# ANTITRUST ENFORCERS INTENSIFY SCRUTINY OF PRIVATE EQUITY DEALS

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## ANTITRUST ENFORCERS INTENSIFY SCRUTINY OF PRIVATE EQUITY DEALS

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Over the last several years, private equity firms have faced an increasingly aggressive antitrust enforcement environment, both in the U.S. and abroad. This increased scrutiny has involved more than just skepticism regarding private equity's suitability as a divestiture buyer — the U.S. Department of Justice, Federal Trade Commission and antitrust agencies in Europe are also closely examining private equity acquisition strategies as a whole, general investment incentives, potential filing violations and board interlocks. Antitrust regulators may, however, ultimately have difficulty proving that private equity business models actually result in less competition, as the very business models currently under the microscope, in practice, often result in faster growth, greater innovation and enhanced competitiveness. The bottom line is that, with the right approach, private equity firms can continue to pursue their investment and acquisition strategies despite greater agency scrutiny.



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# I. INTRODUCTION

For the last several years, across two U.S. presidential administrations and amidst increased focus in the European Union and UK, private equity ("PE") firms have faced a rising tide of aggressive antitrust enforcement rhetoric. In the U.S., the wave of increased scrutiny on PE began in earnest with then-FTC Commissioner Rohit Chopra's statements in 2018 on the suitability of PE firms as divestiture buyers. In the years since, both the Federal Trade Commission ("FTC") and the U.S, Department of Justice ("DOJ") have doubled down on their commitment to put PE in the spotlight — not only with respect to PE's role in the divestiture process, but also for PE's acquisition strategy as a whole, general investment incentives and creation of potentially problematic board interlocks.

In the last few months, both agencies have started to make good on this promise. The FTC has reinstituted prior approval and notice requirements in merger-related consent decrees, requiring PE firms to agree to FTC oversight of certain future acquisitions. Additionally, both U.S. antitrust agencies have recently included new provisions in merger-related subpoenas ("Second Requests") to solicit information on PE incentives and potential board interlocks. And recently, the DOJ has begun issuing letters to PE firms informing them that the agency is investigating potential violations of Section 8 of the Clayton Act, which prohibits board interlocks among competitors.

This call for closer scrutiny of PE firms' acquisition strategy and behavior has echoed across the Atlantic. In the UK, former Chief Executive of the Competition and Markets Authority ("CMA"), Andrea Coscelli, has in recent years highlighted the potential need for antitrust regulators to take account for PE acquirers' business models when assessing the anticipated effects of PE transactions. Coscelli has also specifically flagged the alleged impact of PE leveraging on post-closing competitiveness of target companies as an area that merits further investigation.

Regulators may, however, ultimately face an uphill battle to show that PE business models render portfolio companies less competitive — in practice, such investments often spur innovation and accelerate growth. Indeed, PE firms' industry experience, management skills and expertise generally allow for the efficient operation and growth of smaller companies. Thus, despite increasing regulatory scrutiny, it is unlikely that PE firms will be discouraged from pursuing certain acquisitions (nor should they be). With the right approach, PE firms can continue to execute on their acquisition strategies without raising significant antitrust issues.

# II. PE ACQUISITION STRATEGY UNDER THE MICROSCOPE

### *A. Background*

One of the most notable ways in which recent U.S. antitrust regulator interest in PE firms has diverged from past PE-related concerns is the call to more closely scrutinize PE acquisition practices and strategy as a whole. While both U.S. agencies have historically relied on Section 7 of the Clayton Act, the U.S. government's primary merger enforcement tool, to prohibit PE acquisitions that substantially lessen competition, management at both the FTC and DOJ have publicly announced an intention to explore new ways to more closely monitor strings of PE acquisitions in the same industry (so-called "roll-ups") and aggressively investigate strategies that, as DOJ Antitrust Division Assistant Attorney General Kanter put it, are "designed to hollow out . . . an industry and essentially cash out."

In Europe, then-Chief Executive Coscelli co-authored a March 2022 working paper on market resilience that reflected on the circumstances in which the effects of highly leveraged acquisitions (including by PE firms) could or should be considered in merger review. Coscelli specifically suggested that such transactions could render target companies more vulnerable to economic uncertainty and, ultimately, failure, resulting in a lessening of competition. This was preceded by a July 2021 letter by Coscelli to the Chair of the UK Parliament's Business, Energy and Industrial Strategy Committee, which raised questions about the scope of the CMA's regulatory powers to review highly leveraged purchases.

