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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN

UNITED STATES OF AMERICA,	)	
Plaintiff,	)	
v.	)	Civil Action No. 98-74611 Judge Hood Magistrate Scheer
NORTHWEST AIRLINES CORP., and CONTINENTAL AIRLINES, INC.,	)	
Defendants.	)	

PLAINTIFF UNITED STATES OF AMERICA'S
MEMORANDUM IN OPPOSITION TO DEFENDANT
NORTHWEST AIRLINES' MOTION FOR SUMMARY JUDGMENT

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CONTROLLING OR MOST APPROPRIATE AUTHORITY

15 U.S.C. § 18 (1996)

Fed. R. Civ. P. 56(c)

Denver & Rio Grande W. R.R. Co. v. United States, 387 U.S. 485 (1967)

Gulf & Western Indus., Inc. v. Great Atlantic & Pacific Tea Co., 476 F.2d 687 (2d Cir. 1973)

United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316 (1961)

P. Areeda & D. Turner, Antitrust Law: An Analysis of Antitrust Principles and Their Application

H. Hovenkamp, Federal Antitrust Policy: The Law of Competition and Its Practice

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MEMORANDUM IN OPPOSITION TO DEFENDANT
NORTHWEST AIRLINES' MOTION FOR SUMMARY JUDGMENT[1]

I. PRELIMINARY STATEMENT

On June 30, 2000, defendant Northwest Airlines Corp. ("Northwest") moved for summary judgment arguing, in effect, that the Court should ignore the anticompetitive harm flowing from its acquisition of voting control over Continental Airlines, Inc. ("Continental") solely because Northwest temporarily gave up the ability to exercise certain shareholder rights. To support this novel proposition, Northwest asks this Court to engraft a new requirement (which the Supreme Court previously rejected) to Section 7 of the Clayton Act -- that it applies only when the purchase of the stock or assets confers the ability to directly control or influence the acquired firm.

Northwest's motion must be denied for the following reasons:

[1] This memorandum is accompanied and supported by the Plaintiff United States of America's Statement of Facts Precluding Summary Judgment (hereinafter "SoF").

- Northwest's legal proposition -- that control or influence is a "threshold" requirement to a Clayton Act violation -- is clearly wrong.

- The United States has submitted substantial evidence in the record that the ultimate effect of the acquisition "may be substantially to lessen competition."

- Northwest does not qualify for the only relevant exemption in the statute -- the "solely for investment" exemption.

First, the Clayton Act is concerned not about the formalities of corporate governance or control, but rather with the ultimate effect on competition. Accordingly, the Supreme Court many years ago, in a case ignored by Northwest, laid to rest the very proposition upon which Northwest's motion depends, stating: "A company *need not* acquire control of another company in order to violate the Clayton Act." *Denver & Rio Grande W. R.R. Co. v. United States*, 387 U.S. 485, 501 (1967) (emphasis added). Indeed, no other conclusion can be squared with the plain words of the statute[2] or common sense.

If Northwest's argument were accepted, it would eviscerate the ability of Section 7 of the Clayton Act to prevent anticompetitive stock or asset acquisitions. Under Northwest's logic, a new and potentially all-encompassing loophole in the antitrust laws would be created. Any firm could purchase a majority voting interest, even up to 99%, of its biggest competitor, as long as it promised to temporarily give away some shareholder rights. Indeed, a company could presumably acquire a controlling interest in all its competitors. For example, American Airlines could purchase 51% of Northwest/Continental, and United Air Lines could then purchase 51% of American/Northwest/Continental, and Delta Air Lines could then purchase 51% of

[2]Section 7 reads in pertinent part: "No person . . . shall acquire, directly or indirectly, the whole or any part of the stock . . . of another person . . ., where in any line of commerce . . . in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18 (1996).

United/American/Northwest/Continental, and the entire series of transactions would be immunized from antitrust scrutiny so long as the parties agreed to some temporary, private contracts purporting to restrict their voting rights. The antitrust laws do not countenance such a result, and thus, the court should reject Northwest's legal argument.

