4 Areas Of Heightened Antitrust Risk In Private Equity

By **Ann O'Brien and Lindsey Collins** (May 18, 2023)

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Antitrust enforcers are echoing claims of recent books and articles decrying private equity firms' reshaping of American business in ways allegedly antithetical to competition.[1]

As antitrust enforcers remain keenly focused on health care, technology and labor, PE firms investing in these sectors have also faced increased antitrust scrutiny.[2]

Antitrust enforcement and litigation risks are moving from the portfolio companies to the PE firms themselves. Areas of heightened PE antitrust risk stand out: interlocking directorates, rollups, divested asset purchases and investment in competing entities. This article addresses these risks and offers takeaways for the current climate.[3]

Interlocking Directorates

The first heightened risk area is interlocking directorates, which can happen when PE firms seek representation on the boards of their portfolio companies. When those portfolio companies are actual competitors — think competitors for products, services or even labor — Section 8 of the Clayton Act prohibits them from appointing two different people from the firm to those boards.[4]

At last year's Spring Enforcers Summit, the head of the Antitrust Division of the U.S. Department of Justice, Assistant Attorney General Jonathan Kanter, proclaimed that the division "will not hesitate" to bring Clayton Act cases "to break up interlocking directorates."[5]

Since then, at least 12 directors have resigned from corporate boards in response to DOJ concerns.[6] Almost half of the directors whose resignation the DOJ touted in an October 2022 press release, represented PE firms.[7]

Both the DOJ and the Federal Trade Commission may seek injunctive relief for interlocking directorate violations. In other words, they can force corporate board members in violation of the statute to resign and/or force a deal restructure to avoid the interlock.

Private plaintiffs technically may seek damages under Section 16 of the Clayton Act, but to date, none have been awarded.[8]

Rollups

A second antitrust private equity area of focus is rollup strategies — i.e., when PE firms acquire multiple companies in the same industry and roll them up into one.

In a May 2022 interview with the Financial Times, Kanter described this business model as "designed to hollow out or roll up an industry and essentially cash out."[9]

That method, he continued, "is very much at odds with the law and very much at odds with the competition we're trying to protect." The Federal Trade Commission has been equally hostile to these methods.

For example, in the June 2022 decision in the Matter of JAB Consumer Partners SCA SICAR, National Veterinary Associates Inc. and SAGE Veterinary Partners LLC, the agency moved to force the owner of a chain of veterinary clinics, JAB Consumer Partners, to divest clinics in California and Texas as a condition of its proposed $1.1 billion acquisition of competing clinic operator SAGE Veterinary Partners LLC.[10]

PE Divestiture Buyers Beware

The third key area of increased antitrust scrutiny is when PE firms hope to become divestiture buyers, i.e., when PE firms purchase divested assets in the wake of an agency merger review. The DOJ, again through Kanter, has signaled a concern that PE divestiture buyers can "fuel additional competitive problems," by "reducing costs at a company, which will make it less competitive, or squeezing out value by concentrating [the] industry in a roll-up," as Kanter said in the Financial Times interview.[11]

Recently in the DOJ's merger challenge of Assa Abloy AB's proposed purchase of Spectrum Brands, the DOJ initially prohibited the smart locks company from divesting assets to any PE buyer to satisfy antitrust concerns, but settled during trial allowing divestiture to a PE firm.[12]

This surprising turn of events seemed to show the DOJ walking back its stance on divesting assets to PE firms, but the chilling effect of the anti-PE DOJ throwdown remains to be seen. Time will tell whether this was a case-specific issue or signals a broader, and new, anti-PE divestiture buyer stance, but it certainly is consistent with Kanter's pronouncements from last spring.

PE Investment in Competing Entities

PE firms investing in competing entities should be aware of the possibility that antitrust enforcers could look at PE firms as facilitating or participating in anti-competitive collusion between competitor companies, which could spur investigations or litigation of alleged Sherman Act, Section 1 collusion — especially price-fixing, market allocation, or other anti-competitive agreements. Bid-rigging, price-fixing and market-allocation conspiracies can be prosecuted criminally by the DOJ.