Of course, merger control reviews in the UK, as well as in the EU and many other jurisdictions (the rest of the world, or "ROW"), generally are not driven by "public interest" concerns or (at least ostensibly) political considerations. Instead, antitrust regulators scrutinize transactions on their merits — namely, the effects on competition of any horizontal overlaps and vertical or conglomerate links between the merging parties. In other words, regulatory challenges to transactions must be grounded in legal and economic analysis of whether the proposed transaction is expected to result in significant harm to competition within a reasonably short timeline.

### *B. U.S.*

Despite the fact that PE firms may operate their portfolio companies entirely independently of one another (including, e.g. owning the portfolio companies in separate funds with different ownership horizons and performance goals, employing separate management teams, etc.), PE acquisitions are still subject to Section 7 of the Clayton Act, which prohibits mergers and acquisitions where the effect "may be to substantially lessen competition, or to tend to create a monopoly." As part of a Section 7 inquiry, the FTC and DOJ will consider whether the PE firm owns any portfolio companies that compete with the target or have a vertical (i.e. supply) relationship with the target or its competitors. If so, the FTC and DOJ will evaluate a number of factors to determine whether the transaction is likely to present anticompetitive effects, such as closeness of competition, market shares and the existence of any entry and expansion barriers. This is particularly relevant for PE firms that routinely pursue deals in the same industry. For deals that involve the acquisition of a minority interest in a company that competes with a PE firm's portfolio company, it is also critical to account for Section 1 of the Sherman Act, which prohibits contracts, combinations and conspiracies in restraint of trade.

Additionally, PE acquisitions are subject to the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act"), provided the acquisition meets certain requirements. The HSR Act requires the notification of the transaction to the FTC and DOJ, as well as the provision of certain information about the deal and select documents. It is worth noting that PE acquisitions are occasionally exempt from HSR filing requirements due to the application of certain HSR definitions and other rules that determine whether affiliate funds are considered to be commonly controlled and whether affiliate fund holdings should be aggregated (for example, a newly created fund may not meet the required HSR filing threshold because the fund's holdings are not aggregated with an affiliate fund).

During the initial 30-day waiting period mandated by the HSR Act (and any subsequent extensions due to, e.g. a Second Request), the parties are prohibited from closing the acquisition. Additionally, during this period, the buyer may not begin exercising operational control over the target (known as "gun-jumping"). Violations of any of the above — failing to report a transaction that meets the requisite HSR thresholds, observe the waiting period or observe appropriate gun-jumping restrictions — can subject the buyer to significant liability.

So-called industry "roll-ups" or repeated acquisitions in the same industry are top of mind for the U.S. antitrust regulators, even where those acquisitions are not reportable under the HSR Act. In a May *Financial Times* piece, AAG Kanter was critical of certain PE acquisition strategies that are allegedly "at odds with the competition we're trying to protect" and suggested such behavior would necessitate aggressive enforcement that is "top of mind for me." In a June interview with the *Financial Times*, Chair Khan echoed these statements, noting that the FTC needs to "improve our tools to go after [PE firms] in a more muscular way."

The agencies' increased focus on PE has already had an impact on the competitiveness of PE buyers in certain auction settings, as well as on negotiations of antitrust risk-shifting terms in purchase agreements. For example, it is not uncommon for sellers to insist that buyers — even PE buyers that do not present any or minimal antitrust issues — agree to a "hell-or-high-water" efforts standard or strict "clear market" provisions that restrict a PE firm's ability to engage in certain other transactions. PE buyers are increasingly pushing back on these covenants, however, given the mounting uncertainty and risk of potentially prolonged review and the prospects of unpredictable remedies that may materially and adversely impact other investments they hold.

