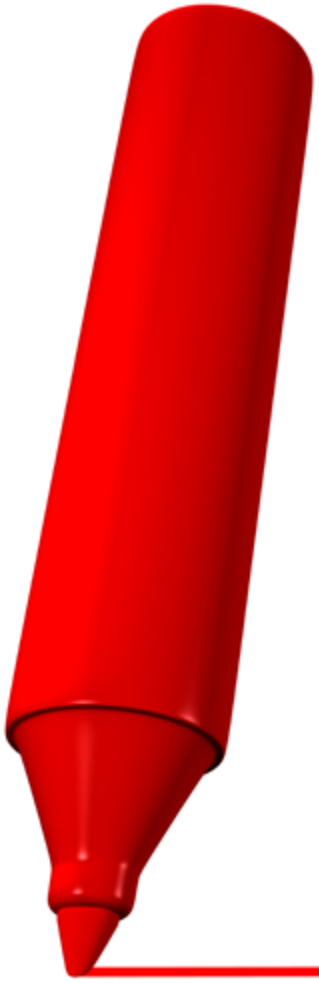
UNCERTAINTY IN THE BOTTOM LINE: NEW ANTITRUST SCRUTINY AND ENFORCEMENT IN PRIVATE EQUITY TRANSACTIONS



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UNCERTAINTY IN THE BOTTOM LINE: NEW ANTITRUST SCRUTINY AND ENFORCEMENT IN PRIVATE EQUITY TRANSACTIONS

By Arindam Kar, Matthew Hans & Mitchell Raup

No industry in America is more in the crosshairs of antitrust scrutiny and enforcement than private equity firms. Private equity transactions and investments, especially in the healthcare sector, are not only subject to "traditional" antitrust enforcement review from the Federal Trade Commission ("FTC") and Antitrust Division of the Department of Justice (collectively, the "Agencies"), but they are also receiving new levels of federal review pursuant to the Biden Administration's "whole-of-government" approach to antitrust enforcement. The expansive enforcement strategy, the FTC's new legal framework, the Agencies' new pending premerger filing rules, and the new Merger Guidelines all represent a massive risk profile paradigm shift for private equity firms. With no end in sight for this level of scrutiny, private equity firms must partner with their antitrust counsel, now more than ever, to get to a successful bottom line.

I. INTRODUCTION

No industry in America is more in the crosshairs of antitrust scrutiny and enforcement than private equity firms. Private equity transactions and investments are not only subject to "traditional" antitrust enforcement review from the Federal Trade Commission ("FTC") and Antitrust Division of the Department of Justice ("DOJ") (collectively, the "Agencies"), but they are also receiving new levels of federal review pursuant to the Biden Administration's "whole-of-government" approach to antitrust enforcement, as set forth in the President's July 2021 Executive Order ("EO").[2] Under this approach, the EO identified at least fourteen different federal departments and agencies that have been tasked to enforce an array of federal "industry-specific fair competition and anti-monopolization laws that often provide additional protections" beyond the Sherman Antitrust Act (15 U.S.C. §1), the Clayton Act (15 U.S.C. §18), and the FTC Act (15 U.S.C. §45).[3] This article highlights the new challenges private equity transactions face in light of (1) the Administration's concern about roll-up acquisitions and their impact on the economy and the public; (2) the FTC's effort to lead and build the legal framework to address these types of acquisitions in response to concerns that prior efforts have not been successful; (3) the proposed modifications to the premerger notification process, pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended ("HSR"), which arms the Agencies with the information they need to review and challenge private equity deals through (4) key provisions of the new Merger Guidelines ("Guidelines") that target private equity firms and transactions.

