final judgment and competitive impact statement in which the DOJ's theory of competitive harm was based on AT&T having a unilateral incentive, even without any control of Sprint PCS or information exchange between AT&T and Sprint PCS, to alter AT&T's competitive behavior), the Agencies' theory of harm often closely tracks some of the theories described by O'Brien and Salop. *See* Jon B. Dubrow, *Challenging the Economic Incentives Analysis of Competitive Effects in Acquisitions of Passive Minority Equity Interests*, 69 ANTITRUST L.J. 113, 120–21 (2001); O'Brien & Salop, *supra* note 6, at 573–76. According to the AT&T impact statement, "an acquisition can cause an individual firm, acting unilaterally, to raise its price more than it would have otherwise (or invest less in service quality than it would have otherwise) because its profit-maximizing price will be higher (or service quality lower) as a result of the acquisition . . . ." AT&T Corp., 64 Fed. Reg. at 2511.
24. *See* ANTITRUST LAW DEVELOPMENTS, *supra* note 16, at 329–30.
25. The term economic analysis here refers to econometrics or empirical techniques for predicting price effects. Many scholars in the antitrust literature call for increased use of econometrics analysis in differentiated-products cases. *See, e.g.*, Jerry A. Hausman & Gregory K. Leonard, *Economic Analysis of Differentiated Products Mergers Using Real World Data*, 5 GEO. MASON L. REV. 321, 343 (1997).

partial acquisitions.[26] Agencies have applied unilateral effects theory to private equity partial equity investments with no controlling interest, but it is unclear what effect private equity firms can have on companies' incentives to compete less aggressively.[27] This application is particularly perplexing given that some commentators have noted that the other private equity investors in the companies have no incentive to cause the respective company to compete less vigorously absent a side arrangement that should be prosecuted under Section 1 of the Sherman Act, not Section 7 of the Clayton Act.[28]

C. Conceptual Explanation of Unilateral Effects Theory: Control vs. Incentives

The unilateral effects theory becomes nebulous and subject to the "real-world" criticisms discussed in Part II of this Article in the theoretical assertion that "[e]ven if [firm] A's investment in [firm] B does not confer any control or information rights, A will take into account the effect of its decisions on B in order to maximize the sum of its own profits plus the return on its investment in B."[29]

In a theoretical perfectly competitive market, the acquiring firm in a partial acquisition will maximize profits by setting its prices equal to its

26. This is not to say that the unilateral effects analysis and the relationship with prices and output has not been shown on a theoretical empirical level, in fact, it has. *See, e.g.*, Robert J. Reynolds & Bruce R. Snapp, *The Competitive Effects of Partial Equity Interests and Joint Ventures*, 4 INT'L J. INDUS. ORG. 141, 142–48 (1986); *see also* Timothy F. Bresnahan & Steven C. Salop, *Quantifying the Competitive Effects of Production Joint Ventures*, 4 INT'L J. INDUS. ORG. 155, 158–59 (1986); O'Brien & Salop, *supra* note 6, at 571-80, 594-602. Salop & O'Brien distinguish between financial interest that affects the incentives of the acquiring firm, and corporate control that affects the incentives of the acquired firm. When this Article discusses control, it is discussing it in the context of both the acquirer and acquired firm's incentives. Salop & O'Brien's two distinguishing terms are useful in their analysis of their specific economic models only and do not serve a useful purpose in this Article.

27. *See, e.g.*, the Kinder Morgan buyout case, Complaint at 6–7, *In re* T.C. Group L.L.C., No. 061-0197, 2007 WL 293866 (Fed. Trade Comm'n Jan. 24, 2007) (analysis of proposed agreement containing consent order to aid public comment) *available at* http://www.ftc.gov/os/caselist/0610197/complaint.pdf.

28. *See e.g.*, Laura A. Wilkinson & Jeff L. White, *Private Equity: Antitrust Concerns With Partial Acquisitions*, 21 ANTITRUST 28, 29 (2007). The authors point out that this observation assumes that the other investors do not also hold an interest in the same competitors (or any other competitors). This may or may not be the case depending on the breadth of a private equity firm's holdings.

29. Hanno F. Kaiser, *Debt Investments in Competitors Under the Federal Antitrust Laws*, 9 FORDHAM J. CORP. & FIN. L. 605, 611 (2004).

marginal costs,[30] with or without control of the target. From an industrial organizational economics perspective, in an imperfectly competitive market a firm understands that, due to product differentiation,[31] it will lose profits and customers who substitute products when it increases prices. Knowing this, it must weigh the benefits from a price increase, e.g., a larger price-cost margin on all the customers that did not switch to rivals, against the loss from diversion of customers to other competitors to determine the net effects of its decision-making. The agencies, too, will consider this cost-benefit analysis in their "small but significant and non-transitory increase" in price test for market definition.[32]

Theoretically, the acquiring firm has an incentive after a total merger to raise prices, knowing that the customers who will be diverted are likely to go to its merging partner where the acquiring firm will be able to capture their purchases of substitute products.[33] On the other hand, in a partial acquisition the incentives are less clear because the acquiring firm may not control or influence the pricing and output decisions of the partially acquired firm. Arguably the incentives of the acquiring firm that neither controls nor influences any aspect of the target firm, in a "solely for investment" scenario, are the least clear because the acquiring firm would be taking more risk to raise prices unilaterally without having control over the target.

In a full merger, wherein an acquiring firm totally controls the target both firms, assuming they are competitors with differentiated products, are inextricably linked and their incentives are aligned. The acquired firm's price increases are likely to increase the profits of the acquiring firm. A post-merger equilibrium is said to occur.

But, what happens to incentives of the acquired firm in a partial acquisition scenario? In theory, while the acquiring firm may still have a financial interest in a price increase that makes sense according to its cost-benefit analysis, the acquired firm may have a sophisticated calculus to consider based on the degree of control the acquiring firm exerts on it. It is safe to assume that a firm has less of an incentive to raise prices as high as in

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30. This is assuming it is not strictly an investor with no product to price, such as a private equity investor.

31. "Products are homogenous when virtually all buyers regard them as identical. Products are differentiated when many buyers regard them as different even though the products perform the same essential function." 2 PHILLIP E. AREEDA, HERBERT HOVENKAMP & JOHN L. SOLOW, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 563a, at 267 (1994).

32. *See* HORIZONTAL MERGER GUIDELINES, *supra* note 5, at § 1.0.

33. *Id.* at § 2.2.

a total merger because of the same cost-benefit and diversion analysis.[34] However, as the foregoing case studies demonstrate, the most recent courts to consider the unilateral effects theory in partial acquisition cases where there was no control did not consider this careful diversion analysis or explain the economic theory behind its decision, leaving much to be desired in the way of clarification and real-world applicability.

1. *Case study: Dairy Farmers of America*

The unilateral effects theory may have been brewing for some time in the partial acquisitions literature, but it boiled over demonstrably in *United States* v. *Dairy Farmers of America*.[35] The DOJ had hinted at the unilateral effects theory where there was no control present in the earlier (October 1998) challenge to the proposed acquisition of Continental Airlines by Northwest Airlines. But the Northwest/Continental matter was settled without full

34. A succinct example of this diversion analysis is useful. Kaiser, *supra* note 29, at 612 ("A makes red widgets and B, A's closest competitor, makes blue widgets at constant marginal costs of $8/widget. At a price of $10, A and B sell 10 widgets each. If A were to raise the price for red widgets from $10 to $11, it would lose three customers to B and one customer would stop buying widgets (of any color) altogether. A's total profits would drop from $20 (10*$2) to $18 (6*$3). Now suppose that A first acquires 35% of B's stock and then increases the price for red widgets from $10 to $11. B gains $6 (3*$2), $2.10 of which belong to A ($6*0.35). A loses $2 from its own operations and gains $2.10 from its investment in B. Thus, A's total profits have increased from $20 to $20.10. The investment made the price increase profitable, and thus diminished A's incentive to compete with B at the margin.").

35. United States v. Dairy Farmers of Am., No. Civ.A. 03-206KSF, 2004 WL 2186215, at *6 (E.D. Ky. 2004). Critics may contest the notion that *Dairy Farmers* is a significant new development by citing several earlier partial acquisition cases where control was similarly brushed aside. However, most of these cases occurred nearly forty-years prior to this decision, when courts and enforcement agencies more often analyzed section 7 violations based primarily on whether the merger increased concentration. While the following cases all indicate that a showing of control may not be necessary to find that a partial acquisition substantially lessens competition, this author contends they each were decided prior to the rise in prominence of the unilateral effects theory in the early 1980s. In other words, these cases can be read to stop short of a unilateral effects theory, *per se*, in partial acquisition cases and it is not at all clear whether the courts in these cases would adopt the Sixth Circuit's reasoning premised on unilateral effects in a *Dairy Farmers* like scenario. On the other hand, even if *Dairy Farmers* is in no sense novel, it is the most modern example of partial acquisition analysis affirmatively dismissing control. *Cf.* Denver & Rio Grande W. R.R. Co. v. United States, 387 U.S. 485, 501 (1967); Gulf & W. Indus., Inc. v. Great Atl. & Pac. Tea Co., 476 F.2d 687, 694 (2d Cir. 1973); Am. Crystal Sugar Co. v. Cuban-Am. Sugar Co., 152 F. Supp. 387, 393 (S.D.N.Y. 1957), *aff'd*, 259 F.2d 524 (2nd Cir. 1958); Hamilton Watch Co. v. Benrus Watch Co., 114 F. Supp. 307, 317 (D. Conn. 1953), *aff'd,* 206 F.2d 738 (2nd Cir. 1953).

litigation of the unilateral effects theory.[36] *Dairy Farmers* also departed from the control-centric approach the DOJ took in *United States v. AT&T Corp.* (June 2000), wherein the DOJ sued to block the proposed partial acquisition by AT&T of MediaOne Group. In that case, the DOJ's competitive impact statement and proposed final judgment focused expressly on the acquiring firm's ability to raise prices or decrease output due to its control or influence over the partially acquired firm.[37] The FTC handled virtually the same issue in a similar manner focusing on control in the Time Warner Inc./Turner Broadcasting 1996 consent decree.[38]

(i). Discussion of Dairy Farmers: Incentives Irrespective of Control

As with other acquisitions subject to Section 7, the competitive implications of a partial acquisition may be analogous to a horizontal merger. The integrated five-step analytic process detailed in the 1992 *Merger Guidelines* helps the agencies determine whether to challenge a partial acquisition.[39] A full merger or majority acquisition presents a case where only one firm

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36. *See* Complaint at 4, United States v. Nw. Airlines Corp., No. 98-CV-74611-DT (E.D. Mich. Oct. 23, 1998), *available at* http://www.justice.gov/atr/cases/f2000/2023.pdf. The DOJ filed suit against Northwest Airlines and Continental Airlines challenging Northwest's partial acquisition. Northwest acquired approximately 14 percent equity interest and 51 percent voting interest in Continental. But when the case was settled after one day of trial, the court never ruled on the incentives theory.

37. *See* AT&T Corp., 65 Fed. Reg. 38,584, 38,588 (Dep't of Justice June 21, 2000) (proposed final judgment and competitive impact statement) (discussing AT&T's control of Excite@Home and its substantial influence or control of Road Runner as enabling AT&T to substantially increase its leverage in dealing with broadband content providers, allowing it to extract more favorable terms for such services and AT&T's resultant ability to use that control to affect the success of individual content providers in a way that would confer market power).