Second, the United States has submitted extensive evidence showing that Northwest's acquisition of voting control will likely harm competition -- the determinative finding required by Section 7 -- both through the inevitable changes in Northwest's and Continental's incentives to compete vigorously and through Northwest's control and influence over Continental. Northwest can control key strategic decisions by Continental, such as mergers, corporate reorganizations, or growth by acquisition of smaller airlines, and can influence Continental management both through direct communication and indirectly through other major shareholders. The expert opinion of Dr. Baker explains how competition between the two companies will be reduced. And, the testimony of Continental's CEO, Gordon Bethune, **[REDACTED MATERIAL**

] Viewing this evidence in the light most favorable to plaintiff precludes any grant of summary judgment to Northwest.

Finally, Northwest does not qualify for the "solely for investment" exception to the Clayton Act. Northwest has admitted that its purposes in acquiring the Continental control block were **[REDACTED MATERIAL]** Accordingly, the exception does not apply.

In sum, Northwest has done little more than agree to postpone temporarily its right to exercise complete control over Continental. This is not a sufficient remedy for a Section 7 violation and will not support Northwest's motion. In order to grant Northwest's motion, the Court would have to find, as a matter of undisputed fact, and as a matter of law, that *even if* Northwest's ownership of the Continental stock would substantially lessen competition, Northwest's promise to relinquish temporarily some of its ownership rights through a series of private contracts, enforceable only by and at the discretion of the parties to them, exempts the acquisition from the Clayton Act. No court has ever so held.

II. BACKGROUND

A. LEGAL STANDARD FOR SUMMARY JUDGMENT

Summary judgment should only be entered where admissible evidence shows "that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). In determining whether there are issues of fact requiring a trial, all evidence must be viewed in the light most favorable to the party opposing summary judgment and that party must be given the benefit of all reasonable inferences. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587-88 (1986); *Rouse v. Chrysler Corp.*, 1997 WL 905508, at *2 (E.D. Mich. Sept. 30, 1997). The Court's function is not to resolve disputed issues of fact but solely to determine if such genuine issues of fact exist. *Rouse*, 1997 WL 905508, at *2.

B. FACTUAL BACKGROUND

The domestic airline industry is highly concentrated, with seven large carriers accounting for over 80% of all domestic air passenger revenues. SoF ¶4. Northwest and Continental are the fourth and fifth largest U.S. airlines respectively, accounting for a combined $10 billion in domestic passenger revenues annually. *Id*. ¶1. Both airlines offer service to most major U.S. cities and have domestic networks that span the United States. In most of the "hub-to-hub" city-pair markets – those routes connecting one of Northwest's hub cities with one of Continental's (*e.g.*, Detroit to Houston) – Northwest and Continental are the only providers of non-stop service and each other's most significant competition. *Id*. ¶3. Prior to Northwest's acquisition of voting control of Continental, Northwest and Continental competed to provide better fares and service to passengers traveling throughout the United States. *Id*. ¶2.

Northwest had long been interested in purchasing Air Partners' Continental shares. SoF ¶¶12-14. In **[REDACTED MATERIAL]** *Id*. ¶13. When Northwest finally purchased Air Partners' shares, it acquired the majority vote of Continental's outstanding shares. *Id*. ¶21. Because the shares constituted a control block, Northwest paid a significant premium above the prevailing stock market price for those shares. *Id*. ¶22. Additionally, because voting control was so important to Northwest, it later sought out and bought additional shares to give it majority voting control of Continental even on a fully-diluted basis (*e.g.*, counting unissued shares that others held an option to buy). *Id*. ¶23.

Upon deciding to buy the stock, Northwest worked out with Continental the extent to which Northwest would use its 51% voting control to govern Continental over the next six years. Under their governance arrangements, Northwest put the stock in a voting trust, but retained the right to vote the stock on the most strategic decisions facing Continental during that time, including mergers and acquisitions, reorganizations, and recapitalizations. SoF ¶33. This gives Northwest an absolute veto over these strategic actions and a significant ability to influence Continental's decision-making even during the remaining four years of the trust. *Id*. ¶32. In addition, Northwest expressly maintains the ability to communicate with Continental management about many competitively sensitive subjects. *Id*. ¶¶38 & 39. As **[REDACTED MATERIAL]** *Id*. ¶32. Northwest's Chairman of the Board, writing after the governance agreements were in place, stated **[REDACTED MATERIAL]** *Id*. ¶25.

