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FTC Challenges Roll-Up Strategy as Illegal Monopolization

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On September 21, 2023, the Federal Trade Commission ("FTC"), delivering on recent agency promises to increase scrutiny of private equity-backed transactions and strategies, released a complaint filed against private equity sponsor Welsh, Carson, Anderson, and Stowe ("Welsh Carson") and U.S. Anesthesia Partners ("USAP"), a Texas-based provider of anesthesia services and Welsh Carson portfolio company. With this slate of claims, the FTC takes aim at Welsh Carson and USAP's serial acquisitions over a decade, post-merger conduct, and the "roll-up" strategy employed by USAP and Welsh Carson.

The complaint alleges numerous violations of Sections 1 and 2 of the Sherman Act, asserting defendants monopolized, conspired to monopolize, and entered into agreements to fix prices and allocate markets with respect to commercially insured hospital-only anesthesiology services. The complaint also claims defendants violated Clayton Act Section 7 and Section 5 of the FTC Act through a string of serial acquisitions which allegedly lessened competition in Texas. The complaint asserts that defendants' "roll-up" strategy represented an "unfair method of competition." Finally, the complaint alleges that Welsh Carson's acquisitions, pricing actions, and horizontal agreements together represent a "scheme to reduce competition in Texas" under Section 5 of the FTC Act. The FTC has asserted in this complaint a novel test for "unfair methods of competition" that forms the basis for separate and standalone claims under Section 5.

Roll-Up Strategy

Private equity firms look for opportunities to use their deal-making, operational, and financial expertise, along with their significant equity funding resources, to create more efficient companies in competitively fragmented landscapes. One strategy, the "roll-up" or (also often referred to as a "buy and build" strategy"), entails combining numerous, smaller companies in a particular industry. Private equity firms typically start with an initial, larger "platform" company acquisition, which then makes often numerous additional acquisitions to create a significantly larger organization that can achieve efficiencies and develop new or greater service offerings through scale, scope, and integration. These strategies can lower prices for consumers and provide other procompetitive benefits by reducing costs through centralizing common support functions or infrastructure costs, using size and scale to increase utilization and often obtain more favorable financing (driving down costs of debt), enhancing purchasing power to produce lower operating costs, and spreading costs across a larger buyer base to allow for innovation and growth into new products and services in ways that would be too expensive for independent smaller businesses.

The FTC's Theories of Harm

Over the past several years, there has been a marked increase in rhetoric from enforcers related to antitrust scrutiny of private equity firms. Although the FTC has discussed leveraging new tools to police private equity[1], much of the FTC's complaint against Welsh Carson and USAP relies on traditional antitrust theories of anticompetitive conduct and harm. The complaint defines a relevant product market ("commercially-insured

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hospital-only anesthesia services") and several relevant geographic markets (metropolitan statistical areas, respectively, of Austin, Dallas, and Houston). It alleges that the serial acquisitions resulted in monopoly level market shares for USAP of 60-70% in each geographic area. The complaint asserts that high switching costs for hospitals, high barriers for entry, and horizontal agreements (both related to prices and territories) with other providers contributed to higher prices for consumers and an inability by hospitals to constrain prices for anesthesia services.

The more novel aspects of the FTC's complaint include the joint Section 7 Clayton Act and Section 5 FTC Act claims, attacking the parties' acquisitions and general roll-up strategy, the complaint takes aim simultaneously at multiple acquisitions over the course of years. Count 2 alleges a roll-up of the Houston market via 3 acquisitions over a period of 3 years, and Count 5 alleges a roll-up of the Dallas market via 6 acquisitions over a period of 3 years. This complaint continues a recent trend of U.S. agency review of consummated and long-past transactions under Section 7 of the Clayton Act, where historically such transactions rarely received oversight or enforcement so long after consummation. With the "roll-up" cause of action envisioned in the complaint, however, the FTC seems to open the door to challenging transactions well after closing, and with the benefit of hindsight assessment of the resulting impact of a multi-deal, multi-year M&A strategy, as part of an alleged broader conspiracy.

The complaint also includes a novel standalone Section 5 claim (Count 8), broadly challenging defendants' alleged "scheme to reduce anesthesia competition in Texas." This claim is unusual in that the FTC has refrained from asserting Section 5 where "enforcement of the Sherman or Clayton Act is sufficient to address the competitive harm arising from the act or practice."[2] This divergence from past practice seems driven by an interest in developing an independent (and perhaps more flexible) framework for prosecuting "unfair methods of competition" in line with policy statements by the FTC issued over the last several years. The complaint's allegation of a scheme to lessen competition through acquisitions and agreements with other providers across Texas rests solely on Section 5 authority. It alleges harms to consumers in the form of increased prices through mechanisms suitably addressable by Clayton Act Section 7 and Sherman Act Sections 1 and 2 (and are addressed through these laws in the other counts). Where the Section 5 count differs is that it alleges a scheme across the state of Texas, and utilizes Section 5 to claim "unfair methods of competition" without defining a relevant product or geographic market as they did with the local metropolitan region claims. If judicially recognized, this would allow the FTC to pursue claims against consolidation and pricing actions with fewer requirements and lower burdens of proof via effects-driven analysis over econometric analysis through established and defined relevant markets. Use of Section 5 as standalone authority may also attempt to circumvent the four-year statute of limitations restrictions on antitrust claims, as many of the contested transactions date farther back than four years.

Implications and Takeaways

All businesses, not just private equity sponsors, whose growth strategy includes significant M&A activity should remain mindful of the context in which it engages customers in price negotiation and competitors in collaborative agreements. As market shares increase, so too does the possibility of broader antitrust scrutiny. Although the complaint identifies the serial acquisitions as one cause of antitrust harm, the alleged pricing actions and agreements with competitors by a growing market participant may have precipitated the investigation and litigation.

Businesses that engage in mergers and acquisitions as part of their growth strategy should consider future M&A plans in light of past acquisitions. Businesses, particularly private equity firms, engaged in multiple acquisitions as part of a "consolidation" strategy (especially transactions where consequent price adjustments are expected) should prepare for increased scrutiny at the investigation stage regardless of the outcome of this lawsuit.

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In this shifting and aggressive enforcement landscape, it is important to consult with counsel early and consider potential antitrust risks in M&A strategy broadly, and not just with respect to individual transactions. While roll-ups can be effective in enhancing competition in many different markets, private equity sponsors and their portfolio companies should be mindful that as an M&A-driven growth strategy produces market share increases, their strategy and overall conduct may attract increased agency scrutiny. Counsel can help advise proactively on risks in strategic initiatives and pipeline acquisitions, as well as assess the potential risk of enforcement involving past M&A-focused growth strategies and post-acquisition market conduct.

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[1] See, e.g. Draft Merger Guidelines, U.S. Department of Justice and Federal Trade Commission (July 19, 2023) (available here); Statement of Commissioner Rohit Chopra Regarding Private Equity Roll-ups and the Hart-Scott-Rodino Annual Report to Congress Commission, File No. P110014 (July 8, 2020) (available here); Statement of Chair Lina M. Khan, Joined by Commissioner Rebecca Kelly Slaughter and Commissioner Alvaro M. Bedoya Regarding JAB Consumer Fund/SAGE Veterinary Partners (June 13, 2022) (available here).

[2] Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act (August 13, 2015) (available here).

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Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding the issues discussed in this update. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Antitrust and Competition, Mergers and Acquisitions, or Private Equity practice groups, or the following authors and practice leaders:

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