38. A case similar to the AT&T/MediaOne Group challenge was brought by the FTC. *See* Time Warner Inc., 61 Fed. Reg. 50,301, 50,304–05 (Fed. Trade Comm'n Sept. 25, 1996) (discussing the FTC clearing the deal with a consent decree that concerned itself with decision making control).

39. *See* HORIZONTAL MERGER GUIDELINES, *supra* note 5. These five steps are (1) defining and assessing the relevant market and the extent to which concentration would be increased by the proposed transaction; (2) assessing the potential adverse competitive effects of the partial acquisition through coordinated interaction and/or unilateral effects; (3) determining whether entry by additional firms into the market would work against these competitive concerns, and the timeliness, likelihood and sufficiency of entry; (4) whether the proposed partial acquisition would result in merger-specific efficiencies; and (5) the assessment of whether but for the partial acquisition either firm would be likely to fail causing assets to exit the marketplace. Note that inquiries (3), (4) and (5) are not as prominent, relative to (1) and (2), in the antitrust literature of partial acquisitions.

survives, and that single firm is analyzed to determine if it will have the power to injure consumers unilaterally and/or whether the acquisition will result in a more concentrated market structure conducive to coordinated interaction. Because in partial acquisition cases there remain, by contrast, two entities, the agencies have suggested that partial acquisitions may better resemble joint ventures than mergers.[40]

Of the few partial acquisitions that have been litigated, the focus has historically been on control, and control's influence on coordinated effects has more often been the theory of harm. Indeed, *Dairy Farmers* looked to be simply another case about control as it relates to coordinated effects, but the DOJ's complaint included a unilateral effects theory in addition to its coordinated effects theory.

The Dairy Farmers of America (DFA) was, at the time of the initial suit in 2003, the largest dairy farmer cooperative in the United States, and had since 2001 been a founding member and fifty percent owner of the voting rights of National Dairy Holdings, LP, the operator of a milk processing plant in Kentucky.[41] As a diversified cooperative, DFA was also an investor, along with a partner, Allen Family Limited Partnership (AFLP), in Southern Belle Dairy Co., LLC, another Kentucky milk processing plant. DFA eventually owned fifty percent of the equity in Southern Belle Dairy, but AFLP had operational control of Southern Belle Dairy. In the *original* agreement, DFA retained some managerial rights, such as control of approval rights for large expenditures, for a time, but by 2004, after the DOJ's complaint had been filed and before DFA filed a motion for summary judgment, DFA relinquished its voting and board representation rights in an *amended* agreement.

The DOJ suit claimed that DFA's investment in Southern Belle was in violation of Section 7. The DOJ sought divestiture, arguing that DFA's interests in National Dairy and Southern Belle would reduce competition in the sale of milk to Kentucky and Tennessee schools since National Dairy and Southern Belle were the only bidders for school milk contracts in forty-six school districts, and were two of only three bidders in fifty other districts.

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40. *See* FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS ¶ 3.34(c)–(d) (2000).

41. Plaintiff's Memorandum in Support of its Motion for Partial Summary Judgment on DFA's "Control" Affirmative Defense at 1, United States v. Dairy Farmers of Am., No. 6:03-206-KSF (E.D. Ky. July 2, 2004), *available at* http://www.justice.gov/atr/cases/f204500/204561.pdf; Joseph G. Krauss & Craig T. Cronheim, *Partial Acquisitions After* Dairy Farmers*: Got Answers?*, 20 ANTITRUST 49, 50 (2006).

(ii). The Economics of the Unilateral Effects Theory in Dairy Farmers was Not Explained

In *Dairy Farmers*, the *original* partial acquisition agreement was amended by DFA to strip DFA of any voting or board representation rights that might confer control. This meant the DOJ at the district court could not focus on control—a typical basis for coordinated effects—because DFA did not have any control.

While not denying that coordinated interaction such as communications between the dairies in the form of sensitive information sharing or managerial pressure from DFA not to compete could occur, the DOJ argued that "[by] giving the [DFA, National Dairy and Southern Belle] plenty of legitimate reasons to talk to one another, greater incentives for cooperating, and grounds for trusting each other more than independent firms in the marketplace," the partial acquisition made it probable that it would be easier for the firms to substantially lessen competition "either through tacit means[42] or otherwise."[43] The phrase "or otherwise" should be highlighted because it set the stage for the unilateral effects theory that the court would go on to imply.

According to the DOJ, DFA's principal defense was that it could not "control" either of the two dairies despite owning fifty percent common interest and all of the preferred interests in the two.[44] The DOJ refuted this argument, saying that it proves too much because "[i]f DFA were correct, the defense would permit the total consolidation of any industry under a single holding company, so long as the parent holds 'only' a 50% common equity interest in all the acquired companies (while still holding all the preferred

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42. It is likely that the nearly 13 year-old historical evidence of conspiracy that the DOJ complained of involving the "former owners" of the Southern Belle and Flav-O-Rich, the National Dairy brand, now under DFA control, had bearing on the outcome of the *Dairy Farmers* case. In the complaint, in its own section, the DOJ argued that "In late 1992, Southern Belle and Flav-O-Rich pled guilty to the felony of conspiring to raise the price of school milk . . . . The current acquisition recreates the effect of this conspiracy in many of those same school districts harmed by the conspiracy for over a decade." Complaint at 6, United States v. Dairy Farmers of Am., No. 6:03-206, 2003 WL 24087862 (E.D. Ky. Apr. 24, 2003).

43. United States v. Dairy Farmers of Am., No. Civ.A. 03-206KSF, 2004 WL 2186215 at *6 (E.D. Ky. 2004).

44. *See* Answer to Amended Complaint at 3, United States v. Dairy Farmers of Am., No. 6:03-206-KSF, 2004 WL 3364907 (E.D. Ky. May 14, 2004). This was DFA's second affirmative defense.

equity)."[45] The DOJ argued that DFA's "control" defense was irrelevant, because it failed to negate a reasonable probability of anticompetitive harm, as all three companies had an incentive to reduce competition. The DOJ's argument here relied on the so-called "incipiency" doctrine,[46] of Section 7, and observed that the market was especially concentrated and there had been a history of collusion between Southern Belle and National Dairy in the form of bid rigging.[47]

The District Court for the Eastern District of Kentucky considered the theories in light of the *amended* partial acquisition agreement that removed DFA's ability to control Southern Belle. After rejecting the *Philadelphia National Bank* presumption that acquisitions that significantly increase concentration in already concentrated markets are illegal absent a rebuttal, the court found that the partial acquisition did not "increase the percentage of the market that DFA 'controls' or even enhance DFA's ability to influence the market because DFA's non-voting interest in Southern Belle does not give it

45. *See* Plaintiff's Memorandum in Support of its Motion for Partial Summary Judgment on DFA's "Control" Affirmative Defense at 2, United States v. Dairy Farmers of Am., No. 6:03-206-KSF (E.D. Ky. July 2, 2004), *available at* http://www.justice.gov/atr/cases/f204500/204561.pdf.

46. The incipiency doctrine of Section 7 can be explained in the following manner, and this is the only usage assigned to it in this Article: Section 7 of the Clayton Act is intended to stop one company from purchasing all or part of a competitor's stock or assets where, in the words of the statute, the acquisition *may* substantially lessen competition. *See* 15 U.S.C. § 18. The so called "delphic language" of Section 7 "was designed to cope with monopolistic tendencies *in their incipiency* and well before they have attained such effects as would justify a Sherman Act proceeding." Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104, 124 (1986) (Stevens, J., dissenting) (quoting S. REP NO. 81-1775, at 4–5 (1950), *reprinted in* 1950 U.S.C.C.A.N. 4293, 4296) (emphasis added). Since Section 7 is predictive, the DOJ/FTC only must show that an anticompetitive effect "may" occur, not that it already has. *See, e.g.*, Fed. Trade Comm'n v. Proctor & Gamble Co., 386 U.S. 568, 577 (1967). Similarly, Section 7 only requires a showing that an acquisition "may" have a substantial anticompetitive effect, meaning that the DOJ or FTC must only show the possibility of anticompetitive effects; no certainty or high probability is required. *See, e.g.*, Fed. Trade Comm'n v. Elders Grain, Inc., 868 F.2d 901, 906 (7th Cir. 1989) (Posner, J.) ("[D]oubts are to be resolved against the transaction.") (citing United States v. Phila. Nat'l Bank, 374 U.S. 321, 362 (1963)); Proctor & Gamble Co., 386 U.S. at 577. *See also* Hosp. Corp. of Am. v. Fed. Trade Comm'n, 807 F.2d 1381, 1389 (7th Cir.1986) ("All that is necessary is that the merger create an appreciable danger of [higher prices] in the future. A predictive judgment, necessarily probabilistic and judgmental rather than demonstrable . . . is called for.").

47. *See* Plaintiff's Memorandum in Support of its Motion for Partial Summary Judgment on DFA's "Control" Affirmative Defense at 12, United States v. Dairy Farmers of Am., No. 6:03-206-KSF (E.D. Ky. July 2, 2004), *available at* http://www.justice.gov/atr/cases/f204500/204561.pdf.

any control over the business decisions made by Southern Belle."[48] Furthermore, the court reasoned that anticompetitive effects are "less likely when the company who has acquired stock in both subject companies does not have the ability to be at all involved in the decision-making that forms the basis of the alleged anticompetitive effects."[49] As support for this link in logic between lack of control and lack of ability to create anticompetitive effects, the district court relied on cases where the acquiring firms had been contractually prohibited in stockholder and shareholder agreements from exercising control over the partially acquired firms.[50] The district court could have cited other cases to prove the same point.[51]

The district court reasoned that, without operational control, the DOJ's theoretical incentives argument fell flat, and it granted DFA's motion for summary judgment. It denied the DOJ's unilateral effects theory at the district court, reasoning that "there must be some mechanism by which the alleged adverse effects in the sale of milk are likely to be brought about by DFA's acquisition of a non-operational interest in Southern Belle"[52] because "[e]very investor, however small, has an incentive to achieve higher profits and perhaps even to communicate with management on these issues . . . [b]ut this obvious point does not establish the probability of anticompetitive effects that would render the investment illegal under section 7."[53]

On appeal, the Sixth Circuit agreed with the district court that control or influence could be the device through which the acquiring company causes competitive harm, but declined to agree "that lack of control or influence precludes a Section 7 violation."[54] By considering the DOJ's claim with respect to the *original* partial acquisition agreement, not the *amended* agreement as the district court had, the Sixth Circuit found that the voting right that

48. United States v. Dairy Farmers of Am., No. Civ.A. 03-206KSF, 2004 WL 2186215 at *3 (E.D. Ky. 2004).

49. *Id.* at *4.

50. United States v. Tracinda Inv. Corp., 477 F. Supp. 1093, 1100–01 (C.D. Cal. 1979) (finding there was not even the "slightest intent" to control as evidenced by Stockholder's agreement when it found the partial acquisition not anti-competitive); United States v. Int'l Harvester Co., 564 F.2d 769, 777 (7th Cir. 1977) (noting that the parties had a clear understanding between the two corporations that Harvester had no intent nor was it to seek control of Steiger through the stock acquisition and that Harvester had not in fact obtained control).

51. *See, e.g.*, Anaconda Co. v. Crane Co., 411 F. Supp. 1210, 1218–19 (S.D.N.Y. 1975) (holding that the "solely for investment" exception sheltered a partial equity acquisition by a competitor).