Following the filing of this suit, Northwest and Continental modified their governance arrangements. SoF ¶28. These modifications did not eliminate Northwest's ability to veto important strategic actions by Continental or change the certainty that, at the expiration of the governance arrangement, Northwest will be able to exercise complete control over Continental. *Id*. ¶32. In addition, Northwest and Continental also entered into a Supplemental Agreement covering years seven through ten following Northwest's stock acquisition. *Id*. ¶28. During years seven through ten, Northwest's ability to exercise control over Continental will be significantly increased because Northwest will be free to vote stock representing 20% of the Continental vote. *Id*. ¶45. Edward Rock, a professor who specializes in corporate governance issues, testified that under these governance arrangements, Northwest possesses all power to give Continental the incentive to cooperate, rather than compete, with it. *Id*. ¶47.

Northwest's purchase of the Continental stock will likely result in a number of anticompetitive effects. Dr. Jonathan Baker, the former head economist of the Federal Trade Commission, described in detail the likely harm to competition. He opined that the transaction will likely lead the two carriers to increase prices in the "hub-to-hub" city-pair markets where the defendants are the only significant providers of non-stop service.[3]

He also concluded that Northwest's acquisition of voting control over Continental will likely lead to a reduction in "system-wide" competition -- competition among the limited number of major airlines across their overlapping route networks. SoF ¶4 & 8. Baker explained that if a major airline's system-wide price increase is not immediately matched by all of the other major airlines, the increase cannot be sustained and the airline has to reduce the prices to the previous

[3] SoF ¶8. Northwest and Continental also compete in such non-price dimensions as the frequency and type of service offered on competing routes. Dr. Baker opined that Northwest's acquisition of the control block of Continental will likely also harm that competition. *Id*. ¶¶7-9.

level. *Id*. ¶5. At times in the past, either Northwest or Continental has played a pivotal role in preventing such system-wide increases, by refusing to match a price hike proposed by other major carriers. *Id*. Similarly, in the past, either Northwest or Continental has been the first to initiate a system-wide fare sale that the other carriers had to match. *Id*. As a result of Northwest's acquisition of the Continental stock, the interests of the two carriers will be more closely aligned, and neither carrier will be as likely to stand in the way of system-wide price increases desired by the other, or to initiate system-wide sales to the detriment of the other. *Id*. ¶8.

[REDACTED MATERIAL

] *Id*. ¶50.

III. THE ULTIMATE ISSUE UNDER SECTION 7 IS HARM, NOT DIRECT CONTROL OR INFLUENCE

In an attempt to avoid Section 7 liability, Northwest argues that the statute does not apply unless "as a threshold matter," the Continental stock can be "used to influence or control Continental in a direct and demonstrable way." Northwest Mem. at 14; *see also id.* at 1 & 12. However, Northwest misstates Section 7 law. Section 7 does *not* require such direct and demonstrable control or influence but focuses instead on whether the transaction harms competition. Northwest also omits critical facts that show that it retains significant ability to make Continental cooperate with, rather than compete against, it.[4]

[4]The United States also sued Northwest under Section 1 of the Sherman Act which bars anticompetitive agreements. Northwest cites no cases that read a control requirement into that statute, but instead relies on cases stating that it may be harder to prove anticompetitive effects under Section 1 of the Sherman Act than Section 7 of the Clayton Act. Northwest's motion would have to be denied because it does not even reach the Section 1 claim in the Complaint.

Section 7 bars firms from acquiring "*any part* of the stock" or assets of another company where "the effect of such acquisition *may* be substantially to lessen competition." 15 U.S.C. § 18 (emphasis added). Section 7 is designed to cope with monopolistic tendencies in their "incipiency" and to "nip monopoly in the bud." *United States v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586, 589 & 593 (1957). Section 7 also explicitly reaches partial stock or asset acquisitions. The statute applies on its face if the effect of the partial stock or asset acquisition "may be substantially to lessen competition." The Supreme Court stated that the question of harm to competition set forth in the statute is the core issue in deciding a Section 7 case.[5] The statute simply makes no mention of a threshold requirement of control or influence prior to analyzing whether the acquisition harms competition.