Not only will the U.S. antitrust agencies more closely scrutinize PE acquisitions in the same industry (including those that are not HSR-reportable), but the agencies are also taking a closer look at whether PE firms are being too cavalier in their observation of filing and operational requirements under the HSR Act. In a June speech at the American Bar Association's Antitrust in Healthcare Conference, Antitrust Division Deputy Assistant Attorney General Andrew Forman flagged that the DOJ had recently become aware of "HSR filing deficiencies in the private equity space" and suggested that PE firms were "not taking seriously enough their obligations under the HSR Act." These statements come on the heels of reports that the antitrust agencies are evaluating pre-merger notification forms to enhance disclosure requirements and require merging parties to provide more information to the agencies up-front. Additionally, in September 2020, the U.S. antitrust agencies announced proposed changes to the HSR process that would greatly expand PE reporting obligations, and potentially slow down the ability of PE firms to quickly prepare and file HSR notifications.

### *C. ROW*

This increased scrutiny of PE transactions is also likely to affect merger review processes outside of the U.S. In the UK, if the CMA has concerns about highly leveraged transactions in sensitive markets, it may be less inclined to grant informal regulatory clearance through the use of so-called "briefing papers," short letters to the authority informing them of the transaction and explaining why it does not raise antitrust concerns.

The CMA typically reviews the information provided in the letter for a period of 2-4 weeks and then either confirms that the authority does not have any further questions (i.e. informal clearance) or calls the transaction in for a full review. The CMA may more frequently require that full notifications be submitted, which would significantly lengthen the review timeline from a few weeks to several months (including, at a minimum, pre-notification interactions lasting a few months followed by a minimum of 40 working days for the formal review period).

Similarly, the European Commission ("EC") may find itself less inclined to permit the use of so-called "short" form notifications, which provide significantly less information and are less burdensome for the parties to prepare than the standard "full" versions of the EU merger control filings. This is especially true for bolt-on PE transactions that may create (albeit limited) overlaps or vertical links between certain PE portfolio companies and the target. Permission to notify transactions in the EU using the short-form submission is at the EC's discretion and is largely based on the parties' market shares in the relevant markets and segments. Thus, increasingly concentrated PE investments may mechanically lead to fewer short-form notifications.

## III. CONTINUED AGENCY SKEPTICISM OF PE DIVESTITURE BUYERS

### *A. Background*

It is not uncommon for PE firms to find themselves in an auction process for assets that are being sold pursuant to a merger-related divestiture (either in connection with a formal remedy or in a "fix-it-first" scenario). Whether PE firms are a suitable buyer for these divestiture assets, however — due, in large part, to a perception that PE financial incentives may not align with the promotion of competition — has been a hot-button issue for a number of years. The FTC has not been shy in its criticism of PE firms as divestiture buyers, as evidenced by then-Commissioner Chopra's commentary on PE buyers in the Linde/Praxair merger. The DOJ, for its part, has — as recently as 2020 — recognized the potential benefits of PE buyers. That said, the current DOJ administration seems to have picked up the FTC's mantle, questioning PE incentives that may degrade the competitive viability of the purchased business.

### *B. U.S.*

In recent years, both the DOJ and FTC have issued formal guidance on the merger remedies process and the characteristics of a suitable divestiture buyer. The DOJ's Merger Remedies Manual, published in 2020 (though just recently declared inactive and withdrawn by the DOJ), notes that the DOJ's approval of a divestiture buyer is based on three core tests: (1) the divestiture must not create an independent antitrust issue, (2) the divestiture buyer must be incented to use the divestiture assets to compete in the relevant market and (3) the DOJ must be satisfied that the divestiture buyer has the requisite sophistication, industry experience and financial ability to effectively compete with the assets over the long term. Importantly, the DOJ guidance specifically notes that "[t]he Division will use the same criteria to evaluate both strategic purchasers and purchasers that are funded by private equity or investment firms," and specifically references the FTC's 2017 merger remedies retrospective that recognized the reasons why, in certain cases, a PE buyer may be preferable to a strategic purchaser.

The aforementioned FTC merger retrospective, officially entitled The FTC's Merger Remedies 2006-2012, offers insight into how the FTC evaluates potential divestiture buyers. The study notes that, historically, strong divestiture buyers were "familiar with the market, dealt with many of the same customers and suppliers, had developed thoughtful business plans with realistic financial expectations and sufficient backing, and were well received by market participants." The FTC specifically highlighted a proposed buyer's "commitment to the market" (essentially, a buyer's commitment to compete with the asset and likelihood of success), as well as a buyer's financial capabilities, including how it plans to finance the deal and grow the business. As noted above, the FTC retrospective "revealed that there were cases where the buyer's flexibility in investment strategy, commitment to the divestiture, and willingness to invest more when necessary were important to the success of the remedy," whereas "there were cases where a buyer's lack of flexibility in financing contributed significantly to the failure of the divestiture."