52. Dairy Farmers of Am., 2004 WL 2186215 at *7.

53. *Id.* at *6.

54. United States v. Dairy Farmers of Am., 426 F.3d 850, 859 (6th Cir. 2005).

DFA retained for a time was the "mechanism" by which it could exercise control over Southern Belle; correspondingly, the acquisition, in light of increased market concentration, was presumptively illegal under *Philadelphia National Bank*.[55] Turning then to the *amended* agreement, the Sixth Circuit held that "a genuine issue of material fact exists as to whether there is a reasonable probability that the [amended] agreement would substantially lessen competition, through DFA's control or otherwise."[56] The "or otherwise" phrase then became the basis for the rest of the opinion.

(iii). Application of E.I du Pont de Nemours & Co. to Dairy Farmers

The Sixth Circuit went on to read *United States v. E.I. du Pont de Nemours & Co.* broadly as precedent for the standard that it adopted in its holding: "even without control or influence, an acquisition may still lessen competition."[57] The Sixth Circuit's expansive application of *du Pont* was justified because the facts in *du Pont* were dissimilar.

In *du Pont*, the Supreme Court found du Pont's twenty-three percent interest in General Motors violated Section 7 because du Pont had acquired the minority equity stake for the express purpose of setting itself up as General Motors primary supplier and because it had succeeded in doing just that through the control of voting rights on the board of directors.[58] On remand, the district court ordered that du Pont's voting rights be stripped and prohibited du Pont officers or directors from serving on General Motors' board.[59] The Supreme Court again heard the issue on appeal, and found that even stripping du Pont of its voting rights was not enough because divestiture would go to shareholders who had the same interests, broadly speaking, as the corporate entity du Pont itself, making it plausible that du Pont could through some clandestine means or the sale of stock to those who could obtain voting rights, still have some leverage with General Motors to substantially lessen competition.[60]

Inexplicably, the Sixth Circuit read this dissimilar vertical merger scenario in *du Pont* to imply that the district court in *Dairy Farmers* had "ignore[d] the possibility that there may be a mechanism that causes anticompetitive

55. *Id.* at 858 (citing United States v. Phila. Nat'l Bank, 374 U.S. 321, 363 (1963)).
56. *Id.* at 862.
57. *Id.* at 860.
58. United States v. E.I. duPont de Nemours Co., 353 U.S. 586, 606–07 (1957); Krauss & Cronheim, *supra* note 41, at 51.
59. United States v. E.I. du Pont du Nemours & Co., 177 F. Supp. 1, 51–52 (N.D. Ill. 1959).
60. United States v. E.I. du Pont du Nemours & Co., 366 U.S. 316, 328 (1961).

behavior other than control,"[61] namely, "closely aligned interests to maximize profits via anticompetitive behavior."[62]

Ultimately, the Sixth Circuit agreed with the DOJ view that what matters is the economic incentive of the parties to substantially lessen the competition between Southern Belle and National Dairy. On that point, the Sixth Circuit quoted from the DOJ's expert, that "[t]o think that the nature of the interaction between the two dairies will not change is naive, because that would be contrary to the economic incentive of all parties."[63]

But the Sixth Circuit stopped there, never expressly identifying what the "mechanism" is, in the absence of control, by which changed economic incentives could be actualized in an anticompetitive manner. Indeed, neither the DOJ nor the Sixth Circuit articulated a clear economic theory, real-world complications, or countervailing efficiencies—or identified the specific mechanism—by which the partial acquisition would lead to anti-competitive effects through aligned incentives.[64]

2. *Case Study: The Kinder Morgan Buyout and Private Equity Partial Acquisitions*

Only a short time after *Dairy Farmers* was first challenged by the DOJ, the FTC took up the "control paradox" of partial acquisitions in the private equity context. The $21.7 billion buyout of Kinder Morgan, Inc. in 2006, the same year ten of the fifteen largest buyouts in history up to that point occurred,[65] marked a watershed in agency enforcement action concerning private equity partial acquisitions. Never before had the FTC issued a consent order involving private equity partial acquisitions in two

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61. *See* United States v. Dairy Farmers of Am., 426 F.3d 850, 862 (6th Cir. 2005).
62. *Id.*
63. *Id.*
64. Indeed the Sixth Circuit made no reference to any one of a number of scholarly works on unilateral effects in partial acquisition cases. Thus, despite the scholars' arguments for the ability to economically model unilateral effects in partial acquisition cases it is unclear the sway these articles had on the court. *See generally* Wilson A. Alley, *Partial Ownership Arrangements and Collusion in the Automobile Industry*, 45 J. INDUS. ECON. 191 (1997) (discussing partial ownership and foreign trade in the Japanese and American automobile industries). For a discussion of the coordinated effects of passive equity investments among competitors, *see* Gilo, *supra* note 6, at 4–5 (2000). *See also* Reynolds & Snapp, *supra* note 26, at 142–8; David A. Malueg, *Collusive Behavior and Partial Ownership of Rivals*, 10 INT'L J. INDUS. ORG. 27 (Mar. 1992); A.E. Rodriguez, *Some Antitrust Concerns of Partial Equity Acquisitions*, 15 (Bureau of Econ. Fed Trade Comm'n Working Paper No. 186, 1991).
65. *See* White & Wilkinson, *supra* note 28, at 28.

competitors.[66] Here, the FTC, in pursuing its enforcement action, placed "control" squarely at issue in its unilateral effects and coordinated effects theories of harm and required that one of the private equity investors become a passive investor.[67] The "control paradox" was rearing its ugly head again.

Partial acquisitions regularly occur among competitors in a given industry as in *Dairy Farmers*, but as has long been the case, private equity companies utilize partial acquisition to achieve significant profits. Even if the aggregate value of private-equity acquisitions worldwide dips in 2008–2009, below the nearly $700 billion aggregate yearly value worldwide that it surged to in recent years, hundreds of billions of dollars will remain available in private equity funds.[68] Precisely because private equity does not suffer in the same way as other investment classes from the sub-prime crisis or illiquidity,[69] the fact that private equity may take a slight rest before heating up again presents an opportunity to analyze recent partial acquisition private equity antitrust concerns in light of the Sixth Circuit's interest in unilateral effects in *Dairy Farmers*.

One case on point is the management-led buyout of Kinder Morgan by its founder Richard Kinder and a group of private equity investors, including The Carlyle Group and Riverstone Holdings L.L.C.[70] At first glance, it did not raise competitive concerns. But, because Magellan Midstream Holdings L.P. and Kinder Morgan were competitors, and Carlyle/Riverstone Global Energy and Power Fund II, L.P. (a preexisting joint venture between The Carlyle Group and Riverstone Holdings L.L.C.) owned an interest in Magellan Midstream Holdings L.P., the FTC complained that the "transaction would substantially lessen competition in certain product markets . . . ."[71] The theory of harm appeared to be pursued on both coordinated effects and

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66. *Id.* at 31. Compare the FTC's challenge to Kohlberg Kravis Roberts & Co's acquisition of RJR Nabisco, Inc. in 1989. There, the FTC resolved antitrust concerns over KKR's majority control of both competitors by requiring divestiture of three product lines, which eliminated product overlap. *See* KKR Associates, 54 Fed. Reg. 7197, 7204 (Fed. Trade Comm'n Feb. 17, 1989) (proposed consent agreement with analysis to aid public comment).
67. *See* Analysis of Proposed Agreement at 2, 4–5, *In re* T.C. Group L.L.C., No. 061-0197, 2007 WL 293866 (Fed. Trade Comm'n Jan. 24, 2007) (analysis of proposed agreement containing consent order to aid public comment), *available at* http://www.ftc.gov/os/caselist/0610197/analysis.pdf.
68. Brad B. Erens & Mark G. Douglas, *Bidders Beware: Private Equity Club Deals Could Be Challenged in Bankruptcy*, 24 No. 11 BANKR. STRATEGIST 1 (Sept. 2007).
69. Thorold Barker, *On Wall St: Private Equity Could Discover a Silver Lining*, FIN. TIMES, Mar. 14, 2008.
70. Wilkinson & White, *supra* note 28, at 31.
71. *Id.* at 31. *See also* T.C. Group, *supra* note 27.

unilateral effects grounds as the proposed transaction would substantially lessen competition by: "(1) eliminating competition between Kinder Morgan and Magellan; (2) increasing the likelihood of, or facilitating, collusion or coordinated interaction between Kinder Morgan and Magellan; and (3) increasing the likelihood that Kinder Morgan or Magellan, or the combination thereof, would unilaterally exercise market power."[72]

Control or influence in the form of governance rights was the mechanism for these three anticompetitive effects, as the right to appoint persons to the board of directors of Kinder Morgan conferred access to sensitive information and veto power.[73] The FTC complaint noted that the partial acquisition of 11.3 percent of Kinder Morgan by Carlyle/Riverstone, jointly, and Carlyle separately, gave both Riverstone and Carlyle the right to appoint board members to Kinder Morgan. At the same time, Riverstone and Carlyle jointly held a fifty percent interest in the general partner of Magellan, and Riverstone could appoint two board members on a four-member board of managers of the Magellan general partner, thus retaining veto power and having access to non-public, competitively sensitive information about Magellan.[74] What the complaint failed to mention, however, was that the general partner in which Riverstone held a 50 percent interest had less than a two percent interest in Magellan Midstream Partners, LP, which had operational control of Magellan.[75]

Only by stripping Riverstone of its influence in the form of governance rights over Magellan was the FTC satisfied that the partial acquisition would prevent the parties from controlling or influencing the management or operations of Magellan.[76] The FTC ordered the creation of firewalls to prevent Riverstone's access to non-public information. Interestingly, however, the FTC allowed Carlyle and Riverstone to appoint one director to the board of Kinder Morgan; some commentators have seen this as an indication that the FTC does not believe that a partial acquisition that confers a minority presence on a board automatically gives rise to concerns about "control."[77]

72. Wilkinson & White, *supra* note 28, at 31.
73. *Id.*
74. *Id.*
75. *Id. See also* Magellan Midstream Holdings, L.P. (Form 10-K), at 1–2, 27–28 (Mar. 15, 2006).
76. *Id.* at 31.
77. *Id.* at 32.

Commentators[78] wonder whether private equity firms will be able to maintain managerial rights to qualify for the Venture Capital Operating Company (VCOC) exception under ERISA rules after the FTC's consent order in *Kinder Morgan*, if to do so would be to exert influence. *Kinder Morgan* suggests exerting control in the form of board of directors' influence may not always be permitted in similar partial acquisition scenarios.[79]

II. THE PASSIVE INVESTMENT EXCEPTION MUST BE STRENGTHENED TO UNTANGLE THE CONTROL PARADOX

While the Sixth Circuit and the DOJ in *Dairy Farmers* rejected "control or influence" as a threshold test in evaluating partial acquisitions, the FTC in *Kinder Morgan* placed "control or influence," in the form of board seats and governance rights, as a central consideration in its review. The Sixth Circuit in *Dairy Farmers* stopped short of setting forth a presumptive prohibition of non-controlling acquisitions, but did little to affirmatively clarify what role control plays, other than to imply that it is sometimes relevant and other times not. Intuitively, by affirming that section 7 "deal[s] with 'probabilities, not with certainties,'"[80] the Sixth Circuit created a situation wherein any transaction, including those "solely for investment" might be struck down if a plaintiff can show the transaction may vaguely align the interests or incentives of two competitors.[81]

This section argues that the weakening of the "solely for investment" exception by the agencies[82]—also known as the passive investment exception

78. *Id.* at 29.