Northwest's argument -- that, in spite of the plain language of the statute, Section 7 of the Clayton Act does not apply unless one company acquires direct and demonstrable control or influence over the other -- was flatly rejected by the Supreme Court. In a case that Northwest ignores, involving ownership of only a 20% voting interest in a competitor's stock, the Supreme Court instructed in clear language: "A company need not acquire control of another company in order to violate the Clayton Act." *Denver & Rio Grande*, 387 U.S. at 501.[6]

The Supreme Court understood that by its plain terms, the statute focuses on the effect of an acquisition, and that an acquisition can have an anticompetitive effect even if it does not confer

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[5] *FTC v. Proctor & Gamble Co.*, 386 U.S. 568, 577 (1967); *see also Gulf & Western Indus. Inc. v. Great Atlantic & Pacific Tea Co.*, 476 F.2d 687, 694 (2d Cir. 1973).

[6] S*ee also* 5 P. Areeda & D. Turner, Antitrust Law: An Analysis of Antitrust Principles and Their Application, § 1203a, at 316 [hereinafter Areeda Antitrust Treatise]; H. Hovenkamp, Federal Antitrust Policy: The Law of Competition and Its Practice, § 12.9, at 497 (1994) [hereinafter Hovenkamp Antitrust Treatise].

control.

> It is not the possibility of control that may prejudice appellants and the public interest, but simply the fact that with [the acquirer] holding 20% of [the acquired company's] stock there is likely to be immediate and continuing cooperation between the companies, cooperation which appellants claim will be to their detriment and which the Government concedes may be against the public interest. If appellants are correct, and if such an alliance would in fact be against the public interest, then § 7 of the Clayton Act requires that it be stopped in its incipiency. *Denver & Rio Grande*, 387 U.S. at 504 (citations omitted).

The Second Circuit reiterated the point in *Gulf & Western Indus.*, 476 F.2d 687. There the acquiring company made the argument that Northwest makes here -- that because it did not attain control over the acquired company, Section 7 did not apply. The Second Circuit rebuffed that argument, stating that the critical issue is harm, not control. "As a matter of law, we are not aware of any decision that requires numerical control in order to establish an antitrust violation. Several cases have held to the contrary. Rather, the critical question is whether the probable future effect of the transaction will be substantially to lessen competition." 476 F.2d at 694 (citations omitted).

Because anticompetitive harm can occur without direct influence as well as without control, the idea that direct and demonstrable influence is an unwritten, but threshold requirement to Section 7 is also flatly inconsistent with both *Denver & Rio Grande* and *Gulf & Western.* And, indeed, Northwest has cited no case that holds that direct influence is such a requirement.[7]

IV. NORTHWEST'S OWNERSHIP OF THE CONTINENTAL STOCK WILL HARM COMPETITION

A. PARTIAL STOCK ACQUISITIONS CAN SUBSTANTIALLY LESSEN

[7] Northwest uses selective quotes from several cases to support its argument, but none of them holds as a matter of law that the absence of control or influence is dispositive in a Section 7 stock acquisition case. The cases show little more than that the courts consider the ability to control or influence as one indicia in assessing whether competitive harm may (or did) occur.

COMPETITION WHETHER OR NOT THEY CONVEY CONTROL OR DIRECT INFLUENCE

As the courts and treatises recognize, competitive harm can occur even where the acquiring firm lacks the legal authority to compel the acquired firm's compliance with its wishes. Indeed, there are at least four ways that such acquisitions, even those involving much smaller ownership percentages than the 51% at issue in this case, can significantly lessen competition.

First, the acquiring firm gains a unilateral incentive to compete less vigorously with the acquired firm. When a company like Northwest acquires a stake in its competitive rival, the competitive dynamics between the two companies are inextricably altered. Put simply, if the acquiring firm beats its rival, it lowers the value of its investment in that rival:

> Competition can be threatened, however, even if the acquiring firm's interest is so small that it has no influence at all over the acquired firm's decisions. Suppose that firms A and B are competitors and A acquires 15% of the shares of B. Clearly the competitive game has acquired a new twist. Under the rules of competition, A would like nothing better than to force B out of the market through A's greater efficiency. As a result of the partial acquisition, however, A suddenly has a strong financial interest in B's welfare.[8]

Second, the acquired firm has a corresponding incentive to compete less vigorously against the acquiring firm. The acquired firm's behavior will naturally also change when it is partially owned by a competitor, regardless of whether the purchasing company assumes *de jure* control:

> At the psychological level, either company might lose some of its former zeal to compete with the other. And, quite apart from any such feelings, the acquired firm may have good reason to direct its competitive energies away from the acquiring

[8] Hovenkamp Antitrust Treatise §12.9, at 497; *see also* Areeda Antitrust Treatise § 1203c, at 320 ("Furthermore the acquiring firm's market decisions might now be affected not only by their impact on its own operations but also by their impact on its investment -- both on dividends and on capital value -- in its competitor. Competition at the borderline of profitability may be abandoned if it seems likely to result in an investment loss.").

