

Client Alert

A report
for clients
and friends
of the Firm October 2008

M&A Unraveling — Government Sues for Divestiture in \$76 Million Deal

The Federal Trade Commission (“FTC”) is seeking to unwind an M&A transaction completed more than six months ago that was not subject to Hart-Scott-Rodino Act (“HSR”) notification requirements. This is the latest in a string of antitrust challenges to consummated transactions. As recently as 2006, the FTC challenged the Hologic/Fischer transaction, which resulted in the near complete divestiture of the acquired business.¹

Last month the FTC issued an administrative complaint against Polypore International, Inc., a Charlotte, NC industrial manufacturer with facilities in the U.S. and abroad. The complaint seeks, among other things, Polypore’s divestiture of Microporous Products L.P. on the grounds that the acquisition is anticompetitive and violates the antitrust laws.² Polypore acquired Microporous and its parent company, along with the company’s battery separator businesses, in February 2008 for \$76 million.

Under the HSR Act, parties to transactions that meet statutory dollar thresholds (presently \$63.1 million) may be required to file notification with the FTC and the Antitrust Division of the Department of Justice, and to observe a waiting period prior to closing.³

The HSR Act provides a framework for the agencies to review transactions and to address competitive concerns prior to completion. Transactions that are not subject to the HSR Act are permitted to close without agency review. However, all mergers and acquisitions are subject to Section 7 of the Clayton Act and Section 5 of the FTC Act, which prohibit transactions likely to substantially lessen competition.

Polypore, operating under the trade name Daramic, manufactures high-performance battery separator membranes, which are porous insulators placed between electrically charged lead plates in lead-acid batteries to prevent short circuits while allowing current to flow through the separator. Prior to the acquisition by Polypore, Microporous was headquartered in Piney Flats, Tennessee and operated battery separator manufacturing facilities in Tennessee and Austria. Microporous had \$37 million in sales in 2007.

According to the complaint, battery separators manufactured for a particular application are not interchangeable and cannot be used effectively for other applications. The FTC’s administrative complaint alleges that the transaction substantially lessened competition in four discrete segments of the battery separator business in North America:⁴

- deep-cycle separators — a component that enables deep-cycle batteries used primarily in golf carts and floor scrubbers to be frequently exhausted and recharged;
- motive separators — used primarily in forklift batteries;

¹ http://www.proskauer.com/news_publications/client_alerts/content/2006_07_19/_res/id=sa_PDF/12773-071906_FTC%20Challenges%20Consummated%20Transaction.pdf

² The complaint also charges Polypore with 1) monopolization and attempted maintenance of monopoly power through coercive bargaining tactics, including threatening to withhold supply to pressure customers to enter exclusive supply agreements, thereby threatening competition and the viability of Microporous; and 2) engaging in unfair competition by entering into a 2001 joint marketing agreement to prevent a potential competitor from entering the market for polyethylene battery separators.

³ The complaint does not address the question of why the Microporous transaction was not subject to the HSR Act’s notification and reporting requirements, but no violation of the HSR Act is alleged.

⁴ The FTC’s complaint also alleges an alternative North American market consisting of all types of battery separators produced from polyethylene (“PE”) or from a blend of PE and rubber (collectively, “PE separators”).

- automotive separators — used in automobile batteries; and
- UPS separators — used in batteries for uninterruptible power supply systems that provide short-term power during power outages.

According to the FTC's complaint, there are only two other significant manufacturers of motive and UPS separators: Amer-Sil S.A., which makes separators in Europe and has negligible sales in North America, and Nippon Sheet Glass Co., Ltd., which makes motive separators in Japan and has no sales in North America. The FTC alleges that producers of battery separators outside of North America are at a cost disadvantage in the supply of separators to North American customers. North American battery makers are said to have a strong preference for their nearest source of supply and typically do not import battery separators from abroad.

The FTC's complaint alleges that Polypore's acquisition of Microporous created a monopoly in the deep-cycle, motive and UPS battery separator markets; eliminated Microporous as an entrant into the automotive battery separator market; and eliminated Microporous as a competitor in the PE separator market. According to the FTC's complaint, the other North American competitor in PE separators, Entek International LLC, operates only in the automotive market. The FTC's complaint further alleges that Polypore's fundamental purpose in acquiring Microporous was to restrain competition unreasonably and that the acquisition allows Polypore to exert market power.

According to the complaint, entry into the relevant product markets "would not be timely, likely, or sufficient in its magnitude, scope, or character to deter or counteract the anticompetitive effects arising from this acquisition." The complaint cites numerous barriers to entry, including: comprehensive testing and qualification requirements by customers; reputation; capital requirements; and intellectual property. The complaint alleges that even the most likely future entrant would not successfully enter any of the relevant markets in a timely manner.

The issuance of the administrative complaint initiates a proceeding in which the allegations will be ruled upon by an administrative law judge at the FTC after a formal hearing. In announcing issuance of the complaint, Acting Director of the FTC's Bureau of Competition David P. Wales said, "The lawsuit filed today should send a clear message that consummation of a merger will not in any way slow or deter us from challenging transactions that raise serious antitrust issues." In another FTC challenge, earlier this year the Fifth Circuit Court of Appeals affirmed an FTC divestiture order in a case brought pursuant to an FTC investigation that commenced following the expiration of the HSR waiting period in 2001.⁵

Antitrust practitioners and in-house counsel should remain alert to potential antitrust issues in all transactions that result in the removal of a competitor from the marketplace, as they are potentially subject to challenge and unwinding.

⁵ *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410 (5th Cir. 2008).

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