79. *Id.* at 34 n.31 (claiming that appointing directors that meet the NYSE standards for independence may be a workable solution to this perceived tension).

80. United States v. Dairy Farmers of Am. 426 F.3d 850, 861 n.4 (6th Cir. 2005) (quoting Fed. Trade Comm'n v. Procter & Gamble Co., 386 U.S. 568, 577 (1967)).

81. *Cf.* Gilo, *supra* note 64, at 4 (arguing that " . . . even totally passive investment by a firm in its competitor (or by a firm's controller in the firm's competitor . . .) in an industry where only a few firms operate, may substantially lessen competition. The main reason, in a nutshell, is that such passive investment causes the investor to compete less vigorously with the firm in which the investment was made because such aggressive competition would lower the value of the investor's investment.").

82. This analysis proceeds in a normative way with respect to the Agencies, yet is aware that Dubrow argues that there appears to be a significant difference between the DOJ's and the FTC's treatment of partial equity interest transactions between competitors. The FTC, Dubrow notes, has shown, perhaps, more leniency in not finding partial equity transactions anticompetitive. *See* Dubrow, *supra* note 23, at 118. *See, e.g.*, Anaconda Co. v. Crane Co., 411 F. Supp. 1210, 1218–19 (S.D.N.Y. 1975) (finding that Crane had the requisite investment intent to qualify for the exemption, and discussing the Consent Order as sufficiently broad to prohibit any unilateral actions by Crane which may have the

in Section 7—has further obfuscated the role of control or influence in merger review. The argument of this section is that the best way to untangle the control paradox is to strengthen the contrast between the passive investment exception and partial acquisitions that do, in a verifiable manner, confer control.[83]

A. Why the Weakening of the Passive Investment Exception is Dangerous

The DOJ in *Dairy Farmers* reasoned that control is not necessary to show anti-competitive effects of a partial acquisition. In so doing, it effectively substantiated the prosecution of passive partial investments, that is, investments that confer no controlling interest, generally, or in the form of governance rights.[84] This is a dangerous substantiation.

It would be dangerous to allow the DOJ's reasoning in *Dairy Farmers* to perpetuate because it may be used to erode the "solely for investment" exemption generally, and especially in highly-concentrated markets where

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effect of lessening competition with Anaconda); United States v. Tracinda Inv. Corp., 477 F. Supp 1093, 1100–02 (C.D. Cal. 1979) (stating that there was not even the "slightest intent" to control as evidenced by Stockholder's agreement when it found the partial acquisition not anti-competitive).

83. While it has been suggested by some scholars that the case law is relatively inconclusive about what constitutes influence or control, the foremost indication of control over competitive decision-making is undoubtedly the nature of the acquiring firm's presence on the board of directors of the company and related governance rights. Related inquiries along this line are clearer and arguably more provable than the incentives analysis. For example, control is apparent when an acquiring firm can designate a disproportionate number of board seats. Control may be greater when an acquiring firm has five rather than two board seats. The so called NYSE status of the board seats is also relevant. If a majority of the board seats meet NYSE standards of independence then the anticompetitive dangers of control by the acquiring firm is diminished. Similarly, veto rights, unanimous, swing, or supermajority voting rights related to core competitive concerns such as budgeting can significantly determine whether the acquiring firm has control. *See, e.g.*, Analysis of Proposed Consent Order at ¶ K, Chevron Corp., No. C-4023, 2001 WL 1022080 (Fed. Trade Comm'n Sept. 7, 2001); Wilkinson & White, *supra* note 28, at 30.

84. *Cf.* Gilo, *supra* note 64, at 4. Gilo's concern that the passive investment exception has allowed passive investors in partial equity stakes to achieve anticompetitive effects is significantly neutralized by the court's reasoning in *Dairy Farmers.* Gilo's complaints that such partial acquisition passive investment cases as Time Warner, Inc., 61 Fed. Reg. 50,301 (Fed. Trade Comm'n Sept. 25, 1996) (proposed consent agreement) and Gillette Co., 55 Fed. Reg. 28,312 (Dep't of Justice July 10, 1990) (proposed final judgment) were free passes by the Agencies, are now moot, in an academic sense, if one considers the Agencies' aggressive pursuit of the unilateral effects theory in *Dairy Farmers*, which was essentially a passive investment situation.

there already may be a structural argument against the acquisition. While some courts[85] and commentators[86] have argued in favor of the DOJ's point of view in *Dairy Farmers*, it is problematic because it (1) further muddles the "control paradox" and (2) disregards the fact, as some scholars have argued,[87] that even in the absence of control, unilateral effects cannot always be *captured* by the acquiring firm and that unilateral incentives will not always be acted on due to reputational considerations or other real world factors.

The DOJ's reasoning in *Dairy Farmers* is also dubious because it perpetuates a universal application of the unilateral effects theory instead of a more limited application of the theory in cases where some control is evident. If instead of this universal application the agencies were to focus on control or influence, they would improve antitrust enforcement from a policy perspective by (1) recognizing the difficulties and uncertainties present in the unilateral effects theories of harm in analyzing non-controlling partial acquisitions, and (2) creating a heightened standard of the kind employed by courts in *Federal Trade Commission v. Arch Coal* and in *United States v. Oracle Corp.*[88] This standard does not deter or enjoin beneficial or at least harmless transactions, especially given that partial acquisitions may increase efficiency as discussed in Part III. The following subsections lay out this argument.

1. The Weakening of the Passive Investment Exception Further Muddles the Control Paradox

Generally speaking, passive investment can be defined as a situation in which the acquirer does not seek to gain control over the target's activities or obtain sensitive information.[89] Traditionally, Section 7 provides an exception

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85. *See, e.g.*, Golden Grain Macaroni Co., 78 F.T.C. 63, 172 (1971) ("[W]hen an acquisition will necessarily affect the competitive behavior of the two involved firms, it cannot be said that the *sole* purpose of the acquisition was for investment.").
86. *See* AREEDA & HOVENKAMP, *supra* note 1, ¶ 1204d, at 294 ("It would be hard to find that an acquisition that would otherwise be deemed anticompetitive was 'solely' for investment.").
87. *See* discussion *infra* Part II.A.2.
88. *See* Fed. Trade Comm'n v. Arch Coal, Inc., 329 F. Supp. 2d 109, 159–60 (D.D.C. 2004); United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1172 (N.D. Cal. 2004) (rejecting the DOJ's attempt to enjoin the merger of PeopleSoft and Oracle because the agency had failed to prove the precise mechanism by which unilateral effects could harm competition.); *cf.* United States v. Dairy Farmers of Am., 426 F.3d 850, 862 (6th Cir. 2005) (noting that the district court "ignore[d] the possibility that there may be a mechanism that causes anticompetitive behavior other than control" but not detailing what that mechanism is).
89. *See* Gilo, *supra* note 64, at 2 n.1.

for stock acquisitions made "solely for investment." To be clear, the Clayton Act reaches not only acquisitions of controlling interests but also acquisitions of part of the equity of another firm that confers no controlling interest.[90] However, if a passive investment in a competitor can give rise to anticompetitive concerns, as the court found in *Dairy Farmers*, then we are in danger of effectively eviscerating the "solely for investment" exception.[91]

2. The Unilateral Effects Theory of Harm As Applied to Passive Investment Disregards Real World Considerations: Capture and Reputational Effects

Aside from *Dairy Farmers*, which should have been considered a passive investment case because there was no control, prosecution of the passive investment exception by the agencies has typically occurred in the form of consent decrees rather than litigation where the theories of harm can be fully tested. Nevertheless, it is apparent from a survey of cases that this weakening of the passive investment exception, even after other courts have held it to be a safe harbor,[92] is premised on what is, at best, a vague incentives analysis. This vague incentives analysis is informed by Salop and O'Brien's economic model[93] for analyzing partial acquisitions.

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90. "This section shall not apply to persons purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition." 15 U.S.C. § 18a (2006). *See also* 16 C.F.R. § 802.9 (2005) (explaining passivity for purposes of reporting under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, but not useful for substantive application).

91. Dubrow, *supra* note 23, at 114–15.

92. The issue of whether the solely for investment-purposes-only language in section 7 exempts passive investments that are anticompetitive is not as debatable as some might expect. *See, e.g.*, United States v. Tracinda Inv. Corp., 477 F. Supp. 1093, 1099 (C.D. Cal. 1979) (citing the two-pronged specific language Congress deliberately chose to include in the investment exemption); Anaconda Co. v. Crane Co., 411 F. Supp. 1210 (S.D.N.Y. 1975) (holding that the "solely for investment" exception sheltered a partial equity acquisition by a competitor). It is notable that in *Crane*, the acquirer agreed that: (1) it would not acquire more than 22.6 percent of the common stock of the target; (2) it would not seek representation on the target's board; and (3) it would comply with section 7 and would not vote its shares "to bring about or attempt to bring about a substantial lessening of competition in any line of commerce . . . ." *Id.* at 1217.

93. *See* Dubrow, *supra* note 23, at 114, 126. *Cf.* O'Brien & Salop, *supra* note 6, at 595–602 (describing two economic models that could be used to predict the potential for anticompetitive unilateral effects that may result from holding a partial equity stake in a competitor). Salop & O'Brien's two models that attempt to quantify the incentive effect based on data collected during a Hart-Scott-Rodino pre-merger review are: (1) Modified Herfindahl-Hirschman Index (MHHI) which is essentially the HHI methodology applied to a partial ownership interest scenario; and, (2) Price Pressure Index (PPI) which is used to analyze unilateral effects in differentiated products markets and is dependant on

Although the model provides a theory that informs the Agencies' prosecution of cases like *Dairy Farmers*, scholars have criticized Salop and O'Brien's attempt at modeling the unilateral effects of partial acquisitions. The most salient criticism is Dubrow's.[94] Dubrow contends that Salop and O'Brien's model is overly abstract and therefore ignores critical "real-world" factors that bear on unilateral effects in partial acquisition cases, such as (1) incomplete information provision by the managers of the acquiring firm, (2) the personal financial incentives of the managers of the acquiring firm, and (3) the inability of the acquiring firm to capture the benefits of its investment.[95] These "real-world" factors eliminate the assumption, according to Dubrow, that an acquiring firm will act on incentives to reduce its competitive intensity following the acquisition of a passive partial financial interest.[96]

In a reply[97] to Dubrow's three-point critique of their model, Salop and O'Brien quibble with the notion that (1) managers of the acquiring firm will have incomplete information that will change incentives, and (2) that the personal financial incentives of the managers of the acquiring firm will not give them an incentive to act in an anticompetitive manner. However, they admit the validity of Dubrow's third criticism.[98]

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diversion ratios, margins earned by the firms and financial interest share for each of the merging firms. The PPI measure aspires to incorporate merger-specific efficiencies. These Salop & O'Brien models have been used in arguing before the agencies. *See* Stanley M. Besen et al., *Vertical and Horizontal Ownership in Cable TV: Time Warner-Turner*, *in* THE ANTITRUST REVOLUTION 452, 466–68 (John Kwoka Jr. & Lawrence J. White eds., Oxford University Press 3d ed. 1999) (where the author observes that economic consultants in the Time Warner/Turner transaction utilized Salop & O'Brien's MHHI analysis). *See generally* Daniel P. O'Brien & Steven C. Salop, *The Competitive Effects of Passive Minority Equity Interests: Reply*, 69 ANTITRUST L.J. 611 (2001) (responding to Dubrow's criticism (*supra* note 23) of their earlier article (*supra* note 6)).