> firm. . . . Directors [of the acquired company] . . . may seek to avoid antagonizing the acquiring company . . . even in the absence of any attempt by the acquiring company to exert influence.[9]

Third, the acquisition weakens the acquired firm's ability to compete. The Second Circuit recognized that an acquisition can create a cloud of uncertainty over the partially acquired company by causing it to lose key employees and organizational morale. *F. & M. Schaefer Corp. v. C. Schmidt & Sons, Inc.*, 597 F.2d 814, 818 (2d Cir. 1979); *See also* Areeda Antitrust Treatise § 1203c, at 318-19 (explaining how partial stock acquisitions can weaken the acquired company and limit its ability to compete effectively).

Fourth, the acquisition makes collusion or cooperation between the two firms more likely. In *Denver & Rio Grande*, the Supreme Court observed that one company's holding of just 20% of the stock of the other made it more likely that the two direct competitors would cooperate, rather than compete, to the detriment of the public interest. 387 U.S. at 504. A preeminent antitrust treatise likewise explained: "[T]he stock acquisition effects some sharing of profits, reduces incentives for "cheating," makes departures from agreed behavior harder to conceal, and thus seals the bargain of express collaboration. These forces might also make tacit understandings more attractive to the parties." Areeda Antitrust Treatise § 1203c, at 319-20.

Thus, even in the absence of direct control rights a partial acquisition can harm competition. And, that is exactly what is occurring here.

First, as Dr. Baker has testified, Northwest's competitive incentives towards Continental

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[9] Areeda Antitrust Treatise § 1203c, at 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.").

have changed simply because Northwest has a claim to approximately 14% of the profits Continental generates. In other words, Northwest will effectively lose fourteen cents for every dollar of profit it may cause Continental to lose due to competition. This result is unaffected by any possible governance arrangements between the defendants. Knowing that its actions may affect Continental's profits (and hence its own profits), Northwest will naturally be less likely to compete vigorously with Continental, and will tend toward actions that benefit Northwest's and Continental's combined interests. As Dr. Baker stated, "Northwest's incentive to compete with Continental will now be muted." SoF ¶11.

Second, Professor Rock has testified that Continental will act differently because the governance arrangements have merely created "a test period during which Continental management can prove itself to be a valuable partner to Northwest." SoF ¶57. Continental's awareness of this test period affects the thousands of decisions Continental's managers make each week, including such competitively significant decisions as fare changes, sales promotions, pricing strategies, scheduling, service frequency, fleet acquisition, network or hub expansion, and aircraft usage. *Id*. ¶¶10 & 41. Indeed, **[REDACTED MATERIAL]** *Id*. ¶10.

Third, Northwest's holding of the stock has created a "cloud of uncertainty" over Continental. **[REDACTED MATERIAL]** SoF ¶56. **[REDACTED MATERIAL]** *Id*.

And fourth, by tying their economic interests together, the stock acquisition increases the likelihood of successful collusion between Northwest and Continental. **[REDACTED MATERIAL**

][10] **[REDACTED MATERIAL**

] The stock acquisition increases the likelihood that the carriers will exploit that opportunity, to the detriment of competition.

B. NORTHWEST RETAINS CONTROL OVER CONTINENTAL'S KEY STRATEGIC DECISIONS DURING THE PERIOD COVERED BY THE GOVERNANCE AGREEMENTS

In fashioning the governance agreements, Northwest explicitly bargained for and retained a number of ways in which it can even now influence Continental to cooperate, rather than compete, with it. First, no one disputes that once the governance agreements expire in eight years, Northwest will automatically have complete *de jure* control over Continental, including the ability to elect 100% of the Continental Board of Directors and to determine the fates of Continental's senior executives. SoF ¶48. Moreover, in just a little over four years, Northwest will have the unfettered discretion to vote shares representing up to 20% of the total voting power of Continental on all matters, which will make Northwest the largest voting shareholder in Continental.[11] In his deposition, **[REDACTED MATERIAL]** SoF ¶45.