There are two primary risks to PE firms that have concentrated investments in particular industries: (1) the immediate risk of a government civil or criminal investigation; or (2) a civil suit arising from those allegations.

For example, in 2019, the DOJ Antitrust Division prosecuted a price-fixing conspiracy in the U.S. canned tuna industry, which resulted in a $100 million criminal fine and jail time for an executive.[13]

A PE firm that had purchased Bumble Bee Foods LLC in 2010 was also sued in a follow-on civil antitrust class action and is still fighting its way out of the case.[14]

By investing in competing entities, or even companies that could potentially compete (nascent competitors), a PE firm runs the risk of allegations that it was the hub in a classic hub-and-spoke conspiracy in violation of Section 1 of the Sherman Act.

Applied to PE, in a hub-and-spoke conspiracy, the common investor, or the hub, coordinates an anti-competitive agreement among the competitors, or the spokes.

For example, the competitors might agree to set a floor or ceiling price or to divide customers, markets or employees. The DOJ Antitrust Division may investigate such suspected agreements criminally, focusing on meetings, emails or text communications between competitors and the common PE investor who might be viewed as facilitating or participating in collusive, anti-competitive agreements.

Civil government antitrust cases are also possible. For example, in the 2013 U.S. v. Apple Inc. decision, the U.S. District Court for the Southern District of New York found Apple liable for conspiring with five book publishing companies to raise and fix the price for ebooks.

Private civil suits are also possible and treble damages can be awarded. In the civil context, such agreements can be inferred from the conduct of the parties or the exchanges between the common investor and the competitors.

Takeaways

- PE firms and portfolio companies should develop compliance and assessment tools to detect board seats in competitor companies and prevent potential interlocking directorates.

- Rollups are likely to face intense antitrust scrutiny.

- PE firm attempts to scoop up divested assets during government merger reviews may be viewed unfavorably by antitrust enforcers.

- PE firms should expect antitrust scrutiny when investing in competitors, or multiple companies in the same industry.

- Investing in multiple competing companies can create the risk of an appearance that PE firms are facilitating or participating in industry collusion, leading to costly and stressful criminal and/or civil investigations and litigation.

- To reduce antitrust risk for PE firms, it should be clear that portfolio companies make independent decisions about prices, wages, what customers to sell to, or in what geographic areas to operate.

- PE firms with portfolio companies that are competitors or potential competitors should also be mindful of information flow to avoid accusation of facilitating or participating in collusive anticompetitive agreements.

- To mitigate these risks, PE firms and portfolio companies should develop solid compliance and assessment tools to detect and prevent antitrust violations, particularly in high-scrutiny areas like health care, tech and labor.

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[1] See, e.g., Ballou, Brendan (2023) Plunder: Private Equity's Plan to Pillage America. New York, NY: Public Affairs; Brendan Ballou, "Private Equity is Gutting America – and Getting Away With It," New York Times, April 28, 2023, available at https://www.nytimes.com/2023/04/28/opinion/private-equity.html.

[2] Ann O'Brien, Leo Caseria, and Joy Siu, "DOJ Loses Third Consecutive Antitrust Labor Trial," Antitrust Law Blog, SheppardMullin (March 24, 2023) available at https://www.antitrustlawblog.com/2023/03/articles/criminal-doj/doj-loses-third-consecutive-antitrust-labor-trial/; Ann O'Brien and Lindsey Collins, "DOJ Antitrust Division Loses Two Bellweather Criminal Antitrust No-Poach and Wage-Fixing Trials, American Bar Association (June 27, 2022) available at https://www.americanbar.org/groups/health_law/publications/aba_health_esource/2021-2022/june-2022/doj-antitrust-division-loses-two-trials/; John Carroll and Rachel Guy, "U.S. Healthcare Industry Remains Antitrust Enforcement Priority," Antitrust Law Blog, SheppardMullin (Sept. 30, 2022) available at https://www.antitrustlawblog.com/2022/09/articles/healthcare-antitrust/us-healthcare-industry-remains-antitrust-enforcement-priority/.