94. *See* Dubrow *supra* note 23, at 114, 126–37.

95. *Id.* at 133–37.

96. Notice this argument about real world factors directly contravenes the argument that passive investment always affects incentives put forth by Gilo. *Cf.* Gilo, *supra* note 64 at 4–4–5 (discussing the notion that there is no doubt that at the theoretical level passive investment in a market where there are only a few firms and they are investing in each other passively, even without tacit collusion, passive investment may have an anticompetitive effect on prices and output). This theoretical result has been demonstrated using economic models. *See, e.g.*, Reynolds & Snapp, *supra* note 26, at 143–48; *see also* Bresnahan & Salop, *supra* note 26, at 158–59; O'Brien & Salop, *supra* note 6.

97. Daniel P. O'Brien & Steven C. Salop, *The Competitive Effects of Passive Minority Equity Interests: Reply*, 69 ANTITRUST L.J. 611, 615–620 (2001).

98. *Id.* at 616, 620–22.

This surprising consensus between Salop and O'Brien and their critic Dubrow on the third criticism about *capture* weakens the unilateral effects theory regarding changed incentives as the basis of unilateral effects in of non-controlling partial acquisitions, implied especially in *Dairy Farmers*, because it evinces the shaky relationship between theoretical incentives and how those incentives could be *captured* in order to harm competition in practice.[99] This is true even if those incentives do have an anticompetitive effect on pricing and output.[100]

Opponents would counter that if a unilateral effect cannot be *captured*, a firm making a partial acquisition will still act to produce unilateral effects, believing (perhaps mistakenly) that it will be able to achieve capture. To this counterargument, one can reply that certainly most firms in the real world, no matter how unique, weigh the effect upon the firm's reputation of acting on incentives to produce anticompetitive unilateral effects.

Firms' considerations as to their reputation would seem to favor not acting unilaterally. As an example, consider a scenario where a cross-shareholding private equity investor is balancing whether to veto an expansion in the target (Firm A's) product line that other members of the board or shareholders are in favor of pursuing, but which will hurt the private equity investor's position in Firm B.[101] In this example, it is certainly conceivable that the partial equity investor will refrain from vetoing A's expansion, even if vetoing would benefit the investor's other investment in B, because it wants to avoid losing its reputation for integrity.

Such intangible real-world tradeoffs suggest that unilateral effects are not always pursued, even though a partial acquirer may have an incentive to act in a way concerning A that benefits it as a cross-owner of B. Real-world considerations such as capture and reputation cannot be underestimated. Yet, these critical considerations were never discussed by the court or agency in *Dairy Farmers* or *Kinder Morgan*.

B. A New Burden of Proof Can Create a More Precise Role for Control

It is critical not to overstate the danger of the weakening of the passive investment exception. Although, most, if not all, partial acquisitions that have

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99. *See* Gilo, *supra* note 64, at 4–4–5. If Gilo is read as a theoretical study of passive investments and incentives then this can be seen as squarely confronting Gilo's argument. Dubrow published his article one year after Gilo and presumably had Gilo's theoretical argument in mind.

100. *Id.*

101. Wilkinson & White, *supra* note 28, at 33.

been held to be illegal under Section 7 were above fifteen percent of holdings,[102] the weakening of the passive investment exception subjects parties to a partial acquisition to considerable uncertainty about whether their acquisition will be challenged.[103] A critical step must, therefore, be taken to modify the standard of proof in partial acquisition cases.

The following paragraphs attempt to briefly recommend how the role of control in partial acquisition cases could be made more precise.[104]

1. A New Burden of Proof: (i) Define "Solely for Investment" as the Absence of Control and (ii) Eliminate the Incipiency Doctrine in Non-controlling Partial Acquisition Cases

The burden of proof in non-controlling partial acquisitions should be modified to reflect the considerable uncertainties and difficulties of predicting unilateral effects in the future. To accomplish this recommendation, the burden of proof in non-controlling partial acquisitions, like *Dairy Farmers*, should reflect not a Section 7 incipiency standard, but the "solely for investment" burden of proof.

Typically, with regard to the burden of proof in passive investment cases, courts have read the passive investment exception in two parts.[105] First, the defendant must show that it made the stock acquisition solely for "investment," which is a term not defined in the statute.[106] Second, assuming this is shown, the plaintiff then must carry the burden of showing that the

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102. *See, e.g.*, Denver & Rio Grande W. R.R. v. United States, 387 U.S. 485, 504 (1967) (20 percent interest); United States v. E.I. duPont de Nemours & Co., 353 U.S. 586, 602–03, 607 (1957) (stating that 23 percent stock acquisition violates section 7 where acquirer had gained influence over the target, a customer, and was receiving information from the target); F. & M. Schaefer Corp. v. C. Schmidt & Sons, Inc., 597 F.2d 814, 818 (2d. Cir. 1979) (finding that an acquisition of 29 percent of a competitor's stock was a violation of section 7 since acquirer could name directors and have access to company information, among other controls); Briggs Mfg. Co. v. Crane Co., 185 F. Supp. 177, 181–82, 184 (E.D. Mich. 1960) (stating that section 7 includes within its scope a percentage interest sufficient to elect nominees to the board of directors who could influence the competitive decisions of the target and divulge information to the acquirer).

103. *See PCEA Report*, *supra* note 9, at 554 (indicating that as far back as the year 2000, 23 percent of transactions reported to U.S. regulators involved the purchase of less than 50 percent equity stakes, that is to say partial acquisitions).

104. This analysis assumes *arguendo* that there is not a coordinated effects argument against the partial acquisition, whether it be passive or controlling partial acquisition. The case of collusion in partial acquisition cases is beyond the scope of this Article. *Cf.* Gilo, *supra* note 64 at 4–5.

105. For discussion of this burden of proof, see for example, O'Brien & Salop, *supra* note 6, at 566.

106. 15 U.S.C. § 18 (2006).

partial acquisition *is* being used to bring about or attempt to bring about a substantial lessening of competition.[107]

(i). *A More Specific Definition of Control*

With regard to the first element of the burden of proof, the statutory construction of the passive investment exception from Section 7 turns on how courts read "investment" in the "solely for investment" phrase. This is problematic in the absence of clear parameters defining what "solely for investment" means in partial acquisition cases: does it mean non-controlling partial acquisitions? The court in *Dairy Farmers* certainly did not see it that way. But what else could a passive investment be but a non-controlling investment?

Some commentators[108] have noted that "investment" could be defined with respect to the Hart-Scott-Rodino Act (HSR)[109] and its implementation regulating provisions adopted by the FTC.[110] The FTC's 1978 Statement of Basis and Purpose reflecting the HSR implementation regulations provides six enumerated factors to define what role control would have in the competitive analysis of partial acquisitions.[111] If any of these six factors are present then the partial acquisition is *not* "solely for investment," and should be analyzed as a partial acquisition capable of conferring control or influence on competitive decision making.[112]

The HSR implementing regulation provides that acquisitions are made "solely for purposes of investment" when the acquirer has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.[113] The FTC's 1978 Statement of Basis and Purpose enumerated six factors that could be considered inconsistent with the solely for investment purpose:

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107. *See, e.g.*, United States v. Tracinda Inv. Corp., 477 F. Supp. 1093, 1098 (C.D. Cal. 1979); Anaconda Co. v. Crane Co., 411 F. Supp. 1210, 1219 (S.D.N.Y. 1975).
108. *See, e.g.*, O'Brien & Salop, *supra* note 6, at 566–67.
109. 15 U.S.C. § 18a (2006). Even though courts have not relied on the HSR Act in this respect, it is a Congressional proclamation that there are not antitrust concerns with respect to reporting requirements of partial acquisitions, when the securities acquired or held do not exceed 10 percent of the outstanding voting securities of the issuer.
110. Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33,450, 33,465 (Fed. Trade Comm'n July 31, 1978).
111. *Id.*
112. *Id.*
113. O'Brien & Salop, *supra* note 6, at 566–67 (citing 16 C.F.R. § 801(1)(i)).

> (1) nominating a candidate for the board of directors of the issuer; (2) proposing corporate actions requiring shareholder approval; (3) soliciting proxies; (4) having a controlling shareholder, director, officer or employee simultaneously serving as an officer or director of the issuer; (5) being a competitor of the issuer; or (6) doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer.[114]

Under these guideposts, control is integrated in the anticompetitive analysis.

Thus, language already exists that defines the concept of control; the Agencies should incorporate it into their analysis of partial acquisitions because it reflects Congressional affirmation of what antitrust concerns are present in partial acquisitions.

Returning the emphasis to something like these six enumerated factors would not be a sea change in terms of how to consider control in partial acquisition cases. Prior to *Dairy Farmers* and *Kinder Morgan*, courts often considered the absence of control due to a consent order[115] or a shareholder's agreement,[116] as permitting the passive investment exception to survive. This evinces the critical role that precisely-defined control can and should play. These cases are precedents for the rule that when there can be no control it is *obvious* that the investment is benign from an anticompetitive standpoint.

(ii). *Eliminate Incipiency Doctrine for Non-controlling Partial Acquisitions*

With regard to the second element of the burden of proof, to adopt the passive investment burden of proof for non-controlling partial acquisitions would be a departure from the way courts have typically considered partial acquisition cases under Section 7. Some courts have noted that that the present-tense language of the passive investment exception ("to bring about") differs from the incipiency language of Section 7's general prohibition ("may be substantially to lessen competition"). Under this formulation, partial

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114. Premerger Notification, *supra* note 110, at 33,465.

115. *See, e.g.*, Anaconda Co. v. Crane Co., 411 F. Supp. 1210, 1218–19 (S.D.N.Y. 1975) (allowing Crane's reliance upon the investment-only exemption, finding that Crane had the requisite investment intent to qualify for the exemption, and discussing the Consent Order as sufficiently broad to prohibit any unilateral actions by Crane which may have the effect of lessening competition with Anaconda).

116. *See, e.g.*, United States v. Tracinda Inv. Corp., 477 F. Supp. 1093, 1100 (C.D. Cal 1979) (finding there was not even the "slightest intent" to control as evidenced by Stockholder's agreement when the court found the partial acquisition not anti-competitive).

acquisitions that confer no controlling interest would require a factual determination of whether the stock ownership *is* being used to lessen competition. This would be a significant clarification because it would require courts to find an economic proof for the anticompetitive effects of a partial acquisition that exist presently, not vaguely in the future; this was a type of proof that the court in *Dairy Farmers* did not require.

Or, as a counterargument for critics who would find this change shocking, an alternative to eliminating the incipiency doctrine would be to subject non-controlling partial acquisitions to a two-phase approach with an *ex ante* review and an *ex post* consummation review. The *ex ante* review would merely be to determine if a partial acquisition conferred control, and if it did then the established theories of harm could be argued, and hopefully economic proof would be shown for theories like unilateral effects. On the other hand, if no control was shown in the *ex ante* phase, the non-controlling acquisition would be guaranteed approval as "solely for investment," subject to an *ex post* consummation review by the agencies of whether anticompetitive effects which were so vague in the pre-consummation phase had materialized and were measurable *ex post*. The implications of this two-phase approach are discussed fully in Part IV.