Northwest must consequently focus its defense on the next four years, but even there it

[10]*See* SoF ¶42; *see also Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984) (immunizing anticompetitive agreements between a parent corporation and its wholly-owned subsidiary); *Novatel Communications, Inc. v. Cellular Telephone Supply, Inc.*, 1986-2 Trade Cases ¶ 67,412 (N.D. Ga. 1986) (applying *Copperweld* immunity to agreements between a parent corporation and its 51%-owned subsidiary).

[11]SoF ¶26 & 46. Courts have found a 20% voting stake in a publicly held corporation to presumptively provide control or significant influence. *See, e.g.*, *Dan River, Inc. v. Unitex Ltd.*, 624 F.2d 1216, 1225 (4th Cir. 1980).

retained the following powers that give it influence, and with regard to certain strategic decisions outright control, over Continental's business decisions. Specifically, Northwest can:

- block any significant "merger, reorganization, share exchange, consolidation, business combination, recapitalization, liquidation, dissolution or similar transaction" that Continental management seeks to initiate;
- block Continental's ability to acquire a smaller airline in order to grow;
- pressure Continental management indirectly through its other major shareholders;
- communicate with Continental's directors, officers and employees regarding Continental's business;
- publicly rebuke Continental management to induce a third party to launch a proxy fight to replace the existing Continental management team;
- refuse to guarantee the election of Continental executives seeking membership to Continental's Board of Directors; and
- seek to influence Continental's Board of Directors or management of the company in connection with the performance of the Northwest/Continental marketing alliance. SoF ¶45.

In **[REDACTED MATERIAL**

] *Id*. ¶53. **[REDACTED MATERIAL**

] *Id*. ¶25. Professor Rock explains that simply by threatening to exercise these powers (*e.g.*, threatening to block a recapitalization program that Continental needs), Northwest can force Continental to cooperate, rather than compete, with it.[12]

[12]*Id*. ¶46. **[REDACTED MATERIAL**

] While Continental may be "independent" in the sense that Northwest cannot immediately replace Continental management, that simply does not address whether Northwest and Continental are no more likely to cooperate, rather than compete. Northwest also claims that both the Department of Transportation (DOT) and the Securities and Exchange Commission (SEC) found that Northwest did not "control" Continental. But neither agency considered the issue before this Court: whether Northwest's stock acquisition harms

In the end, Northwest's acquisition of voting control over Continental fundamentally alters the carriers' incentives to compete with each other, and no amount of elaborate drafting of governance agreements can change or avoid that consequence. Northwest's attempt to characterize the temporary agreements as a complete cure to the anticompetitive harms arising out of Northwest's ownership of voting control over its rival simply does not square with the facts. Moreover, in the context of a request for summary judgment, it is impossible to reach that conclusion as a matter of law. Accordingly, Northwest's motion must be rejected.

V. THE GOVERNANCE ARRANGEMENTS CANNOT REMEDY THE ANTICOMPETITIVE HARM FROM NORTHWEST'S STOCK OWNERSHIP

What Northwest has really tried to do with these governance agreements is to offer this Court an inadequate remedy for an antitrust violation. The Supreme Court, however, has instructed trial courts that the relief they fashion in "an antitrust case must be 'effective to redress the violations' and 'to restore competition.'" *Ford Motor Co. v. United States*, 405 U.S. 562, 573 (1972) (citations omitted). Once a court is convinced that a transaction violates Section 7, all doubts as to the remedy must be resolved against the defendants. *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 334 (1961). The Supreme Court has held that the appropriate remedy for an anticompetitive acquisition is divestiture because it does not require constant judicial or administrative oversight.[13] Indeed, the only time the Supreme Court faced the issue of

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competition. DOT was considering whether Northwest's acquisition constituted a transfer of Continental's route authorities, but decided to defer its determination pending this lawsuit. The SEC considered only whether Northwest as a majority shareholder of Continental should use an alternative form of accounting.

[13]*See du Pont*, 366 U.S. at 334; *see also California v. American Stores Co.*, 495 U.S. 271, 285 (1990) ("divestiture [is] the remedy best suited to redress the ills of an anticompetitive merger"); *Ford Motor*, 405 U.S. at 573 ("[c]omplete divestiture is particularly appropriate where asset or stock acquisitions violate the antitrust laws").

whether a "voting trust" arrangement sufficiently ameliorated the competitive harm of a partial stock acquisition, it unambiguously rejected it.