II. THE BIDEN ADMINISTRATION ROLLS OUT NEW SCRUTINY OF PRIVATE EQUITY ROLL-UPS AND OTHER TRANSACTIONS

While this article focuses on the Biden Administration's efforts in this space, the recent concerns about private equity transactions, particularly with regard to roll-up acquisitions, actually started under Trump Administration. Roll-up acquisitions reflect a comprehensive strategy when "dozens, hundreds, or even thousands of small businesses [are combined] into a large one with increased purchasing power, greater brand recognition, lower capital costs, and more effective advertising" such that it can be sold to a buyer as part of an investment exit strategy.[4] This type of acquisition strategy, according to the FTC, is highly problematic for a number of reasons. Former FTC Commissioner Rohit Chopra, in 2020, noted:

> [P]rivate equity buyouts are add-ons from previous acquisitions. One quarter of these private equity acquisitions are tied to an investment with at least five add-ons . . . . I am especially concerned about the unreported roll-ups in the health care sector . . . . Through these strategies, private equity sponsors can quietly increase market power and reduce competition . . . . The Commission should actively identify enforcement targets who may be engaged in monopolization or who have consummated unlawful mergers."[5]

The Biden Administration recognized this concern and built part of its antitrust policy in response to it, taking the explicit position that greater antitrust review and enforcement would significantly help address "decades of industry consolidation [that] have often led to excessive market concentration" across many sectors of the economy.[6] The White House has unabashedly accused private equity interests in health care of "profiteering" -- reducing quality to increase profits -- which "can lead to the consolidation of a market and contribute to worse patient outcomes while increasing taxpayer costs."[7] This consolidation has been going on for quite some time:

> Private-equity ownership in the health care industry has ballooned, with approximately $750 billion in deals between 2010 and 2020—in sectors including, but not limited to, physician practices, nursing homes, hospices, home care, autism treatment, and travel nursing. Too often, aggressive profiteering by private equity-owned practices can lead to higher patient costs and lower quality care.[8]

2 Executive Order on Promoting Competition in the American Economy (July 9, 2021).

3 *Id.* at Sections 2(c)-(e).

4 See Paul Carroll & Chunka Mui, *Seven Big Ways to Fail*, Harvard Business Review, (September 2008).

5 Statement of Commissioner Rohit Chopra Regarding Private Equity Roll-ups and the Hart-Scott-Rodino Annual Report to Congress (July 8, 2020).

6 EO, *supra* note 2.

7 Fact Sheet: Biden-Harris Administration Announces New Actions to Lower Health Care and Prescription Drug Costs by Promoting Competition (December 7, 2023).

8 *Id.*

The White House's multi-agency approach to addressing private equity transactions recently culminated with two events in March of 2024: (1) the "Virtual Workshop of Private Equity in Health Care," sponsored by the FTC, DOJ, Health and Human Services ("HHS") and the Centers for Medicare and Medicaid Services ("CMS") ("Virtual Workshop"), and (2) the FTC, DOJ, and HHS Request for Information ("RFI") seeking the public's input on "Corporate Greed in Healthcare."[9] The Virtual Workshop, headlined by FTC Chair Lina Khan, DOJ Assistant Attorney General Jonathan Kanter, HHS Inspector General Christi Grimm, and CMS Principal Deputy Administrator and Chief Operating Officer Jonathan Blum, highlighted the government's grave concerns that private equity deals in healthcare have reduced access and quality, while increasing costs. In a keynote presentation at the Virtual Workshop, Center for Economic and Policy Research Co-Director Eileen Applebaum identified a number of detrimental effects of private equity ownership in healthcare, including but not limited to (1) keeping profits that, under other forms of ownership, would be invested in capital improvements, human talent, and/or technology; (2) cutting costs by reducing medical staffing to the detriment of patient care; and (3) structuring debt such that it compromises the sustainability of healthcare companies.