In contrast with the above apparent receptiveness to PE buyers, the FTC has, over the last several years, maintained a skepticism when it comes to PE firms' role in the remedy process. In a much-publicized statement on the Linde/Praxair merger in 2018, then-FTC Commissioner Chopra criticized the approved remedy as not going far enough to "safeguard against risks often posed by the private equity buyer interest in the divested assets, as well as the level of debt financing and investment horizons involved." Commissioner Chopra specifically questioned whether the financing or governance structure would hamstring future investments or incentivize a quick flipping of the asset that would ultimately reduce competition. This concern is reflected in the FTC's recommitment (under Chair Khan and Bureau of Competition Director, Holly Vedova, both of whom worked closely with Commissioner Chopra during his tenure) to prior approval and notice requirements (of the type implemented in *Prince/Ferro, ANI/Novitium* and other recent decisions) that are designed to protect against the short-term resale of a divested business.

Current DOJ leadership has also raised doubts recently about PE firms' suitability as divestiture buyers. In a June speech at the American Bar Association's Antitrust in Healthcare Conference, Antitrust Division Deputy Assistant Attorney General Andrew Forman called out PE's "undue focus on short-term profits and aggressive cost-cutting" that influence why the DOJ "often looks more favorably on a market participant as a buyer of assets than a private equity firm." Interestingly, former Antitrust Division Assistant Attorney General Delrahim took to The Wall Street Journal in late July to counter these claims that PE investment has a chilling effect on competition.

### *C. ROW*

PE firms face similar issues in the EU, where the agencies have shown a certain reluctance to accept PE firms as divestiture buyers. On the one hand, European regulators' more interventionist approach presents opportunities for PE firms to acquire divested assets as part of third-party transactions requiring structural remedies. On the other hand, these agencies have consistently raised the bar on what constitutes a suitable divestiture buyer. European competition authorities are increasingly requiring divestiture buyer approval prior to clearing the overall divestiture and, by extension, the main transaction. Such conditions — known as upfront buyer requirements (UFB) — can be burdensome on all parties, including the prospective buyer. This is because UFBs require (i) a detailed antitrust assessment of the divestiture's impact on competition and the buyer's ability to take on and compete with the divested business from day one, and (ii) final form transaction documents, which must be approved by the regulator (and sometimes by multiple regulators across continents with potentially divergent approaches) prior to closing of the main deal.

With respect to point (i), PE firms must show that they would be suitable divestiture buyers. This, in turn, entails demonstrating not only that the divestiture will not generate competition issues of its own (e.g. because the PE firm is already present in the relevant space via another portfolio company), but also that the buyer will have the requisite industry experience and expertise to foster the divested business's growth and competitiveness. For these reasons, European competition authorities have occasionally ruled out PE firms as divestiture buyers by for want of industry experience. Regulators may instead favor strategic investors operating in spaces that are adjacent or vertical to the divested business.

## IV. INTERLOCKING DIRECTORATES RECEIVING RENEWED ATTENTION

### *A. Background*

Both the DOJ and FTC have expressed a renewed interest in enforcement under Section 8 of the Clayton Act, the primary antitrust enforcement mechanism limiting directors and officers from simultaneously serving as a director or officer of a competing company. This is particularly relevant to PE firms, which may have a particular industry focus or have employees serving concurrently on multiple portfolio company boards. Though not historically a focus for either agency (indeed, when enforced, Section 8 violations were often remedied retroactively with minimal punishment for the offenders), the DOJ and FTC have recently doubled down on their respective commitments to pursue Section 8 violations, with the DOJ stating in multiple forums that it intends to aggressively investigate board interlocks and the FTC including Section 8-focused provisions in Second Requests.

