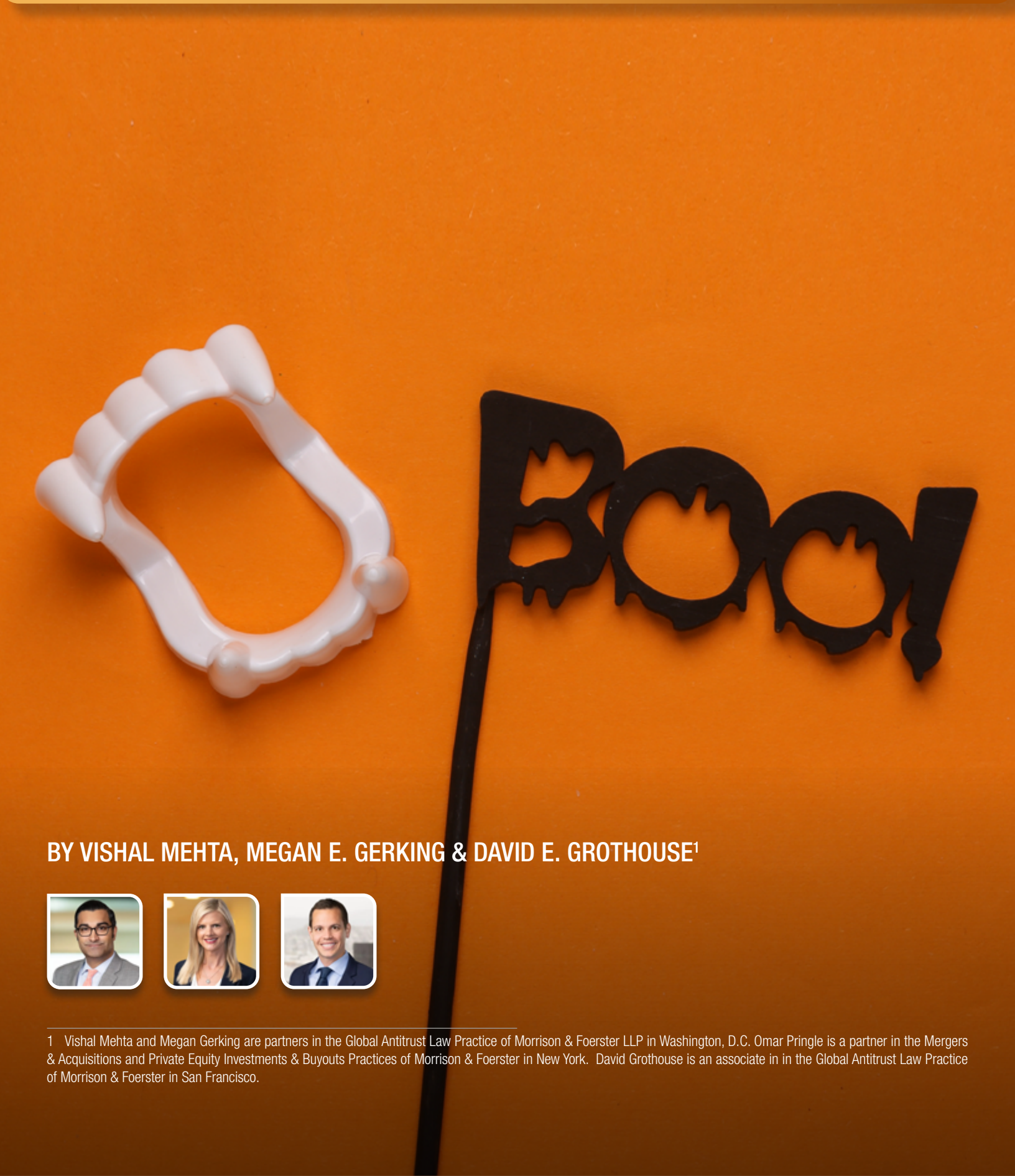
THE VAMPIRE DIARIES: ANTITRUST SCRUTINY INTENSIFIES AROUND PRIVATE EQUITY



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THE VAMPIRE DIARIES: ANTITRUST SCRUTINY INTENSIFIES AROUND PRIVATE EQUITY

By Vishal Mehta, Megan E. Gerking & David E. Grothouse

The private equity ("PE") industry has experienced extraordinary growth over the past few years. In parallel, antitrust scrutiny of PE by the U.S. enforcement authorities has intensified, with visceral rhetoric from the agencies and Capitol Hill transforming into aggressive action. Most recently, these actions have ranged from strong concessions demanded in PE transactions under review to DOJ letters alleging illegal interlocking directorates and threatening lawsuits. In this article, we explore antitrust focus on PE in the context of broader enforcement trends, highlight recent enforcement activity, preview what dealmakers and practitioners may expect on the horizon, and offer practical tips for navigating this new landscape.