For FTC Chair Khan, the concerns about private equity ownership in healthcare have seemingly shifted from economics to patient safety arguments. She asserts that one study found that "private equity takeovers of nursing homes and the staffing cuts that followed have led to increased mortality rates—specifically around 21,000 excess deaths among nursing home patients over the course of just 12 years."[10] DOJ Assistant Attorney General Kanter also echoed concerns about private equity directives guiding medical care decisions: "private equity firms . . . have inserted themselves at virtually every level of the health care system [and] are now positioned as intermediaries with the ability to pull these levers of healthcare."[11] Similarly, medical professionals shared stories about the adverse impact of private equity in rural healthcare, which has manifested in the form of poor patient care and outcomes.[12]

On the same day of the Virtual Workshop, the DOJ, FTC, and HHS issued an RFI seeking a better understanding on "how certain health care market transactions may increase consolidation and generate profits for firms while threatening patients' health, workers' safety, quality of care, and affordable health care for patients and taxpayers."[13] The RFI also sought information on "deals conducted by health systems, private payers, private equity funds, and other alternative asset managers that involve health care providers, facilities, or ancillary products or services," including deals not reportable under the HSR rules.[14] The RFI also explicitly calls for more information about private equity "transactions . . . structured to facilitate private equity investment, circumventing applicable corporate practice of medicine restrictions."[15] On May 1, 2024, the DOJ, FTC and HHS extended the RFI comment period through June 5, 2024 to build upon the nearly two thousand comments the three agencies had received.[16] In addition to the RFI comments, the three agencies also created a public portal to make it easier for the public to report to the government their concerns about competition in the healthcare marketplace, including the impact of private equity ownership.[17] According to HHS Secretary Xavier Becerra, "[t]he Biden-Harris Administration . . . know[s] it is our responsibility to stop monopolistic, anti-competitive practices that undermine the delivery of health care to Americans. The information provided by the public will help to root out these behaviors."[18]

III. FTC DUSTS OFF THE FTC ACT TO BUILD THE FRAMEWORK TO SCRUTINIZE PRIVATE EQUITY TRANSACTIONS

With strong White House support, the FTC implemented a thoughtful but expansive strategy to create the legal infrastructure to go after private equity roll-up deals, especially since prior legal efforts to use Section 7 of the Clayton Act to challenge roll-ups had proved to be difficult.[19] The

9 Workshop, Private Capital, Public Impact: An FTC Workshop on Private Equity in Health Care (March 5, 2024.

10 *Id.*

11 *Id.*

12 *Id.*

13 Press Release, DOJ, Federal Trade Commission, the Department of Justice and the Department of Health and Human Services Launch Cross-Government Inquiry on Impact of Corporate Greed in Health Care (March 5, 2024).

14 *Id.*

15 Request for Information on Consolidation in Health Care Markets, Docket No. ATR 102 (March 5, 2024) at p. 5.

16 Press Release, FTC, FTC, DOJ, and HHS Extend Comment Period on Cross-Government Inquiry on Impact of Corporate Greed in Health Care (May 1, 2024).

17 Press Release, FTC, Federal Agencies Launch Portal for Public Reporting of Anticompetitive Practices in the Health Care Sector (April 18, 2024).

18 *Id.*

19 See, e.g. *Washington v. Franciscan Health,* No. C17-5690 BHS (W.D. Wash. 2019) (Washington AG challenge to two physician practice acquisitions, allegedly as part of a roll-up strategy, failed because "[w]ithout evidence on the impact of the [first transaction] standing alone, the Court finds that the State has not shown a dispute of material fact to preclude summary judgment on its prima facie claim that the [first transaction] violates Section 7").

FTC's challenge to JAB Consumer Partners' acquisitions of veterinary clinics was its first foray into challenging a roll-up strategy under Section 5 of FTC Act (which arguably prohibits more transactions than does Section 7 of the Clayton Act), albeit in a traditional merger review context ("JAB").[20] In that matter the agency not only sought divestitures, but it also imposed onerous notification and approval processes for any future JAB acquisitions, noting the compelling basis to stem the "growing trend towards consolidation in the emergency and specialty veterinary services markets across the United States in recent years by large chains, including JAB, which regularly monitors local markets throughout the United States in contemplation of continued growth through potential small and large acquisitions of specialty and emergency clinics."[21] Under the settlement, JAB is required to obtain prior approval from the agency before a specialty or emergency veterinary clinic acquisition within twenty-five miles of a JAB-owned clinic in five jurisdictions; it also requires JAB to notify the FTC before acquiring any specialty or emergency veterinary clinic within 25 miles of a JAB-owned clinic anywhere in the United States, even if the transaction is not HSR-reportable. The approval and notification obligations last for ten years.[22]