III. THE OVERLOOKED EFFICIENCIES IN PARTIAL ACQUISITION CASES

A. Why Consider Efficiencies?

What does control have to do with efficiencies? Areeda and Hovenkamp assumed that there may be few, if any, efficiencies created by partial acquisitions without the integration of control.[117] In other words, a partial acquisition that does not lead to any control creates no efficiencies.[118] There was no evidence that the Sixth Circuit in *Dairy Farmers* or the DOJ seriously evaluated efficiencies.

Yet, having explored the role control might play in the analysis, the next Section argues for the recognition of efficiencies in partial acquisitions, in non-controlling and controlling scenarios that perhaps Areeda and Hovenkamp never envisioned[119] and which may be significant and specific

117. *See* AREEDA & HOVENKAMP, *supra* note 1, ¶ 1203d, at 283.
118. Letter from Herbert Hovenkamp to the author (March 25, 2008) (on file with author).
119. Areeda & Hovenkamp may have just been thinking of efficiencies in terms of reductions in fixed and marginal costs such as combining complementary assets, eliminating duplicate activities or working towards scale economies. *See, e.g.*, HORIZONTAL MERGER GUIDELINES, *supra* note 5, at § 3.0.

enough to convince a court of the countervailing efficiencies defense. This section takes a realist perspective and argues that if the definition of control remains flexible, as evidenced by the rationale used by the Sixth Circuit in *Dairy Farmers*, in order to be fair to partial acquirers who obtain no control, there should be more consideration given to countervailing efficiencies.

As merger review continues to mature and organizational change takes place, not only through total mergers but also partial acquisitions and joint ventures, it is critical for agencies to integrate efficiencies into their review analysis. As the President's Council of Economic Advisors stated:

> The challenge for antitrust scholarship and public policy is to provide an integrated framework for all these organizational innovations [such as partial acquisitions and joint ventures] that properly accounts for both competitive and efficiency effects. These types of transactions evoke intertwined issues in corporate governance and competition policy, and so an integrated framework supports sound policymaking . . . . Even ascertaining that the acquirer will gain control need not imply that the [partial acquisition] transaction would be anticompetitive; as in merger policy, that depends upon the market environment and on the efficiencies that the [partial acquisition] transaction would create.[120]

Ultimately, the objective of competition policy is to "protect competition as the most appropriate means of ensuring the efficient allocation of resources—and thus efficient market outcomes—in free market economies."[121] Thus, this Article proceeds with the policy goal shared by some scholars[122] that efficiency, not just competition, is a final goal of the antitrust laws.

B. The Legal Framework for Evaluating Efficiencies Under Section 7

Courts have held that the rule of reason clearly permits an efficiencies justification.[123] But, to rebut an alleged violation of Section 7, defendants have argued, generally without success,[124] that their acquisition should be

120. *See PCEA Report*, *supra* note 9, at 566.
121. Org. for Econ. Co-operation and Dev., *Competition Policy and Efficiency Claims in Horizontal Agreements*, OECD/GD (96) 65, 5, Paris 1996.
122. *See, e.g.*, Andrew Dick and William J. Kolasky, *The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers*, 71 ANTITRUST L.J. 207, 207 (2003).

permissible, despite competitive harm, because the acquisition created competitive efficiencies overall. The Supreme Court has instructed "that a merger the effect of which 'may be substantially to lessen competition' is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial."[125]

Yet there may be efficiencies arguments to consider in partial acquisition cases. It does not seem implausible that an efficiencies defense may succeed if a defendant can (1) prove that the efficiencies cannot be achieved through other means that are not as competitively harmful as a partial acquisition,[126] and (2) do so by clear and convincing evidence,[127] that is not self-serving.[128]

Such potential is indicated by a trend towards integration of efficiencies analysis into merger review[129] and the narrow opening that the D.C. Circuit created in *FTC v. H.J. Heinz Co.*[130] for novel efficiencies defenses, such as,

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123. *See, e.g.*, Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85,113–14 (1984); Cal. Dental Ass'n, 121 F.T.C. 190, 297-98 (1996).

124. *See, e.g.*, United States v. Nw. Airlines Corp., No. 98-CV-74611,1999 WL 34973961, at *4–5 (E.D. Mich. 1999) (noting where Northwest Airlines in the partial acquisition case argued for efficiencies but lost, because, *inter alia*, Northwest could not prove that holding the Continental stock, with its attendant harm, was necessary to attain any of the purported alliance benefits).

125. United States v. Phila. Nat'l Bank, 374 U.S. 321, 371 (1963).

126. *See, e.g.*, Fed. Trade Comm'n v. Univ. Health, Inc., 938 F.2d 1206, 1222–23 n.30 (11th Cir. 1991) (indicating that courts should require "proof that the efficiencies to be gained by the acquisition cannot be secured by means that inflict less damage to competition"); Fed. Trade Comm'n v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 61–62 (D.D.C. 1998) ("efficiencies, no matter how great, should not be considered if they could also be accomplished without a merger"); Fed. Trade Comm'n v. Staples, Inc., 970 F. Supp. 1066, 1088–89 (D.D.C. 1997) (holding that cost savings must be specific to the combination of the merging parties).

127. Univ. Health, 938 F.2d at 1223 (holding the defendant is responsible for proving the efficiencies); Staples, 970 F. Supp. at 1089 (holding that it is the defendant who bears the burden of proof with regard to efficiencies). *Cf.* HORIZONTAL MERGER GUIDELINES, *supra* note 5, at § 4 ("merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firms' ability and incentives to compete, and why each would be merger-specific.").

128. Univ. Health, 938 F.2d at 1223 (noting that defendant cannot carry its burden of proof with regard to efficiencies "based solely on speculative, self-serving assertions").

129. *See e.g.* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N., REVISION TO SECTION 4 OF HORIZONTAL MERGER GUIDELINES, *reprinted in* 72 Antitrust & Trade Reg. Rep. (BNA) 359 (Apr. 10, 1997) [hereinafter 1997 Revisions]. *See generally* Dick, *supra* note 122, at 207–251.

130. Fed.Trade Comm'n v. H.J. Heinz Co., 246 F.3d 708, 720–22 (D.C. Cir. 2001) (denying the efficiencies defense due to high concentration levels and insufficient showing that the

perhaps, an efficiencies defense in a partial acquisition. The Supreme Court has not revisited the role of efficiencies in defense of acquisitions since the Court's early decisions in *Brown Shoe*, *Philadelphia National Bank*, and *Procter & Gamble.*[131] However, a number of Courts of Appeals, including the Eleventh, Eighth, Sixth, and D.C. Circuits, have shown a willingness to consider an efficiency defense to a prima facie case of anti-competitiveness.[132]

While most district courts that have accepted an efficiencies defense have been in the hospital merger arena,[133] one case stands out: *United States v. Country Lakes Foods, Inc.*[134] In this merger of two dairies, an efficiencies defense prevailed. The DOJ lost because the court found that "the efficiencies that would result from an increased volume of production due to the merger would enable the merged firm 'to compete directly with the market leader' and thereby 'enhance competition.'"[135]

Country Lakes Foods suggests that although no court has yet considered a successful efficiencies defense in a partial acquisition case, the future integration of efficiencies is not precluded. A realistic approach assumes that better arguments can be made than were made in the cases where courts rejected the efficiencies defense.[136] Indeed, cases abroad have actually taken efficiencies into account as a positive factor in merger review.[137]

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merger was the only way to benefit from the efficiencies or that the efficiencies were "extraordinary").

131. United States v. Phila. Nat'l Bank, 374 U.S. 321 (1963); Brown Shoe Co. v. United States, 370 U.S. 294 (1962); United States v. Proctor & Gamble Co. 356 U.S. 677 (1958). *Cf.* Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104, 115, 117, 122 (1986) (discussing efficiencies but not as a defense to an otherwise anticompetitive merger).

132. There are numerous examples of Courts of Appeals that have shown willingness to not only hear evidence of efficiencies but allow them to rebut a prima facie case of anti-competitiveness. *See, e.g.*, Univ. Health, Inc. 938 F.2d at 1222 (holding that ". . . [I]n certain circumstances, a defendant may rebut the government's prima facie case with evidence showing that the intended merger would create significant efficiencies in the relevant market"); Fed. Trade Comm'n v. Butterworth Health Corp., 121 F.3d 708 (6th Cir. 1997); United States v. Rockford Mem'l Corp., 898 F.2d 1278, 1283–84 (7th Cir. 1990); Fed. Trade Comm'n v. Tenet Health Care Corp., 186 F.3d 1045, 1054 (8th Cir. 1999); Fed. Trade Comm'n v. H.J. Heinz Co., 246 F.3d 708, 720 (D.C. Cir. 2001).

133. For a hospital merger case relating to efficiencies see, for example, United States v. Long Island Jewish Med. Ctr., 983 F. Supp. 121, 147–48 (E.D.N.Y. 1997).

134. United States v. Country Lake Foods, 754 F. Supp. 669, 680 (D. Minn. 1990).

135. Dick, *supra* note 122, at 235, citing *Country Lake Foods*, 754 F. Supp. at 680.

136. A discussion of the progress of the efficiency defenses is helpful. *See, e.g.*, David Balto, *The Efficiency Defense in Merger Review: Progress or Stagnation*, 16 ANTITRUST 74, 74 (2001).

137. Council Regulation 139/2004, On the Control of Concentrations Between Undertakings (the EC Merger Regulation), 2004 O.J. (L 24) 1, 4 (EC).

The 1997 revisions to the Merger Guidelines on efficiencies explained that the mechanism by which efficiencies could increase firms' competitiveness was by "increasing their incentive and ability to compete." The Revised Guidelines critically defined "cognizable" efficiencies as those efficiencies that would be eligible for consideration.[138] Cognizable efficiencies are defined by three characteristics:[139] they (1) are merger-specific;[140] (2) have been verified by reasonable means and are not vague and speculative; and (3) do not arise from anticompetitive reductions in output or service.[141]

Having mentioned these caveats and considerations, the following are specific potential efficiencies that should be considered in partial acquisition cases, assuming the above criteria are shown.

1. *Argument for Efficiencies in Partial Acquisitions Conferring Controlling Interests*

Even if it is true that the control an acquirer may exercise over a target may indeed increase the acquirer's incentive to make certain relationship-specific investments,[142] from a policy standpoint of promoting organizational efficiencies, this may not be anticompetitive. In fact, the acquirer's control may be the mechanism that facilitates competition by making it "less likely the target will later 'hold up' the acquirer, and deprive it of its appropriate return on its investment."[143] Control in another sense, even if the result only of a partial acquisition, may reduce costs internally of the parties who in the absence of control might be tempted to, for example, litigate written agreements, dispute business arrangements,[144] or otherwise waste resources

138. 1997 Revisions, s*upra* note 129, at § 4.
139. *Id.*
140. Merger specific efficiencies are efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. *See id.*
141. The revision does not elaborate what the guidelines means by the statement "do not arise from anticompetitive reductions in output or service." *Id.* Some scholars have suggested this provision is meant to focus merger review on "changes that improve, not degrade, allocative efficiency." *See* Dick, *supra* note 122, at 228.
142. *See PCEA Report*, *supra* note 9 at 572 ("Relationship-specific investments are those that, once made, are much more valuable inside a particular business relationship than outside it, such as fabrication equipment that is specialized to a particular customer's design.").
143. *Id.*
144. *Id.* at 572 n.85. (citing Oliver E. Williamson, MARKETS AND HIERARCHIES: A STUDY IN THE ECONOMICS OF INTERNAL ORGANIZATION (Wheatsheaf Books 1986) (1975)); Benjamin Klein, Robert G. Crawford & Armen Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297 (1978); Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and*

that may be then passed on in the form of added costs to consumers. On the other hand, control may lead to improper influencing of decision-makers. At any rate, the influence costs of an acquirer seeking to lobby decision-makers of the target will be affected by market forces, which will "lead firms to choose the arrangement that minimizes their total costs."[145]

Another mechanism by which efficiency can result from a controlling partial acquisition is the action of internalizing side effects of partial acquisitions.[146] For example, assume two firms sell products regarded by consumers as complementary (e.g. credit cards and identity theft prevention software). If Firm A, the maker of credit cards, markets its product extensively, then some of the positive externalities will spill over into Firm B's identity theft prevention business. If Firm A under-promotes its product, this may hinder society's ability to effectively procure good credit. On the other hand, if Firm A acquires a partial equity stake in Firm B, it will internalize some measure of the positive externalities of increasing its promotional effort, assuming (although this is arguably not always the case) that it can capture a share of Firm B's resultant profits.