It is no secret that the private equity ("PE") industry has reached extraordinary heights in recent years. The past 18 months have been particularly explosive: buyout values and exit multiples have skyrocketed, fundraising has surged, and PE strategies such as buy-and-build and growth investing have experienced dynamic growth.[2] In spite of recent economic headwinds stemming from factors such as rising inflation, high interest rates, and the war in Ukraine, the industry has remained strong. Its allure has even penetrated the rare air of pop culture royalty, with reality star Kim Kardashian recently announcing the launch of SKKY Partners, a private equity firm focusing on consumer products, hospitality, luxury, digital commerce, and media.[3]

Against this backdrop, antitrust scrutiny of PE by the Federal Trade Commission ("FTC") and the U.S. Department of Justice Antitrust Division ("DOJ") has intensified, as political rallying cries and sharp rhetoric have transformed into enforcement action with real economic consequences. In this article, we explore this transition in the context of broader enforcement trends, highlight recent enforcement activity, and preview what dealmakers and practitioners may expect on the horizon.

I. VISCERAL ANTITRUST ENFORCEMENT RHETORIC

Over the last several years, the chorus of voices calling for greater antitrust scrutiny of PE has grown louder. In July 2019, Senator Elizabeth Warren famously described PE firms as "vampires [that bleed companies] dry and walk away enriched" and "suck value out of the economy."[4] Former FTC Commissioner and current head of the Consumer Financial Protection Bureau, Rohit Chopra (another outspoken critic of PE) previously remarked that "many [PE] funds load companies up with debt and sell off the best assets," which "can kill off competition."[5] In July 2020, Chopra released a statement criticizing roll-ups involving successive, non-HSR-reportable transactions. Focusing on the impact of roll-ups in the healthcare sector, Chopra called out nefarious practices resulting from consolidation, including excessive billing by out-of-network physicians and "body brokering" by opioid treatment centers.[6] More recently, FTC Chair Lina Khan has vowed to take a "muscular" approach to PE enforcement to forestall the "life and death consequences" of PE firms controlling too much of the economy.[7] And, DOJ Antitrust Division head Jonathan Kanter recently declared, "the era of lax enforcement is over, and the new era of vigorous and effective antitrust law enforcement has begun."[8]

The visceral rhetoric calling for heightened scrutiny of PE – seemingly lifted from the pages of a David Cronenberg script – has now coalesced with a major escalation in antitrust enforcement across the board. This is occurring at a time when many PE firms are opting for sector-specific investment strategies, whether through the more recent trend of industry-focused funds, or through longstanding roll-up/add-on strategies at the individual portfolio company level.

II. BROADER ANTITRUST ENFORCEMENT CHANGES IMPACTING PRIVATE EQUITY

The Biden administration, Congress, and the agencies have undertaken significant reforms to merger review that have had a real-time impact on PE. These changes – recently characterized by FTC Commissioner Christine Wilson as "death by a thousand cuts" to the HSR regime – include (1) President Biden's Executive Order calling for a whole-of-government approach to antitrust enforcement;[9] (2) indefinite suspension of early

2 The Private Equity Market in 2021: The Allure of Growth, Bain & Company (March 7, 2022).

3 Kim Kardashian's Newest Business Venture: Private Equity, The Wall Street Journal (Sep. 7, 2022).

4 Elizabeth Warren, *End Wall Steet's Stranglehold on Our Economy*, Medium (Jul. 18. 2019), https://medium.com/@teamwarren/end-wall-streets-stranglehold-on-our-economy-70cf038bac76.

5 Rohit Chopra, Twitter (Jan. 28, 2019).

6 Rohit Chopra, Statement of Commissioner Rohit Chopra Regarding Private Equity Roll-ups and the Hart-Scott-Rodino Annual Report to Congress (July 8, 2020), https://www.ftc.gov/legal-library/browse/cases-proceedings/public-statements/statement-commissioner-rohit-chopra-regarding-private-equity-roll-ups-hart-scott-rodino-annual.