Emboldened, in part, by the victory in JAB, the FTC set out a new legal framework incorporating some of the themes in JAB through its November 2022 Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act Commission ("Policy Statement).[23] The Policy Statement, in establishing that Section 5 of the FTC Act prohibits "unfair methods of competition," sets forth that:

> Section 5 reaches beyond the Sherman and Clayton Acts to encompass various types of unfair conduct that tend to negatively affect competitive conditions" including "a series of mergers, acquisitions, or joint ventures that tend to bring about the harms that the antitrust laws were designed to prevent, but individually may not have violated the antitrust laws.[24]

By expanding what the FTC can investigate (and in turn the ability to seek remedies for antitrust violations), the agency was once again ready to test its mettle. One of the first tests of the FTC's new, self-ascribed powers was its lawsuit against U.S. Anesthesia Partners, Inc. ("USAP") alleging that Welsh Carson's (the private equity owner of USAP) acquisition history constituted an unfair method of competition in violation of Section 5 of the FTC Act, "whether consider[ing] individual[ ] [acquisitions] or as a series of acquisitions."[25] The FTC pulled no punches in the complaint, alleging that:

> USAP and Welsh Carson[] [engaged in a] multi-year anticompetitive scheme to consolidate anesthesia practices in Texas, drive up the price of anesthesia services provided to Texas patients, and increase their own profits . . . . USAP and Welsh Carson engaged in what they referred to as a "roll-up," buying nearly every large anesthesia practice in Texas… . All told, USAP's roll-up scheme involved over a dozen practices, 1,000 doctors, and 750 nurses . . . . Thanks to its roll-up, price-setting agreements, and market allocation scheme, USAP is the dominant provider of anesthesia services in Texas and in many of its major metropolitan areas, including Houston and Dallas. No rival comes close to matching USAP's size. As of 2021, USAP was at least four times larger than the second-largest group in Houston; six times larger than the second-largest group in Dallas; and nearly seven times larger than the second-largest group in all of Texas. It is also one of the most expensive, with reimbursement rates that are double the median rate of other anesthesia providers in Texas . . . . In other words, thanks to its anticompetitive conduct, USAP has been able to extract monopoly profits while simultaneously growing its monopoly power. Defendants' scheme was so successful that Welsh Carson has already begun 'deploying a similar strategy to consolidate multiple other physician practice specialties.'[26]

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20 Press Release, FTC, FTC Approves Final Order against JAB Consumer Partners to Protect Pet Owners from Private Equity Firm's Rollup of Veterinary Services Clinics (October 14, 2022).

21 *Id.*

22 Press Release, FTC, 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).

23 Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act Commission File No. P221202 (November 10, 2022).

24 *Id.* It is also important to note that the groundwork for the expansion of Section 5 was the withdrawal of the FTC's 2021 policy that limited Section 5 to only what the Sherman Act and Clayton Act prohibited.

25 *FTC v. U.S. Anesthesia Partners, Inc., et al.*, Case No. 4:23-cv-03560 (S.D. Tex. Sep. 21, 2023), ¶¶ 354-55.

26 *Id.* at ¶¶ 1,4,8-9.

The adjudication of this case will provide significant insight on the viability of the FTC Section 5 strategy where Section 7 of the Clayton Act has largely failed to prohibit small, serial transactions in the same industry segment. The FTC has already suffered a significant blow in the case, with the district court granting Welsh Carson's motion to dismiss (but denying USAP's motion).[27] While this decision, if it holds, will impact the FTC's efforts to bring enforcement against private equity firms with minority interests and future conduct (as discussed in greater detail below), it remains to be seen if USAP's early deals during its nine-year acquisition history will be deemed illegal based on the subsequent, more recent acquisitions because of the purported anticompetitive roll-up strategy. And finally, it will be fascinating to see what the court may craft, if the FTC prevails, as to an appropriate remedy for an illegal roll-up strategy.