In *du Pont*, the Supreme Court rejected defendant's claim that certain court-supervised remedial provisions added enough protection against anticompetitive conduct to make the trial court's decree effective. 366 U.S. at 334. The clauses in *du Pont* (*e.g.*, those barring du Pont from influencing the selection of GM officers or directors and prohibiting preferential trade relationships between du Pont and GM) are not unlike those found in Northwest's governance agreements. The Court found that framing an injunction to address adequately all possible means of improper influence by du Pont with its 23% stake in GM would be impossible. *Id*.

Furthermore, while Northwest would have this Court entrust private corporations with the protection of the interests of the millions of consumers who purchase passenger airline services in the United States every year, neither Northwest or Continental owes any duty to consumers. As private corporations, they can be expected to act in their own pecuniary interests, not in the interests of vigorous competition. Northwest and Continental are free to ignore these agreements at any time it serves their own interests, and Northwest's stock ownership makes it more likely that collusive conduct between the two competitors may escape antitrust scrutiny. This is precisely why courts have repeatedly rejected promises or agreements to compete as a defense to an otherwise anticompetitive transaction.[14]

Northwest's purported governance "fix" thus seeks to preempt the Court's duty to fashion an effective remedy to cure the anticompetitive effects of the challenged transaction. However,

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[14]*See Community Publishers, Inc. v. Donrey Corp.*, 892 F. Supp. 1146, 1168 n.17 (W.D. Ark. 1995), *aff'd*, 139 F.3d 1180 (8th Cir. 1998); *FTC v. University Health Inc.*, 938 F.2d 1206, 1224 (11th Cir. 1991); *United States v. Ivaco*; 704 F. Supp. 1409, 1426-29 (W.D. Mich. 1989).

Northwest has never pointed to any case where a court accepted the fix that Northwest proposes here, especially at the summary judgment stage, before the government has even been given the opportunity to fully present its evidence of anticompetitive effects to the Court.

VI. NORTHWEST'S ACQUISITION OF VOTING CONTROL DOES NOT FALL WITHIN THE NARROW "SOLELY FOR INVESTMENT" EXEMPTION TO SECTION 7

As a secondary argument, Northwest claims that it meets the "solely for investment" exemption to Section 7. This exemption sets forth two criteria that Northwest must meet: (1) Northwest must have purchased the Continental stock "solely for investment" and (2) Northwest cannot use the stock to "bring about the substantial lessening of competition."[15] Northwest fails to meet either of the two necessary criteria and thus the exemption does not apply.

Congress included the "solely for investment" exemption to clarify that Section 7 did not apply to investments by institutional investors who were only interested in the growth of the value of a company's stock. Areeda Antitrust Treatise § 1204b at 326. Congress added the exemption to ease concerns that Section 7 would interfere with the then-prevailing investment practices of colleges and banks. 51 Cong. Rec. S 14466-67 (1914). H.R. Rep. No. 627, 63d Cong., 2d Sess. at 17 (1914) As an exemption, it should be narrowly construed, and not expanded beyond its plain terms or limited purpose. *See California v. Federal Power Comm'n,* 369 U.S. 482, 485 (1962). Thus, there are very few recorded cases where a defendant has even tried to claim the exemption. And, as a defense, the defendant bears the burden of proving that it meets the criteria of the exemption. *United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 776 n.87 (D.

[15] 15 U.S.C. §18 ("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.").

Md. 1976).

The statute requires that the stock purchase be "solely" as an investment. If Northwest had any other purpose, the exemption does not apply.[16] Here, Northwest has proclaimed another purpose, **[REDACTED MATERIAL**

] SoF ¶13.