Furthermore, private equity partial acquisitions may promote efficiencies by structural changes in capital markets and operational controls, which, as Peacock and Cooper point out, are not necessarily anticompetitive:

> By judicious use of leverage, [private equity investment] encourages a capital structure which maximises post-tax return for a given risk appetite. Second, by identifying inefficiencies in the pricing of businesses, [private equity partial acquisitions] help to produce a more efficient allocation of resources. Third, private equity, combined with leverage, encourages operational efficiency, particularly cash-flow efficiency.[147]

Lateral Integration, 94 J. POL. ECON. 691 (1986); Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 232 (1979)).

145. *See PCEA Report*, *supra* note 9, at 572 (citing Paul Milgrom & John Roberts, *Bargaining Costs, Influence Costs, and the Organization of Economic Activity*, *in* PERSPECTIVES ON POSITIVE POLITICAL ECONOMY 57 (James E. Alt & Kenneth A. Shepsle eds., 1994)).

146. This example is attributed to Andrew Dick's analysis of partial acquisitions. *See* Wilkinson & White, *supra* note 28, at 34 n.12 (citing Andrew Dick, Presentation to N.Y. State Bar Association Antitrust Law Section, Partial Acquisitions: Economic Analysis and Case Applications 17 (March 23, 2006)).

147. Ian Peacock &Stuart Cooper, *Private Equity: Implications for Financial Efficiency and Stability*, 40 BANK OF ENGLAND QUARTERLY BULLETIN 69, 74 (2000), *available at* http://ssrn.com/abstract=764149.

2. *Argument for Efficiencies in Partial Acquisitions of Non-controlling Interests*

While the greatest efficiencies exist in a full merger with common control, passive partial acquisitions may have redeeming efficiencies if it can be shown that there are inefficiencies in the allocation of production among firms prior to partial acquisition. A passive investment may cause "more efficient firms to produce more of the industry's output, while causing less efficient firms to produce less of the industry's output."[148] While this countervailing efficiency in production allocation may have welfare benefits, some scholars have observed that:

> [I]t is not clear to what extent courts and antitrust agencies take such efficiencies into account when assessing a transaction such as a merger or a passive investment . . . [because] The Department of Justice and Federal Trade Commission 1992 Horizontal Merger Guidelines . . . do not specifically cite improved allocation of production as one of the efficiencies to be considered in assessing a merger.[149]

Although courts and agencies have not heretofore considered this aspect of efficiencies in partial acquisition cases, it is still worthy of note for use in the future. This is especially true since this production allocation efficiency is most likely to "arise when a less efficient (high-cost) firm invests in the stock of a more efficient (low-cost) firm,"[150] which is a likely occurrence. So likely, in fact, that Farrell and Shapiro have shown with a formal economic model[151] that a high-cost firm invests in a low-cost firm more often than vice-versa and a low-cost firm would never want to passively invest in a high-cost firm, unless the low-cost firm gained control over the high-cost firm's actions (not possible in a passive investment scenario). The point here is that when there is not collusion in a partial acquisition scenario, an assumption this Article makes, scholars agree that although a high-cost firm in this situation may reduce output when it invests in the low-cost firm, and the low-cost firm may reduce output also, making aggregate industry output decreased, the

148. *See* Gilo, *supra* note 6, at 43–44.
149. *Id.* at 43 n.140 (citing HORIZONTAL MERGER GUIDELINES, *supra* note 5).
150. *Id.* at 43–44.
151. Joseph Farrell & Carl Shapiro, *Asset Ownership and Market Structure in Oligopoly*, 21 RAND J. ECON. 275, 287 (1990). *See also* Gilo, *supra* note 6, at 18.

allocation of output is more efficient, and causes the low cost firm to produce more of the aggregate output.[152]

Turning to other procompetitive effects of noncontrolling partial acquisitions, Dick has argued that even noncontrolling acquisitions mitigate the effects of investing in a new product or company facing uncertain market demand.[153] In many cases these new products can have broad welfare benefits, such as new drugs with health applications for consumers. If a venture capitalist firm, according to Dick, could obtain a partial equity stake in the company producing the drug, as opposed to a fixed interest rate contract (which would discourage investment by misallocating risk or a royalty based on product sales and would entail inefficient and high monitoring costs), then that investor could proceed knowing it had efficiently invested in a manner that would reflect the company's long run valuation.[154]

In addition to the aforementioned efficiencies of partial acquisitions, further study may one day show that a competitor of Firm A may have information on Firm A that is superior to that of an ordinary investor in Firm A, due to the competitor's operations in the same market segment.[155] Thus, "passive investment by a competitor may be an efficient way of raising capital for the firm in which the investment is made;"[156] assuming a case where Firm A is issuing new stock.[157]

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152. This was proved in Farrell & Shapiro's model. Farrell & Shapiro, *supra* note 151. *See also* Gilo, *supra* note 6, at 44.

153. *See* Wilkinson & White, *supra* note 28, at 34 n.12 (citing Andrew Dick, Presentation to N.Y. State Bar Association Antitrust Law Section, Partial Acquisitions: Economic Analysis and Case Applications 17 (March 23, 2006)).

154. *Id.*

155. *See* Gilo, *supra* note 6, at 42–43.

156. *Id.*

157. While not exactly an efficiency for merger review purposes, it has also been suggested by an Australian study of United Kingdom and Australian shareholders that shareholders in target companies and acquiring companies involved in partial acquisitions experience a neutral to positive wealth effect as a result of the partial acquisition. *See* Linda Whatman & Peter Mayall, *The Trading Strategies of Buying into a Partial Takeover: An Empirical Comparison of an Open Market vs. Closed Market*, (undated) (unpublished study), *available at* http://ssrn.com/abstract=264173.

IV. TOWARDS A NEW PARADIGM: EX ANTE—EX POST REVIEW OF NON-CONTROLLING PARTIAL ACQUISITIONS

A. A New Paradigm: Ex Ante-Ex Post Review

Unilateral effects are usually proven by showing that a firm controls an undue percentage of the market, but partial acquisitions often do not confer control. This is part of the control paradox as explained in this Article. If a first step in merger analysis is typically to measure the change and level of market concentration based on the percentages of a market that various competitors control, how can anticompetitive effects be measured in a partial acquisition that confers no control or influence? The Eastern District of Kentucky and the Sixth Circuit in *Dairy Farmers of America* provided opposing answers to this paradox.

In the end, the Sixth Circuit ultimately implied a unilateral effects theory of harm without elaborating on its economic basis. In so doing, the court's opinion mirrored the most fundamental change in the 1992 Horizontal Merger guidelines, which was to shift decision making about anti-competitiveness "away from structural presumptions based on market shares and concentration ratios and to place greater emphasis on qualitative competitive effects analysis, or what one of the revised guidelines' principal authors, Bobby Willig, called 'story telling.'"[158] The "story" the Sixth Circuit told was about the reasonable probability that competitors, Southern Belle and National Dairy, would have changed incentives to reduce competition after the partial acquisition, even in the absence of control. The burden of proof was so low that the DOJ only had to show anticompetitive effects in their incipiency.

With the acceptance of this incipiency doctrine and the vague story about incentives, the Sixth Circuit may have been operating on the assumption that Section 7 is a good net for catching non-controlling partial acquisitions because even anticompetitive effects in their incipiency may lead to later harm. The court may have been concerned about false positives, the prior history of coordination in *Dairy Farmers*, or other facts specific to the case. Indeed, *Dairy Farmers* may turn out to be an anomaly of sorts. Whatever the court's reasoning was in *Dairy Farmers*, in the interest of clarity and recognition of efficiencies in partial acquisitions, this section argues for a new

158. *See* Dick, *supra* note 122, at 224 (citing Charles A. James, *Overview of the 1992 Horizontal Merger Guidelines*, 61 ANTITRUST L.J. 447, 448, 452 (1993)).

paradigm of *ex ante* and *ex post* consummation review of partial acquisitions that confer no controlling interest in the target.

B. Recommendation: Ex Ante and Ex Post Review

Notwithstanding the DOJ's victory in *Dairy Farmers*, with the agencies' recent losses in *Arch Coal* and *Oracle*, courts have shown a willingness to insist on more than a vague storytelling about incentives.[159] In both *Oracle* and *Arch Coal*, the courts refused to take the Agencies' word that there was some mechanism by which competition would be harmed in the absence of control. This was a push towards certainty and precision.

Yet courts have not shown widespread discomfort with the principle that Section 7 "can deal only with probabilities, not with certainties"[160] in non-controlling partial acquisition cases. Thus, realistically, the uncertainties in non-controlling partial acquisition cases where unilateral effects are theorized are not likely to dissipate under Section 7 analysis. They will likely continue to be related to an analysis of complex incentives in a motley blend of corporate governance forms, market factors, and management structures. Courts will be faced with the same questions about probabilistic harm in cases that do not involve control unless the agencies utilize a new paradigm of *ex ante* and *ex post* consummation review of non-controlling partial acquisitions.

1. *Ex Ante Phase*

Recognizing the difficulties of proving unilateral effects in non-controlling partial acquisitions, the agencies and courts could permit non-controlling partial acquisitions to be approved absent some showing of control or influence that the acquisition *is* anticompetitive. If there were no showing of coordinated effects or unilateral effects as a result of control or ability to exert influence, then, it is likely, the clearest anticompetitive effects would exhibit themselves after consummation, if at all. Because non-controlling partial acquisitions have no intrinsic threat to competition, those enforcing antitrust laws could proceed with extreme caution and put a greater burden of proof on the agencies to show actual anticompetitive harm. If none were shown then the non-controlling partial acquisition could be approved subject to an agreed upon *ex post* review that the parties willingly enter into.

159. Fed. Trade Comm'n v. Oracle Corp., 331 F.Supp. 2d 1098, 1175 (N.D. Cal. 2004); Fed. Trade Comm'n v. Arch Coal, Inc., 329 F.Supp. 2d 109, 115–17, 157–58 (D.D.C. 2004).