7 Stefania Palma, Mark Vandevelde, and James Fontanella-Khan, *Lina Khan vows 'muscular' US antitrust approach on private equity deals*, Financial Times, https://www.ft.com/content/ef9e4ce8-ab9a-45b3-ad91-7877f0e1c797.

8 Jonathan Kanter, Assistant Attorney General, Antitrust Division, United States Department of Justice, Keyn Address at the University of Chicago Stigler Center: Antitrust Enforcement: The Road to Recovery (April 21, 2022).

9 Exec. Order No. 14036, 86 FR 36987 (2021).

termination for deals that are competitively benign;[10] (3) legislation that will increase HSR filing fees for large transactions;[11] (4) expansion of the scope of Second Requests to cover areas such as impact on labor markets; (5) issuance of "warning letters" cautioning merging parties that agency investigations remain open indefinitely, and they close at their own risk;[12] (5) adoption of a "prior approval" policy requiring parties that enter into settlements to resolve competition concerns to give the FTC veto power over future deals;[13] and (6) a comprehensive reassessment of the Merger Guidelines.[14]

Many of these changes have already impacted dealmaking, particularly transactions involving existing portfolio companies, or where sponsors have multiple investments in the same or adjacent sectors. These impacts include longer deal timetables, the agencies discrediting deal efficiencies, skepticism around the labor market impact of anticipated headcount reductions, and complications in purchasing divestiture assets (not particularly easy for PE in the first place).

III. ENFORCEMENT FOCUS ON HEALTHCARE TRANSACTIONS

While these impacts are seemingly broad-ranging and sector-agnostic, the healthcare sector has been a particular focus of the agencies, foreshadowing how antitrust enforcement in the PE context may unfold in other areas.

On June 3, 2022, in prepared remarks presented at the ABA Antitrust Healthcare Conference in Washington, DC, DOJ Deputy Assistant Attorney (AAG) General Andrew Forman publicly stated that the DOJ is considering "enhancing antitrust enforcement around a variety of issues surrounding private equity."[15] Forman set the stage by pointing to the volume of PE dealmaking in 2021, citing "a record 14,730 deals globally worth $1.2 trillion… that is trillion with a T," adding that healthcare was the second leading sector for PE investments. While acknowledging that "[p]rivate equity can play an important role in our economy," he suggested that "certain private equity transactions and conduct suggest an undue focus on short-term profits and aggressive cost-cutting" that in the healthcare space "can lead to disastrous patient outcomes and, depending on the facts, may create competition concerns."[16]

In addition, Forman referred to testimony from industry stakeholders at healthcare "listening forums" hosted by the Federal Trade Commission and DOJ, describing "firsthand experiences about the effect of consolidation and acquisitions by private equity groups … [such as] fewer caregivers, degradation of care, commoditization of health care services, and increased prices."[17] He also remarked that the DOJ

10 Press Release, Fed. Trade Comm'n, FTC, DOJ Temporarily Suspend Discretionary Practice of Early Termination (February 4, 2021), https://www.ftc.gov/news-events/news/press-releases/2021/02/ftc-doj-temporarily-suspend-discretionary-practice-early-termination.

11 On September 29, 2022, the U.S. House of Representatives passed the Merger Filing Fee Modernization Act of 2022 (H.R. 3843, 117th Cong. § 2 (2022)). The Senate passed a similar bill in 2021, and the Biden Administration expressed its support for the bill. Executive Office of the President, Statement of Administrative Policy: H.R. 3843 – Merger Filing Fee Modernization Act of 2022 (September 27, 2022).

12 See Holly Vedova, Acting Director of the Fed Trade Comm'n's Bureau of Competition, Adjusting merger review to deal with the surge in merger filings (August 3, 2021), https://www.ftc.gov/enforcement/competition-matters/2021/08/adjusting-merger-review-deal-surge-merger-filings.

13 See Press Release, Fed Trade Comm'n, FTC Rescinds 1995 Policy Statement that Limited the Agency's Ability to Deter Problematic Mergers (July 21, 2021), https://www.ftc.gov/news-events/press-releases/2021/07/ftc-rescinds 1995-policy-statement-limited-agencys-ability-deter.

14 Press Release, Fed. Trade Comm'n and Dep't of Justice, Federal Trade Commission and Justice Department Seek to Strengthen Enforcement Against Illegal Mergers (Jan. 18, 2022), https://www.ftc.gov/news-events/news/press-releases/2022/01/federal-trade-commission-justice-department-seek-strengthen-enforcement-against-illegal-mergers.