[3] On April 19, 2023, Sheppard Mullin hosted a webinar called "Beware: Private Equity Firms Facing Heightened False Claims Act and Antitrust Risks" addressing these risks. A recording of the webinar is available at https://www.sheppardmullin.com/multimedia-479.

[4] 15 U.S.C. § 19, available at https://www.law.cornell.edu/uscode/text/15/19. The statute has other requirements – namely a financial threshold the companies must meet (over approximately $41 million in profits) – and the interlock itself is a "per se" violation whether or not there has been any actual competitive injury.

[5] Jonathan Kanter, "Assistant Attorney General Jonathan Kanter Delivers Opening Remarks at 2022 Spring Enforcers Summit," (April 4, 2022) available at https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-opening-remarks-2022-spring-enforcers.

[6] See Practical Law The Journal, "GC Agenda: May 2023," available at https://www.reuters.com/practical-law-the-journal/transactional/gc-agenda-may-2023-2023-05-01/.

[7] Press Release, "Directors Resign from the Boards of Five Companies in Response to Justice Department Concerns about Potentially Illegal Interlocking Directorates," Department of Justice (Oct. 19, 2022), available at https://www.justice.gov/opa/pr/directors-resign-boards-five-companies-response-justice-department-concerns-about-potentially; Jean M. Fundakowski, Allison Davis, Yonaton Rosenzweig, and Kaley Fendall, "DOJ and FTC Step Up Scrutiny of Interlocking Directorates," Davis Wright Tremaine LLP, (Dec. 6, 2022) available at https://www.dwt.com/insights/2022/12/doj-ftc-antitrust-interlocking-directorates.

[8] Interlocking Directorates, Practical Law Practice Note w-002-9202.

[9] Stefania Palma, "Crackdown on buyout deals coming, warns top US antitrust enforcer," Financial Times, (May 19, 2022) available at https://www.ft.com/content/7f4cc882-1444-4ea3-8a31-c382364aace1.

[10] Press Release, "FTC Acts to Protect Pet Owners from Private Equity Firm's Anticompetitive Acquisition of Veterinary Services Clinics," Federal Trade Commission, (June 13, 2022) available at https://www.ftc.gov/news-events/news/press-releases/2022/06/ftc-acts-protect-pet-owners-private-equity-firms-anticompetitive-acquisition-veterinary-services.

[11] Palma supra note 8.

[12] Bryan Koenig, "DOJ Told Assa Abloy: No Private Equity Buyers," Law360.com (April 24, 2023) available at https://www.law360.com/articles/1600512. On May 6, 2023, Assa Abloy and the DOJ reached a settlement which permitted Assa Abloy to divest certain assets, including its Smart Residential business, to the PE firm Fortune Brands. See, Press Release. Assa Abloy, (May 6, 2023) available at https://www.assaabloy.com/group/en/news-media/press-releases/id.2c18a7926479fdff.

[13] See Press Release, "StarKist Ordered to Pay $100 Million Criminal Fine for Antitrust Violation," DOJ (Sept. 11, 2019) available at https://www.justice.gov/opa/pr/starkist-ordered-pay-100-million-criminal-fine-antitrust-violation.

[14] See Press Release, "Former Bumble Bee CEO Sentenced to Prison for Fixing Prices of Canned Tuna," (June 16, 2020) available at https://www.justice.gov/opa/pr/former-bumble-bee-ceo-sentenced-prison-fixing-prices-canned-tuna; Nadia Dreid, "PE Firms Look to Slip Tuna Price-Fixing Claims," Law360.com (March 28, 2023) available at https://www.law360.com/articles/1590499/pe-firms-look-to-slip-tuna-price-fixing-claims.