160. Fed. Trade Comm'n v. Procter & Gamble Co., 386 U.S. 568, 577 (1967).

2. *Ex Post Phase*

There are a variety of options that the agencies could utilize after non-controlling partial acquisitions are consummated. Agencies could examine non-controlling partial acquisitions under Section 7, or under other antitrust statutes that place the burden on plaintiffs to show actual competitive harm. Post-consummation antitrust statutes that could be used include Section 8 of the Clayton Act, which would be particularly useful in private equity partial acquisition cases due to the VCOC rules discussed previously. Section 8 prohibits a person from serving as a director or board-elected or board-appointed officer of two or more corporations, if the corporations are competitors, with limited exceptions.[161] A partial acquisition that "does not entitle its holder to designate at least one director is therefore generally not sufficient to provide an investor with a meaningful listening line into the strategic decision making process of the target."[162] Section 1 of the Sherman Act could also be used, under the theory that partial acquisitions constitute restraints of trade and that there may be situations in which a side arrangement makes it likely that competitors will compete less aggressively. Section 1 is especially useful in private equity non-controlling partial acquisition cases because without a Section 1 violation, such as a side arrangement, it has been suggested that a private equity firm would have no mechanism to influence the other investors in the firms it owns to compete less aggressively.[163] Of course, Section 5 of the Clayton Act and Section 2 of the Sherman Act could also be utilized *ex post* to show unfair trade practices or predatory acts.

C. Special Implications of Ex Post Review

1. *On Economic Proof of Theories of Harm*

With regard to the passive investment exception, Part II of this Article proposed that when courts review a partial acquisition that confers no controlling interest they make a factual determination that stock ownership *is* being used to lessen competition. This clarification would require courts to

161. 15 U.S.C. § 19(a)(2) (2006).
162. *See* Kaiser, *supra* note 29, at 611–12.
163. *See* Wilkinson & White, *supra* note 28, at 29 n.16 ("assuming the other investors do not also hold an interest in the same competitors (or any other competitors for that matter)").

find an economic proof for the anticompetitive effects that exist presently, not vaguely in the future.

That suggestion was not intended to dismiss Salop and O'Brien's model completely. Undoubtedly, Salop and O'Brien's model has merit, despite its criticisms that Part II highlighted. This Article's recommendation is that the model be used *ex post* partial acquisition as additional supporting evidence.[164] By using the model *ex post* partial acquisition, the model could be used as supporting evidence to determine what anticompetitive effects were actually captured in the real world and could better show actual efficiencies.[165]

The model is especially useful because of the manner in which it incorporates a sliding scale of control in partial acquisition cases and reflects the complicated reality that an acquired firm's incentives depend on the its precise degree of control, from none (passive investment) to total (full merger).

Salop and O'Brien argue that passive investment "does not lead to any change in the incentives of the acquired firm."[166] Total control, on the other hand, confers the greatest potential for anticompetitive effects and the least competitive incentives.[167] Between these extremes exists a range of partial acquisition control scenarios: fiduciary obligation, Coasian joint control, one-way control, and proportional control, as Salop and O'Brien term them.[168] Although Salop and O'Brien argue convincingly that control in a partial acquisition has a sliding scale of implications for changed incentives, the Sixth Circuit in *Dairy Farmers* would have us operate under the standard that control is not relevant to unilateral effects.[169] Using Salop and O'Brien's economic model would allow courts and Agencies to show with considerable precision *ex post* partial acquisition the changed pricing incentives of various degrees of control:

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164. This analysis assumes *arguendo* that there is not a coordinated effects argument against the partial acquisition, whether it be passive or controlling partial acquisition. The case of collusion in partial acquisition cases is beyond the scope of this Article. *Cf.* Gilo, *supra* note 64, at 2–3.

165. In correspondence with Salop in April 2008, Salop agreed that the model could perhaps be used as supporting evidence in a post-consummation scenario. The econometric method that could be used to show whether the anticompetitive effects had actually been captured would be no different than the model that Salop & O'Brien propose, but it would have more certainty because it would be less predictive.

166. *See* O'Brien & Salop, *supra* note 6, at 577.

167. *Id.* at 577–79.

168. *Id.* at 579–80.

169. Though a complete explanation is not necessary, a short summary may be useful. *See, e.g.*, *id.* at 577–80.

The pricing incentives of these partial control scenarios vary along a continuum. The most competitive pricing incentives arise in the case of fiduciary obligation. These incentives replicate the incentives of silent financial interest in which the acquiring firm has no control at all over the acquired firm. The least competitive of the partial control scenarios is Coasian joint control, which replicates a full merger. Proportional control and one-way control lead to outcomes in between these two ends of this continuum. All of these partial control scenarios lead to more competitive incentives for the acquired firm than does total control.[170]

Placing control at the forefront of the partial acquisition analysis, and assuming the vagueness with respect to real world problems such as capture has been removed by doing the modeling *ex post* partial acquisition, Salop and O'Brien's model allows for an econometric evaluation of the unilateral effects theory of partial ownership acquisitions. The model builds upon established use of the Herfindahl-Hirschman Index in corporate control scenarios and utilizes the diversion ratio methodology for the Bertrand differentiated products model in the form of something they call the Price Pressure Index (PPI).[171] The result is more precision in antitrust review.

2. *On Efficiency Analysis*

The fundamental problem confronting efficiencies analysis in partial acquisition cases is that, under the incipiency doctrine, courts are comfortable predicting future anticompetitive effects, because such future effects can at times arise from present conditions such as market structure. Not so with efficiencies; agencies are far less comfortable predicting efficiencies. There exists a bias against efficiency analysis as economic studies of efficiencies are surprisingly inaccurate when projected into the future.[172]

To alleviate this problem of proof, some scholars, including the former FTC chairman Robert Pitofsky and Joseph Brodley, have called for a two-

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170. *Id.* at 580.

171. For a complete explanation of the model, refer to *id.* at 594–602.

172. *See, e.g.*, DAVID J. RAVENSCRAFT & F.M. SCHERER, MERGERS, SELLOFFS AND ECONOMIC EFFICIENCY: FORESIGHT VS. HINDSIGHT (The Brookings Institution 1987) (1952); Richard E. Caves, *Mergers, Takeovers, and Economic Efficiency*, 7 INT'L J. INDUS. ORG. 151, 152, 162–64 (1989); Raymond S. Hartman, *The Efficiency Effects of Electric Utility Mergers: Lessons from Statistical Cost Analysis*, 17 ENERGY L.J. 425, 437–39 (1996).

stage review of efficiencies.[173] First, an *ex ante* (threshold) phase during which the FTC or DOJ could screen transactions to determine if they are likely to create substantial efficiencies due to an identified market imperfection.[174] Secondly, an *ex post* phase, in which the agency could examine efficiency outcomes and enforce competitive remedies if none were found.[175] The two-stage procedure would have the benefit of being information conserving in the sense that the "agency can apply an under-inclusive legal rule at the ex-ante stage when information is uncertain; it can then undertake more stringent review at the ex-post stage when actual results are available."[176] This dual pronged approach for efficiencies could dovetail with the suggestion made in this Article for an *ex ante* and *ex post* review of partial acquisitions, generally.

Pitofsky thus suggests an *ex post* review of partial acquisitions that would not have to be completely post-consummation but could also incorporate an *ex ante* phase. This dual pronged approach would have the benefit of clearing obviously efficient partial acquisitions in the *ex ante* stage, while also reducing the possibility that partial acquisitions which may be harmless, and perhaps beneficial with a greater evidentiary showing, are not denied because of the agencies' concerns about false positives in merger reviews. Presently, the efficiencies argument is handicapped by the inability to make a strong proof showing *ex ante*, in the majority of cases; if the agencies hold firms to their proof *ex post* consummation this handicap would be alleviated. This change would decrease the costs to transacting firms of merger review and preparing an *ex ante* defense when the evidence is hypothetical at best. If opportunity costs, such as those spent defending merger review, can be reduced, greater allocative efficiencies may arise, also.

Scholars have observed that this *ex post* approach to efficiencies would not put an additional burden on the agencies, because the procedure would be essentially adjudicatory, rather than regulatory.[177] The agencies would not have to regulate how the parties in an *ex post* proceeding conduct their businesses, but would simply adjudicate by verifying if the *ex ante* efficiencies

173. Joseph Brodley, *Proof of Efficiencies in Mergers and Joint Ventures*, 64 ANTITRUST L.J. 575, 577 (1996); Robert Pitofsky, *Proposals for Revised United States Merger Enforcement in a Global Economy*, 81 GEO. L.J. 195, 218–20 (1992).

174. *See* Brodley, *supra* note 173, at 577; Pitofsky, *supra* note 173, at 218–20.

175. *See, e.g.*, Brodley, *supra* note 173, at 577–78; *see also* Pitofsky, *supra* note 173, at 213, 218; *Pitofsky Explores Subsequent Review as Approach to Antitrust Enforcement*, 69 Antitrust & Trade Reg. Rep. 1725, at 157 (Aug. 10, 1995).

176. Brodley, *supra* note 173, at 577–78.

177. *Id.* at 608.

claims made by the parties to the partial acquisition had been achieved.[178] This would dovetail with a similar *ex ante-ex post* anticompetitive review for partial acquisitions, generally. Cases would either be closed quickly, or agencies could order a "one-shot" divestiture or other remedy that requires no particular long-term supervision.[179] As discussed below, remedies in partial acquisition scenarios would not be particularly cumbersome to adjudicate in an *ex post* setting.

3. On Remedies in Partial Acquisition Cases

Ex post review of mergers has been avoided because of the perceived complexity of deal making. From an organizational behavior perspective, divestiture is seen as problematic once firms have integrated cultures and operations. From an antitrust perspective, the fear is that divesture of a consummated entity will weaken competition overall by breaking a firm into less competitive parts in the near term. In a partial acquisition case, however, remedies in an *ex ante-ex post* review scenario would not be fatal to this new paradigm because if one assumes that partial acquisition cases can often be remedied by the removal of control, then a simple sale of stock or abrogation of board seats or veto power is all that is necessary remedially. Such remedies hardly present the problems of a full merger for dealing with *ex post* review after there has been integration of firm cultures and assets.

V. CONCLUSION

Given the many unanswered questions about partial acquisitions under the antitrust laws, there exists a dire need for policies that address partial equity ownership by competing firms "in distinguishing cases that pose serious threats to product market competition from those that promote efficien[cies]."[180] At the very least, this challenge must be embarked upon with more caution than the Sixth Circuit showed in *Dairy Farmers.*

Although the court's ruling in *Dairy Farmers* would suggest it as a new paradigm in partial acquisition cases, for all intents and purposes, it seems to be anything but definitive or clear. A two pronged *ex ante-ex post* review would, by contrast, be advantageous because it would: (1) recognize the difficulties and uncertainties present in the unilateral effects theory of harm,

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178. *Id.* at 608.
179. *Id.* at 608.
180. *See PCEA Report*, *supra* note 9, at 569–70.

especially in analyzing non-controlling partial acquisitions, and (2) create a heightened standard of the kind employed by courts in the *Arch Coal* and in *Oracle Corp.* cases that neither deterred nor enjoined beneficial or at least harmless transactions.[181] The latter effect is particularly beneficial because partial acquisitions may in fact increase efficiency. Despite likely pushback from our current ingrained merger review practices, these advantages seem reason enough to move towards this new paradigm and revise the approach taken in *Dairy Farmers.*

181. *See* Fed. Trade Comm'n v. Arch Coal, Inc., 329 F.Supp.2d 109, 158–60 (D.D.C. 2004); Fed. Trade Comm'n v. Oracle Corp., 331 F.Supp.2d 1098, 1175 (N.D. Cal. 2004).