15 Andrew Forman, *The Importance of Vigorous Antitrust Enforcement in Health Care*, Remarks as Prepared for Delivery, https://www.justice.gov/opa/speech/deputy-assistant-attorney-general-andrew-forman-delivers-keynote-abas-antitrust.

16 *Id.*

17 *Id.*

is analyzing recent competition studies, which he said illustrate the negative impact of certain PE acquisitions in healthcare products and services, including home health care, inpatient services, outpatient services, and pharmaceuticals.[18]

Against this backdrop, Forman highlighted four specific areas of enforcement focus:

1. Roll-Ups: Increased scrutiny of PE "roll-ups" consisting of smaller, often sub-HSR-reportable transactions that may cumulatively reduce competition or create a monopoly over time. Along similar lines, the DOJ is analyzing whether reportable PE acquisitions may violate the antitrust laws by creating or enhancing market power across a stack of technology or other products or services.

2. Incentives: The DOJ is focused on whether PE transactions may chill competition by dampening firms' incentives to act as disruptors or mavericks, and/or causing them to focus on short-term financial gain, rather than innovation or quality.

3. Interlocking Directorates: The DOJ is committed to taking "aggressive action" to enforce Section 8 of the Clayton Act, which prohibits interlocking directorates. Subject to certain exceptions, a prohibited interlock can occur where the same person – or different individuals appointed by the same firm – serve(s) as an officer or director of one or more competing portfolio companies.[19]

4. HSR Deficiencies: Forman also indicated that the DOJ has recently become aware of unspecified "HSR filing deficiencies" relating to PE transactions causing them to "ask themselves whether private equity companies may not be taking seriously enough their obligations under the HSR Act." The agency is considering next steps in these areas.

IV. RECENT ENFORCEMENT – JAB CONSUMER PARTNERS

Less than two weeks after Forman's remarks, on June 13, 2022, the FTC announced it had entered into a consent agreement with JAB Consumer Partners SCA SICA (JAB), a PE owner of two portfolio companies operating veterinary clinics, in connection with its proposed acquisition of veterinary clinic operator SAGE Veterinary Partners, LLC (Sage) for $1.1 billion. The FTC's complaint alleged that the combination would substantially lessen competition in the market for internal medicine, neurology, medical oncology, critical care, surgery, and emergency veterinary services in Austin, Texas; San Francisco, California; and between Oakland, Berkeley, and Concord, California.[20] The settlement requires JAB to divest competing veterinary clinics in Texas and California.[21] In addition, JAB must obtain the FTC's prior approval for any acquisition of a veterinary clinic within 25 miles of its existing clinics in California and Texas for 10 years,[22] and provide 30-day written notice to the FTC of any acquisition of a veterinary clinic within 25 miles of an existing JAB clinic anywhere in the U.S.[23]

18 See, e.g. Laura Alexander and Richard Scheffler, *Soaring Private Equity Investment in the Healthcare Sector: Consolidation Accelerated, Competition Undermined, and Patients at Risk* (May 18, 2021), available at https://publichealth.berkeley.edu/wp-content/uploads/2021/06/AAI-Petris-Private-Equity-Healthcare-Report.pdf; Liu, Tong, Bargaining with Private Equity: Implications for Hospital Prices and Patient Welfare (July 30, 2021) https://ssrn.com/abstract=3896410 (finding that PE buyouts led to "an 11% increase in total healthcare spending for the privately insured in affected markets"). More generally, there is a growing body of scholarship finding that common ownership of minority interests in competing companies can lead to anticompetitive effects. See Fiona Scott Morton and Herbert Hovenkamp, *Horizontal Shareholding and Antitrust Policy*, 127 Yale L.J. 2026 (2018); Jose Azar, Martin C. Schmalz, and Isabel Tecu, Anticompetitive Effects of Common Ownership, 73(4) Journal of Finance 1513 (2018). Other scholars have found "ample empirical evidence that PE funds raise the productivity of the businesses they acquire," with a tendency to decrease marginal costs and increase product quality, and that "blocking acquisitions [by PE funds] may come at the cost of forgoing the reorganization of inefficient firms." Pehr-Johan Norbäck, Lars Persson & Jooacim Tåg, *Private Equity Buyouts: Anti- or Pro-Competitive?*, SSRN Electronic Journal at 2-3 (January 2018), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3128858. Along similar lines, former DOJ Antitrust Division head Makan Delrahim has warned that aggressive enforcement against private equity firms is "at odds with the economic evidence," as "[a]cademic studies have found that private equity is good for competition…" Makan Delrahim, *Antitrust Attacks on Private Equity Hurt Consumers*, Wall Street Journal, Jul. 31, 2022.

