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PE Sponsor and Majority-Owned Portfolio Company Considered Single Entity Under the Sherman Act

PE firms with non-competitor, majority-owned portfolio companies will face reduced risks of antitrust liability under Section 1 of the Sherman Act in the Eleventh Circuit.

On May 24, 2022, the United States Court of Appeals for the Eleventh Circuit held that a private equity firm and its majority-owned and -controlled portfolio company could not, as a matter of law, engage in an antitrust conspiracy under Section 1 of the Sherman Act in *OJ Commerce, LLC v. KidKraft Inc.*¹ The Eleventh Circuit held that a company “ordinarily cannot conspire with an entity it owns and controls and with which it does not compete,” applying a functional framework for analyzing the ownership structures of private equity firms, which considers whether the entity is majority-owned and -controlled by the sponsor, and whether the two companies compete.²

Private equity firms with non-competitor, majority-owned portfolio companies will face reduced risks of antitrust liability under Section 1 of the Sherman Act in the Eleventh Circuit and in courts that have similarly expanded Section 1 protection for majority-owned, parent-subsidary relationships. Yet, whether the Department of Justice (DOJ) and Federal Trade Commission (FTC) will follow this approach in other areas of antitrust enforcement remains to be seen. Indeed, this decision comes on the heels of heightened and intense antitrust scrutiny of private equity firms, including their acquisitions of competitors and non-competitors alike, and portfolio-level interlocking directorates and information sharing.

OJ Commerce, LLC v. KidKraft Inc.

In *OJ Commerce*, OJ Commerce, LLC and Naomi Home — a toy retailer and manufacturer, respectively — alleged that KidKraft, Inc., a large manufacturer of wooden play kitchens, and its private equity investor MidOcean Partners, violated Section 1 of the Sherman Act by conspiring to refuse to sell to and to boycott OJ Commerce solely on the basis that it sold Naomi Home kitchens, a competitor of KidKraft.³ One of the questions on appeal was whether MidOcean and its 57%-owned KidKraft were capable of conspiring under Section 1 of the Sherman Act, which prohibits agreements between two or more individuals or independent entities that unreasonably restrain trade.⁴

The case law to date has failed to provide useful guidance for private equity firms regarding when an investor and a portfolio company constitute separate entities that are capable of conspiring with each other under Section 1 of the Sherman Act. The Supreme Court in *Copperweld Corp. v. Independent Tube Corp.* held that a parent and a *wholly-owned* subsidiary are considered a single entity, but the Court declined to address whether a parent and a *partially-owned* subsidiary could be liable for conspiring as a

matter of law.⁵ Several circuit courts extended the *Copperweld* doctrine to wholly-owned sister subsidiaries of the same parent,⁶ and several district courts extended it to parents with more than 50% ownership of the subsidiaries' voting shares based on the parent's legal control over the entity.⁷

The Eleventh Circuit in *OJ Commerce* held that MidOcean and KidKraft could not conspire, even though KidKraft was majority but not wholly-owned by MidOcean, because “a company ordinarily cannot conspire with an entity it owns and controls and with which it does not compete.”⁸ The court called for a functional analysis of “competitive reality” instead of a “formalistic distinction,” noting that separate officers, headquarters, and independent day-to-day operational decisions do not suffice to show separate entities under Section 1.

- **Majority Ownership:** MidOcean had a 57%-ownership interest in KidKraft, which gave them additional rights, such as appointing a majority of the KidKraft board of directors and approval rights. The court held that while the presence of a minority interest in a subsidiary is not dispositive of whether a subsidiary can conspire with its parent, MidOcean's majority ownership in KidKraft weighed in its favor.
- **Control & Timing of Control:** That MidOcean maintained control over the strategic direction of KidKraft weighed in favor of the defendants being a single entity and therefore being protected by *Copperweld*. Additionally, KidKraft required MidOcean's prior approval to change the size of the Board, appoint or remove officers, or enter into a transaction in excess of US\$1 million. Also, because MidOcean controlled and owned a majority of KidKraft *before* the alleged agreement at issue, the Eleventh Circuit held that the two entities shared a “corporate consciousness.”
- **Non-Competitor:** The Eleventh Circuit focused on the fact that the subsidiary was not a competitor of the private equity owner. When the parent and subsidiary are non-competitors, the court reasoned that the majority and minority interest-holders will usually have a unity of economic interest.