IV. THE AGENCIES REVAMP THE HSR FORM TO IMPROVE THE REVIEW EFFICACY OF PRIVATE EQUITY TRANSACTIONS UNDER THE GUIDELINES

The FTC, along with the DOJ, rolled out their merger review strategy through the announcement of a new proposed HSR premerger notification form and the Guidelines. In June 2023, the Agencies outlined that the rationale for the massive redesign of the HSR filing was to, in part, gain more information and a better understanding of transactions in light of the complexity of deals and the insufficient information currently elicited through the HSR form.[28] The new form seeks more information on the "structure of entities involved such as private equity investments."[29] The Agencies will also seek "details regarding previous acquisitions," including nonreportable transactions, by requiring "both the acquiring person and the acquired entity to provide information about prior acquisitions" in overlap markets for the past 10 years "to assist the Agencies in identifying a potential pattern of acquisitions in a particular industry that has contributed to a trend toward concentration."[30]

The information that the Agencies will receive will position them well to analyze transactions under the Guidelines, which were issued in December 2023.[31] While all the Guidelines will impact the substantive analysis of any proposed transaction, the two Guidelines directed primarily at private equity transactions are Guidelines 8 and 11. Guideline 8, "When a Merger is Part of a Series of Multiple Acquisitions, the Agencies May Examine the Whole Series," makes clear that the DOJ and FTC take the position that "[a] firm that engages in an anticompetitive pattern or strategy of multiple acquisitions in the same or related business lines may violate Section 7" despite the unfavorable case law previously referenced.[32] The DOJ and FTC believe that:

> Where one or both of the merging parties has engaged in a pattern or strategy of pursuing consolidation through acquisition, the Agencies will examine the impact of the cumulative strategy under any of the other Guidelines to determine if that strategy may substantially lessen competition or tend to create a monopoly.[33]

This Guideline squarely makes roll-up acquisitions a new subject of merger reviews.

Guideline 11, "When an Acquisition Involves Partial Ownership or Minority Interests, the Agencies Examine Its Impact on Competition," reveals another layer of government scrutiny of private equity transactions.[34] Not only are roll-up deals in the crosshairs, but so are partial acquisitions. According to the Agencies, "[l]ess-than-full control may still influence decision-making at the target firm or another firm in ways that may substantially lessen competition." Competition could be lessened by influencing competitive conduct in a number of ways. For example, a partial acquisition could give a minority owner influence over the target's competitive decisions through voting and nonvoting interests; by disincentivizing companies from rigorously competing against other competitors, especially when a private equity firm may have interest in both; and by enabling coordination through improper information exchange.[35] To assess these competitive risks, the Agencies have indicated that they will review items such as board member appointments, board meeting access, operations decisions, and information exchange during board meetings.[36]

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27 *USAP*, Memorandum Opinion and Order (May 13, 2024).

28 Press Release, FTC, FTC and DOJ Propose Changes to HSR Form for More Effective, Efficient Merger Review (June 27, 2024).

29 *Id.*

30 Federal Register, FTC Proposed Rule, Premerger Notification; Reporting and Waiting Period Requirements (August 10, 2023).

31 Press Release, FTC, Federal Trade Commission and Justice Department Release 2023 Merger Guidelines (December 18, 2023).

32 FTC and DOJ Merger Guidelines, Guideline 8 (December 18, 2023); *see Franciscan Health, supra* note 19.

33 *Id.*

34 FTC and DOJ Merger Guidelines, Guideline 11 (December 18, 2023).

35 *Id.*

36 *Id.*

The whole-of-government enforcement strategy, the FTC's new legal framework, the Agencies' new pending HSR filing rules and the Guidelines all represent a massive risk profile paradigm shift for private equity firms. With no end in sight for this level of scrutiny, private equity firms must partner with their antitrust counsel, now more than ever, to get to a successful bottom line.

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