19 Michael E. Blaisdell, *Interlocking Mindfulness*, Competition Matters (FTC Blog) (June 26, 2019), available at https://www.ftc.gov/enforcement/competition-matters/2019/06/interlocking-mindfulness.

20 Complaint at 3-5, *In the Matter of JAB Consumer Partners SCA Sicar et al.*, File No. 211 0140, Docket No. C-4766 (June 13, 2022).

21 Decision and Order, *In the Matter of JAB Consumer Partners SCA Sicar et al.*, File No. 211 0140, Docket No. C-4766 (June 13, 2022).

22 *Id.* at 21.

23 *Id.*

In a statement supporting the action, FTC Chair Lina Khan, joined by Commissioners Rebecca Slaughter and Alvaro Bedoya, opined that such provisions would enable the agency to "better address stealth roll-ups by private equity firms."[24] In addition, Chair Khan issued a scathing rebuke of the private equity business model, which could be read as a policy position on PE M&A moving forward:

> Antitrust enforcers must be attentive to how private equity firms' business models may in some instances distort incentives in ways that *strip productive capacity, degrade the quality of goods and services*, and *hinder competition*. Private equity firms' playbook for purchasing or investing in companies can include tactics such as leveraged buyouts, which saddle businesses with debt and shift the burden of financial risk in ways that can *undermine long-term health and competitive viability*. While private equity firms can support capacity expansion and upgrades, firms that seek to strip and flip assets over a relatively short period of time are focused on increasing margins over the short-term, which can *incentivize unfair or deceptive practices and the hollowing out of productive capacity*. Meanwhile, serial acquisitions or "buy-and-buy" tactics can be used by private equity firms and other corporations to roll up sectors, enabling them to accrue market power and reduce incentives to compete, potentially leading to *increased prices and degraded quality*.[25]

Two weeks later, the FTC announced another settlement with JAB in connection with its acquisition of VIPW, LLC and Ethos Veterinary Health LLC. That settlement also contained a prior approval provision and required JAB to divest veterinary clinics in various metropolitan areas.[26] In the FTC's press release announcing the consent agreement, Holly Vedova, Director of the Bureau of Competition, explained that the agency took action to "prevent private equity firm JAB from gobbling up competitors in regional markets that are already concentrated."[27]

V. AGGRESSIVE ENFORCEMENT AROUND INTERLOCKING DIRECTORATES

Following AAG Andrew Forman's public warning, U.S. antitrust enforcers have been taking aggressive action to discover and eliminate unlawful interlocks under Section 8 of the Clayton Act, with potentially serious consequences for private equity funds.

Section 8 prohibits a "person" from serving simultaneously as an officer or director of competing corporations engaged in commerce in the U.S., where each corporation has capital, surplus, and undivided profits of more than $41,034,000 (adjusted annually).[28] Section 8 has historically been a prophylactic statute intended to prevent antitrust violations by reducing the opportunity for competitors to coordinate decision-making or exchange competitively sensitive information. While the agencies or private plaintiffs may seek injunctive relief or civil damages, the most common remedy has been elimination of the interlock through removal of a conflicted officer or director. Historically, agency enforcement actions and litigated cases have been uncommon, with Section 8 enforcement relying instead on a mix of proactive self-policing and naming-and-shaming. However, this may change in light of the agencies' recent aggressive posture

In September 2021, the FTC adopted a resolution giving staff greater authority to issue compulsory process to investigate "common directors and officers and common ownership."[29] In April 2022, DOJ's Kanter vowed to "ramp[] up efforts to identify [Section 8] violations" and bring enforcement actions.[30] In late September 2022, DOJ began issuing letters to public companies, investors, and individuals, alleging unlawful

24 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 Commission File No. 2110140 (June 13, 20220, https://www.ftc.gov/system/files/ftc_gov/pdf/2022.06.13%20-%20Statement%20of%20Chair%20Lina%20M.%20Khan%20Regarding%20NVA-Sage%20-%20new.pdf citing Eileen Appelbaum & Rosemary Batt, Private Equity at Work: When Wall Street Manages Main Street (2014); Statement of Commissioner Rohit Chopra Regarding Private Equity Roll-ups and the Hart-Scott Rodino Annual Report to Congress (July 8, 2020).