Based on this functional approach, the Eleventh Circuit determined that the district court correctly entered summary judgment in favor of KidKraft and MidOcean because the parent and subsidiary shared a “common purpose” and a “single corporate consciousness,”⁹ and the agreement at issue would not “deprive the marketplace of independent centers of decisionmaking.”¹⁰ This decision on the conspiracy claim indicates a lower likelihood that private equity investors that hold a majority interest in a non-competitor portfolio company would face antitrust liability under Section 1 of the Sherman Act.

Although *OJ Commerce* provides useful guidance for private equity firms and their majority-owned portfolio companies, its functional legal framework on operational control is limited to Sherman Act Section 1 claims in the Eleventh Circuit. The case does not inform whether or how private equity firms and their ownership structures will face antitrust scrutiny in other courts or whether the DOJ may try to challenge this approach in its own cartel investigations.

Notwithstanding the expanded *Copperweld* protection of the parent-subsidiary relationship in the courts, antitrust regulators have signaled aggressive scrutiny of private equity portfolio-level conduct, including interlocking directorates and information-sharing.

Heightened Antitrust Scrutiny on Private Equity

Recent DOJ and FTC rhetoric regarding private equity firms seems to blur the lines between ownership and control that lie at the heart of antitrust regulation. Last month, the DOJ's Assistant Attorney General (AAG) for the Antitrust Division, Jonathan Kanter, criticized private equity as a business model, saying

that private equity deals are often “very much at odds with the competition we’re trying to protect,” and promised a “fuller assessment” of private equity deals going forward.

On June 13, 2022, all five FTC Commissioners — including FTC Chair Lina Khan, two other Democratic commissioners, and two Republican commissioners — voted in favor of requiring private equity firm JAB Consumer Partners to sell six veterinary clinics to settle concerns that its acquisition of SAGE Veterinary Partners would harm competition among vet service clinics in Austin, TX, and San Francisco, CA. In a separate public statement, the Democratic commissioners explained that the divestitures and prior notice and approval provisions were required in this deal because the business models of private equity firms “may in some instances distort incentives in ways that strip productive capacity, degrade the quality of goods and services, and hinder competition.”¹¹ Further, the statement flagged how the commissioners plan to use early warning and veto powers to address “stealth roll-ups by private equity firms . . . and serial acquisitions by other corporations.”

Both AAG Kanter and Chair Khan have addressed how the merger guidelines will likely spotlight PE’s business strategies and incentives that drive acquisitions. Indeed, practitioners have noted an increase in merger investigations where there is little to no competitive overlap between the private equity firm’s existing holdings and the target. Publicly, the DOJ and FTC have signaled greater attention to:

- **Portfolio-level Antitrust Scrutiny:** AAG Kanter recently announced that the DOJ increasingly would consider the broader impact of a private equity firm’s acquisitions when reviewing private equity deals. This is a throwback to 2015, when the DOJ was expected to (but did not) challenge the merger of Ainsworth Lumber Co. Ltd. and Norbord Inc., which are majority-owned portfolio companies of Brookfield Asset Management.¹² In 2022, the DOJ has signaled closer attention to whether a single sponsor bringing together different companies could restrain competition, even if the companies are *not* direct competitors.
- **“Interlocking Directorates” and Information-sharing Between Portfolio Companies:** Kanter suggested that the DOJ is re-thinking whether there are ways to challenge the private equity model itself as lessening competition, including challenging the sponsor’s role on portfolio companies’ boards as an “interlocking directorate,” or attacking the role of the sponsor as a conduit for information-sharing between portfolio companies. Such scrutiny of sponsor relationships with their majority-owned portfolio companies directly runs up against the outer bounds of *Copperweld* and whether or not they are considered a single entity under the antitrust laws. Although majority-owned subsidiaries are typically considered to be protected under *Copperweld* and its progeny in the lower courts, it is unclear how the current antitrust regulators will scrutinize portfolio relationships and conduct in light of this recent, aggressive rhetoric.
- **Private Equity Investor Liability for Cartels:** While parental liability of private equity firms for the cartel activity of their subsidiaries is a concept more developed in the EU,¹³ the current pro-enforcement agencies may be on the lookout for other theories to test. Regulators might argue that the *Copperweld* single-entity doctrine could conversely be applied to hold private equity firms liable for the actions of their portfolio companies. The decision in *OJ Commerce* could be cited to argue that a parent can be liable for its subsidiaries’ violation of the Sherman Act. Private equity companies would, therefore, be advised to consider their options for controlling their antitrust liability risks when acquiring full or partial ownership of portfolio companies.