### *B. U.S.*

Section 8 of the Clayton Act prohibits a person from simultaneously serving as a director or officer of competing companies. The purpose of Section 8 is "to nip in the bud incipient violations of the antitrust laws by removing the opportunity or temptation to such violations through interlocking directorates." Section 8 does not require any actual anticompetitive conduct — rather, service itself on the board of directors of two competing companies is *per se* unlawful. The applicability of Section 8 is, however, subject to a number of requirements, including:

1. the companies must be horizontal competitors (based on traditional market definition criteria) and

2. the companies must each have "capital, surplus, and undivided profits" aggregating more than $41,034,000 (this is the 2022 threshold, which is adjusted annually).

Additionally, in order to remove *de minimis* competitive overlaps from the scope of Section 8, certain interlocks are exempt, including where

1. the competitive sales of either company are less than $4,103,400 (adjusted annually),
2. the competitive sales of either company are less than 2% of that company's total sales, or
3. the competitive sales of each company are less than 4% of that company's total sales.

In the last several months, Section 8 enforcement has taken center stage as an enforcement priority for both U.S. antitrust agencies. In an April speech, AAG Kanter noted that the DOJ would be "ramping up efforts to identify [Section 8] violations across the broader economy and will not hesitate to bring Section 8 cases to break up interlocking directors." The following month, AAG Kanter again flagged Section 8 issues as a key focus area for the DOJ in a *Financial Times* interview. At the American Bar Association's Antitrust in Healthcare conference in June, DOJ Antitrust Division Deputy AAG Andrew Forman stated that "to the extent PE investments in competitors leads to board interlocks in violation of Section 8, the division is committed to taking aggressive action." While the FTC has been less explicit in addressing Section 8 enforcement publicly, both agencies have added new Second Request provisions explicitly targeting information necessary to evaluate potential Section 8 issues.

The DOJ's recommitment to Section 8 enforcement has started to result in significant corporate action. In mid-October, the DOJ announced that seven directors resigned from the boards of five companies—across a variety of industries—as a result of DOJ investigations into Section 8 violations. These violations included both "direct" interlocks (where an individual serves simultaneously on the boards of two competitors) and "indirect" interlocks (where representatives of an entity or person serve on the boards of competing firms). Notably, these resignations were the culmination of DOJ investigations that occurred outside of the merger context (and as a result of Staff's efforts to independently seek out and investigate potential interlocks), signaling that AAG Kanter is making good on his prior statements regarding Section 8 enforcement and dedicating agency resources to look into possible violations. Proactively reviewing potentially problematic interlocks before the DOJ comes calling is a very worthwhile endeavor given the current enforcement environment, particularly for PE firms with a specific industry focus.

### *C. ROW*

Outside of the U.S., many jurisdictions apply the "control" test to determine whether an individual or company is acquiring "decisive influence" over another entity. As such, interlocking directorates tend to be less of an immediate issue in ex-U.S. jurisdictions. That being said, a number of jurisdictions do require notifying parties to provide information on interlocking senior management as part of their standard merger notification forms. Appointing the same individuals as board members of a number of portfolio companies operating in the same space may therefore raise increased scrutiny in the relevant jurisdictions.

## V. KEY TAKEAWAYS

The next several months will be particularly telling in terms of how U.S., UK and European antitrust enforcers translate rhetoric into action. It is critical, however, that PE firms plan ahead to mitigate against increased scrutiny and consider the following:

- Take a close look at any industry-specific acquisition plans, including initial investments. Antitrust agencies will aggressively scrutinize perceived "roll-ups" and may seek to impose prior approval and notice requirements as conditions for transaction approval.

- Be prepared to proactively address potential agency concerns if vying to be a divestiture buyer, including regarding investment incentives, business plans, industry experience, corporate infrastructure, and appropriate financial support.

- Think carefully when negotiating risk-shifting language in acquisition agreements given increasing agency aggressiveness and unpredictability, including the various obligations the agreement places on the merging parties in light of any substantive antitrust risk the deal poses.

- Observe extra caution when pursuing a transaction in "hot button" industries, including, e.g. tech and healthcare.

- Assess currently held board positions at competing portfolio companies to ensure compliance with Clayton Act Section 8 and other antitrust laws, and proactively remedy any issues.

By planning accordingly, PE firms can continue to pursue their acquisition strategies even in a challenging antitrust environment.

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