25 *Id.* (emphasis added).

26 Decision and Order, *In the Matter of JAB Consumer Partners SCA Sicar et al.*, File No. 2110174, FTC Docket No. C-4770 (June 29, 2022).

27 Press Release, Fed Trade Comm'n, FTC Takes Second Action Against JAB Consumer Partners to Protect Pet Owners from Private Equity Firm's Rollup of Veterinary Services Clinics (June 29, 2022), https://www.ftc.gov/news-events/news/press-releases/2022/06/ftc-takes-second-action-against-jab-consumer-partners-protect-pet-owners-private-equity-firms-rollup-of-veterinary-services-clinics.

28 Section 8 provides a safe harbor where (1) the competitive sales of either corporation are less than $4,103,400 (adjusted annually); the competitive sales of either corporation are less than two percent of that corporation's total sales; or (3) the competitive sales of each corporation are less than four percent of that corporation's total sales. There is also a one-year grace period for resignation if there is change (e.g., corporations becoming competitors) that creates an interlock in violation of Section 8.

29 Press Release, Fed Trade Comm'n, FTC Streamlines Consumer Protection and Competition Investigations in Eight Key Enforcement Areas to Enable Higher Caseload (September 14, 2021), https://www.ftc.gov/news-events/news/press-releases/2021/09/ftc-streamlines-consumer-protection-competition-investigations-eight-key-enforcement-areas-enable.

30 Jonathan Kanter, Opening Remarks at 2022 Spring Enforcers Summit (April 4, 2022), https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-opening-remarks-2022-spring-enforcers.

interlocking directorates, citing public filings in support of their claims, and threating legal action if the recipients did not respond within 24–48 hours. The DOJ has sent similar notice to PE private firms, presumably stemming from information provided in HSR filings.

On October 19, 2022, the DOJ announcement that seven board members of five separate companies had resigned in response to DOJ's concerns around potential Section 8 violations.[31] The resignations spanned several industries, including healthcare, aerospace infrastructure, transportation, online educational services, and alternative energy software.[32] In the DOJ's press release, Antitrust Division head Kanter signaled that this was just the beginning, saying "[t]he Antitrust Division is undertaking an extensive review of interlocking directorates across the entire economy and will enforce the law."[33]

VI. KEY TAKEAWAYS

In light of these developments, practitioners and PE dealmakers should note the following:

· Private equity dealmaking is increasingly a focus of the U.S. antitrust enforcers. The agencies' recent statements and decisions illustrate that their escalating rhetoric and skepticism towards private equity is culminating in action, with real consequences for M&A in this space, with more headwinds likely on the horizon.

· Private equity firms considering M&A in any segment of the healthcare sector should anticipate greater scrutiny, particularly for deals that may create portfolio overlaps, entail vertical relationships with portfolio companies, target market disruptors, or involve companies that operate in areas that are adjacent to existing holdings. They should also pay close attention to antitrust-related regulatory provisions upfront, including with respect to efforts, cooperation, hell-or-high-water obligations, outside date, reverse termination fees, and responsibilities in the event of receipt of a warning letter from the agencies.

· Private equity teams should pay close attention to the language they use in their deal analyses and investment memoranda and assume they will be examined by antitrust enforcers. Even sparing use of seemingly innocuous terminology that is common in the transaction context can be taken out of context by the agencies, leading to protracted review. Moreover, deal elements such as SG&A headcount synergies, which previously may have been considered procompetitive, may be closely scrutinized for their potential impact on labor.

· Private equity firms should work with antitrust counsel to conduct thorough HSR filing analyses, ensure that HSR filings are complete and accurate, and assess the risk of any potential interlocks stemming from transactions. They should also understand that agencies may utilize filings to gain greater transparency into fund and portfolio structure and M&A pipelines.

· Finally, private equity firms should (1) undertake detailed, proactive review of governance frameworks across portfolios to identify potential Section 8 issues; (2) work with counsel to closely analyze the applicability of Section 8, including possible exemptions and relevant case law; and (3) and implement appropriate compliance safeguards to address existing issues and prevent future violations.

31 Press Release, Dep't of Justice, Directors Resign from the Boards of Five Companies in Response to Justice Department Concerns about Potentially Illegal Interlocking Directorates (October 19. 2022), https://www.justice.gov/opa/pr/directors-resign-boards-five-companies-response-justice-department-concerns-about-potentially.

32 *Id.*

33 *Id.*

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