***Copperweld's* Indeterminate Scope in the Private Equity Context**

Perhaps most significantly, *OJ Commerce* does not address the gray area of whether a private equity firm's portfolio companies (which may compete with each other) can conspire among themselves if the private equity firm owns a partial stake in either or both of those companies.¹⁴ The Supreme Court held that a parent and wholly-owned subsidiary are incapable of conspiracy in *Copperweld*, and lower courts have extended *Copperweld* to wholly-owned sister subsidiaries as well as majority-owned subsidiaries with legal control, whether or not apparently exercised on a day-to-day basis. However, it is unclear if the current administration would find that two majority-owned (but not fully-owned) portfolio companies are incapable of conspiring under *Copperweld*.

Earlier decisions outside the Eleventh Circuit suggest that *Copperweld* may not always apply in the private equity context. In *In re Platinum & Palladium Commodities Litig.*,¹⁵ the court held that the defendants — an investment firm that manages various investment funds and co-general partners of the funds — were not “incapable of conspiring with each other merely by virtue of their legal affiliations.”¹⁶ This decision suggests that separate portfolio companies are capable of conspiring despite their affiliation through the private equity firm. Ultimately, the court held that the defendants in that case were incapable of conspiring under *Copperweld* because “the manipulative conduct was born of a single source,” not from an agreement “joining together independent centers of decisionmaking.”¹⁷ In another decision, analogous to the private equity context, a district court in Oregon held that a parent and its two majority subsidiaries (in which the parent owned 60% and 70% respectively) should not be treated as a single entity.¹⁸ That judgment relied upon a decision in the D.C. Circuit that declined to extend *Copperweld* where AT&T owned minority interests of less than 35% in each of the two corporations.¹⁹

While the law on this issue is nascent and remains unclear, the functional analysis of purpose, interests, and control is of paramount importance in the private equity context, where there are potentially multiple “centers of decisionmaking.” The extent to which stakeholders, such as the fund manager, general partners, or management, exert influence over a portfolio company will determine whether they are capable of conspiring with another portfolio company owned by the same private equity firm (wholly or in part). In those circumstances, the “common purpose” and “single corporate consciousness” prongs would be harder to establish if the portfolio companies are owned by different investors through separate funds.

Conclusion

The Eleventh Circuit's functional framework for considering a private equity company a single entity with its majority-owned portfolio company under the Sherman Act is at least likely to inform antitrust analyses of private equity ownership structures in this period of active enforcement. Indeed, the judicial system may prove to be the essential check on the government's regulation of private equity companies' ownership structures, as has been occurring in other areas of antitrust enforcement.²⁰