Northwest paid a substantial premium for the stock it acquired from Air Partners because it provided control, and subsequently sought out and bought additional shares so that it would indisputably have more than 50% of the total voting power of Continental. *Id*. ¶22 & 23. Northwest retained the right to vote that stock (and thus control the outcome) on Continental's most strategic decisions for the next few years, knowing the stock would give it the right to control all of Continental's decisions by at least 2008. *Id*. ¶48. Such actions are completely

[16]*See, e.g., du Pont*, 353 U.S. at 602, 605-06 (finding that du Pont's acquisition of General Motors stock was not solely for investment where du Pont used its stock position to become a major supplier to GM); *United States v. Jerrold Elec. Corp.*, 187 F. Supp. 545, 563 (E.D. Pa. 1960), *aff'd per curiam,* 365 U.S. 567 (1961); *American Crystal Sugar Co. v. Cuban-American Sugar Co.*, 152 F. Supp. 387, 395 (S.D.N.Y. 1957) ("solely for investment" exemption inapplicable where objective of stock purchase was a closer association, or joint venture, between firms), *aff'd*, 259 F.2d 524 (2d Cir. 1958); *Hamilton Watch Co. v. Benrus Watch Co.*, 114 F. Supp. 307, 316 (D. Conn. 1956) (no exemption where purpose to obtain "minority representation," not control"), *aff'd*, 206 F.2d 738 (2d Cir. 1953); *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.") (emphasis in original), *modified in other respects*, 472 F.2d 882 (9th Cir. 1972), *cert. denied*, 412 U.S. 918 (1973); *Chesapeake & Ohio Ry. Purchase*, 271 I.C.C. 5, 14 (1948) ("stock was not acquired as an investment" where bought to help create an alliance); Areeda Antitrust Treatise § 1204d at 331 (word "solely" is the key to exemption and anticompetitive acquisitions not solely for investment.").

inconsistent with any notion that Northwest purchased the stock solely as an investment.[17]

Northwest also fails to meet the second necessary prong of the exemption – that its stock ownership not bring about a substantial lessening of competition.[18] As discussed above, because Northwest holds a stake in Continental the two companies will act less competitively towards each other to the detriment of consumers.

The few cases Northwest cites in support of its claim of an exemption did not concern facts anywhere close to those present here.[19] First, in neither of those cases did the purchaser buy anything approaching 51% of the voting power of a competitor.[20] Indeed, no court has ever found a stock purchase to be "solely" for investment, and the investment exemption to apply, where a company bought voting control of its competitor. Second, in neither of those cases did the purchaser acquire the right to mandate, by virtue of its voting control, the outcome of major corporate issues like mergers and corporate reorganizations as Northwest does here. And third, in those cases the courts found, only *after* an evidentiary hearing, that the challenged stock

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[17]The investment exemption cannot be invoked based merely on the adoption of temporary measures to prevent the acquisition or exercise of total control. *See Navajo Terminals, Inc. v. United States*, 620 F. 2d 594, 599 (7th Cir. 1977).

[18]The most critical issue for the exemption, and ultimately Section 7 analysis, is whether acquiring and holding the stock in question will be likely to substantially lessen competition. *See, e.g., Gulf & Western Indus.*, 476 F.2d at 694 (stating that "critical question is whether the probable future effect of the transaction will be substantially to lessen competition"); *Crane v. Harsco Corp.*, 509 F. Supp. 115, 123 (D. Del. 1981) (finding that a 20% interest was sufficient to reject defendants' claim that the purchase was only an investment and to proceed to consider the broader issue of the potential anticompetitive effects of the acquisition).

[19]*United States v. Tracinda Invest. Corp.*, 477 F. Supp. 1093 (C.D. Cal. 1979); *Anaconda Co. v. Crane Co.*, 411 F. Supp. 1210 (S.D.N.Y. 1975).

[20]*See Tracinda*, 477 F. Supp. at 1096 (acquiring company purchased 25% interest); *Anaconda*, 411 F. Supp. at 1212 (22.6% ownership acquired).

purchase would not lessen competition. Here, there is already substantial evidence to support the government's allegations of anticompetitive effects, and, in ruling on this motion, the court must view this evidence in the light most favorable to the government. Northwest's attempt to find immunity in the "solely for investment" exemption thus fails.

For all of these reasons, Northwest's motion for summary judgment should be denied.

DATED: July 28, 2000

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing PLAINTIFF UNITED STATES OF AMERICA'S MEMORANDUM IN OPPOSITION TO NORTHWEST AIRLINES' MOTION FOR SUMMARY JUDGMENT, and PLAINTIFF UNITED STATES OF AMERICA'S STATEMENT OF FACTS PRECLUDING SUMMARY JUDGMENT were served by hand and/or first-class U.S. mail, postage prepaid, this 28th day of June, 2000 upon each of the parties listed below:

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