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Endnotes

- ¹ OJ Commerce, LLC v. KidKraft, Inc., 2022 U.S. App. LEXIS 14012 (11th Cir. 2022).
- ² *Id.* at 2*.
- ³ OJ Commerce also analyzed a monopolization claim under Section 2 of the Sherman Act and a tortious interference claim. The court found that the district court did not err in finding insufficient evidence for a monopolization claim through refusal to deal. The court held that because the antitrust claim failed, so too did the tortious interference claim.
- ⁴ 15 U.S.C. § 1.
- ⁵ 467 U.S. 752, 777 (1984).
- ⁶ The Tenth Circuit in *Lenox MacLaren Surgical Corp. v. Medtronic, Inc.*, 847 F.3d 1221 (10th Cir. 2017), and the Sixth Circuit in *Total Benefits Planning Agency, Inc. v. Anthem Blue Cross & Blue Shield*, 552 F.3d 430 (6th Cir. 2008), held that coordinated acts of sister subsidiaries wholly owned by the same parent are incapable of conspiring under Section 1.
- ⁷ See, e.g., *Novatel Commc'ns, Inc. v. Cellular Tel. Supply, Inc.*, 1986 WL 15507 (N.D. Ga. Dec. 23, 1986) (finding that a 51% ownership stake “assured [the parent] full control over [the subsidiary] and assured it could intervene at any time that [the subsidiary] ceased to act in its best interests,” and therefore, the parent and subsidiary should be treated as a single entity); *Rohfling v. Manor Care, Inc.*, 172 F.R.D. 330, 344–45 (N.D. Ill. 1997) (ruling that a parent, a wholly-owned subsidiary, and an 82.3%-owned subsidiary shared a “unity of interest”); *Coast Cities Truck Sales, Inc. v. Navistar Int'l Transp. Co.*, 912 F. Supp. 747, 765–766 (D.N.J. 1995) (finding “unified economic objectives and the same corporate purpose” where a parent owned 70% to 100% of two subsidiaries, or alternatively, the parent had substantial voting shares, a “substantial interest in the success” of each subsidiary, and controlled the subsidiaries through its corporate governance structure).
- ⁸ OJ Commerce, 2022 U.S. App. LEXIS 14012, at 2*.
- ⁹ *Id.* at 15* (citing *Copperweld Corp. v. Indep. Tube Corp.*, 467 U.S. 752, 771 (1984)).
- ¹⁰ *Id.* (citing *Am. Needle, Inc. v. Nat'l Football League*, 560 U.S. 183, 196 (2010)). The Supreme Court in *American Needle* held that the National Football League and its constituent teams were capable of conspiring under the Sherman Act because each team was a “substantial, independently owned, and independently managed business,...and their objectives [were] not common.” *Id.*
- ¹¹ *Statement of Chair Lina M. Khan Joined by Commissioner Rebecca Kelly Slaughter and Commissioner Alvaro M. Bedoya In the Matter of JAB Consumer Fund/SAGE Veterinary Partners*, FED. TRADE COMM'N 3 (June 13, 2022), https://www.ftc.gov/system/files/ftc_gov/pdf/2110140C4766KhanStatement.pdf; *FTC Acts to Protect Pet Owners from Private Equity Firm's Anticompetitive Acquisition of Veterinary Services Clinics*, FED. TRADE COMM'N (June 13, 2022), <https://www.ftc.gov/news-events/news/press-releases/2022/06/ftc-acts-protect-pet-owners-private-equity-firms-anticompetitive-acquisition-veterinary-services>.
- ¹² While the DOJ did not explicitly state its reasons, it would have faced a substantial challenge to overcome Brookfield's *Copperweld* argument that all three companies should be treated as a single entity because they were under common legal control.
- ¹³ EU Court of Justice, Case C-595/18 P, Goldman Sachs, ECLI:EU:C:2021:73 (Jan. 27, 2021) (financial investors, like other parent companies, can be held liable for antitrust infringements committed by their subsidiaries where they exercise decisive influence over them).
- ¹⁴ Note, however, that *Copperweld* does not only pertain to the parent-subsidiary relationship of a private equity firm but also any company.
- ¹⁵ 828 F. Supp. 2d 588 (S.D.N.Y. 2011).
- ¹⁶ *Id.* at 596.
- ¹⁷ *Id.*
- ¹⁸ See *Aspen Title & Escrow, Inc. v. Jeld-Wen, Inc.*, 677 F. Supp. 1477 (D. Or. 1987). See also *In re Sulfuric Acid Antitrust Litig.*, 743 F. Supp. 2d 827, 884–85 (N.D. Ill. 2010) (holding that where a company owned between 47% to 70% of a subsidiary's stock, whether the subsidiaries shared a unity of interests was a triable issue of fact).
- ¹⁹ See *Sonitrol of Fresno, Inc. v. AT&T Co.*, No. 83-2324, 1986 WL 953 (D.D.C. Apr. 30, 1986).
- ²⁰ Courts have stymied a number of recent DOJ efforts to criminally prosecute individuals under Section 1 of the Sherman Act. In *United States v. Penn et. al*, the DOJ failed to convict any chicken manufacturer employees of price-fixing after two trials. 2022 U.S. Dist. LEXIS 97823 at 30* (D. Colo. June 1, 2022). In another District of Colorado case — *United States v. DaVita, Inc.* — the jury acquitted DaVita and its ex-CEO on all charges to conspire with competing employers to not hire each other's employees in violation of Section 1. No. 21-cr-00229-RBJ (D. Colo. Apr. 15, 2022).