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An Antitrust Roadmap for Private Equity Investment

BY KARA KURITZ AND MATTHEW WHEATLEY

IN RECENT YEARS, THE PRIVATE EQUITY (PE) industry has boomed. A Bain report indicates that 2018 capped a historic five-year pace for PE deals and fundraising.[1] From 2014 through 2019, the total value of investments realized through an exit (e.g., sale of a portfolio company) was $2 trillion—the largest five-year total on record.[2] In 2019, PE firms raised nearly $600 billion in new capital.[3] This deal flow and level of investment certainly caught the attention of the U.S. antitrust authorities.

In 2018, then recently appointed Democratic Commissioner of the Federal Trade Commission, Rohit Chopra, speaking at an antitrust conference, said, "I think we need to renew our attention to better understand how [private equity] funds and how these deals are affecting competition in our economy."[4] At the conference, Commissioner Chopra specifically called for increased scrutiny of many PE business strategies. The FTC and its sister antitrust enforcement agency, the Antitrust Division of the Department of Justice, are closely monitoring how the growth in PE investment and deal flow impacts competition and consumers.

In a 2019 dissenting statement, Commissioner Chopra raised concerns about the long-term motives of a PE-backed entity acquiring a vertical supplier. In his dissent, he said, "While some investment firms have strategies to invest substantial capital to grow and nurture a business, other investment firms might not have a strategy that is aligned with vigorous competition."[5] He then called into question the PE entity's "approach and track record [, which] suggest[s] that the fund will operate assets much differently than a typical buyer, in ways that lead to higher margins, without any guarantee of greater output and service offerings."[6] One example of a notable failed private equity divestiture buyer was in 2013 when, within several months of the FTC approving Hertz's $2.3 billion acquisition of Dollar Thrifty with a divestiture of a small rental car operator to a private equity sponsor, the divested business filed for Chapter 11 bankruptcy protection.[7]

The onset of the coronavirus pandemic, while slowing down mergers and acquisitions at least temporarily,[8] has shown that some in government positions remain skeptical of PE buyers. In April of this year, Senator Elizabeth Warren and Representative Alexandria Ocasio-Cortez proposed the Pandemic Anti-Monopoly Act.[9] Their proposal, which came shortly after Representative David Cicilline proposed a ban on mergers, would freeze mergers that include companies that have more than $100 million in revenue or market capitalization; are run by hedge funds or PE firms; have exclusive patents impacted by the crisis, like key medical equipment;[10] or are otherwise reportable under the Scott-Hart-Rodino (HSR) Act. While Republican FTC Commissioner Noah Phillips spoke out in opposition to any such merger moratorium, and the possible bill is unlikely to gain any traction in the Republican-controlled Senate, the Democratic lawmakers' focus on antitrust and PE firms was clear.[11]

As the economy stabilizes, the U.S. antitrust agencies will continue to scrutinize PE firms' investment activity. This article discusses key points where PE funds should exercise caution, including the application of the HSR Act's premerger notification regime and the application of substantive antitrust laws to common PE business practices.

The HSR Process for PE Funds

HSR analysis for transactions involving PE funds may be challenging because PE funds tend to employ more complex acquisition structures and are often investors in portfolio companies that themselves engage in mergers and acquisitions. PE funds often do not anticipate that certain conduct may trigger a filing obligation, such as: (1) re-allocating an investment among funds, (2) a portfolio engaging in a stock-for-stock transaction, and (3) acquisitions of small, minority interests that do not qualify for the narrow "investment-only" exemption. Aside from instances in which PE firms may be surprised by potential filing obligations, their interest in exiting investments to maximize returns or justifying the value of a potential investment may make them more prone to creating transaction documents that lead to inquiries by the antitrust agencies. That tendency, combined with skepticism on the part of the agencies, can lead to unnecessary inquiries into potential transactions and delay.

Whether a potential transaction requires an HSR filing generally depends on whether the "Size of Transaction" and "Size of Person" tests are met. The complex acquisition structures employed by PE funds mean that some transactions that initially appear reportable are often determined to be nonportable after a more thorough analysis and, conversely, some transactions that a PE firm would not expect to be reportable require an HSR filing. Nonetheless, the same thresholds apply to PE transactions as to other acquisitions. First, the HSR Act's Size of Transaction threshold is satisfied if the acquiring person will hold in the aggregate over $94 million

Kara Kuritz is Counsel and Matthew Wheatley is an Associate at Goodwin Procter LLP. *The authors thank Andrea Murino and Paul Jin for their assistance with this article.*

assets, voting securities, or controlling non-corporate interests of the acquired person.[12] For voting securities and non-corporate interests, the value of all voting securities or non-corporate interests of the company that will be held by the acquiring person after the transaction must be aggregated, meaning previously acquired securities or interests generally must be included, not just those currently being purchased.

If the transaction is valued at over $376 million, the Size of Person test does not apply and the deal is generally reportable, unless an exemption applies. If the transaction is valued at less than $376 million, however, the Size of Transaction and Size of Person tests both apply and each must be satisfied for an HSR filing to be required.[13] The Size of Person test is based on the size of the acquiring and acquired persons—the "ultimate parent entities," as discussed in more detail below. In general, this test is met if one person has total assets or annual net sales of at least $18.8 million and the other person has total assets or annual net sales of $188.8 million or more.[14]

A PE firm's acquisitions may not meet these thresholds for a number of reasons. For example, if a PE fund is acquiring a minority interest in a non-corporate entity, such as an LLC, the PE fund may not be acquiring control of the LLC, and acquisitions of such non-corporate interests must be controlling for an HSR filing to be required.[15] Further, a newly formed entity, such as a fund or an acquisition vehicle that is its own ultimate parent entity, typically will not meet the Size of Person threshold. Even an acquisition by a relatively newly formed fund or acquisition vehicle that is its own ultimate parent entity may not meet the Size of Person threshold if neither the acquiring nor acquired person has total assets or annual sales of $188.8 million or more.

Reallocating Investments in Portfolio Companies

When applying thresholds, the HSR Act views transactions through the lens of ultimate parent entities. "Ultimate parent entity" is defined as "an entity which is not controlled by any other entity"[16] and control of a non-corporate entity is defined as "having the right to 50 percent or more of the profits of the entity, or having the right in the event of dissolution to 50 percent or more of the assets of the entity."[17] When analyzing acquisitions by a PE fund, acquisition vehicle, or portfolio company, the analysis requires following the chain of control from the entity engaging in the transaction up to the ultimate parent entity. PE funds are typically organized as limited partnerships, and because they are generally widely held, they rarely have a limited partner (or group of limited partners themselves under common control) that has the right to 50 percent or more of the profits or assets upon dissolution. In other words, PE funds are typically their own ultimate parent entities. The fact that a fund is managed by a general partner is irrelevant to the HSR control analysis. This HSR analysis for PE funds differs from other jurisdictions, including the EU, and means that when multiple funds invest, each fund's investment is assessed separately to determine whether the Size of Transaction and Size of Person thresholds are met.

The HSR rules have an important corollary for PE firms: when reallocating investments in portfolio companies between funds or moving a portfolio company from one fund to another, those transactions are between two different ultimate parent entities and, therefore, may trigger an HSR filing, despite the reality that the two funds are both within the PE firm's family of funds. The following example is illustrative. PE Fund I, through its controlled acquisition vehicle AV I, holds Portfolio Company I. After the acquisition, the PE Firm decides that it wants to reallocate that investment between PE Fund I and PE Fund II, so PE Fund II will now control AV I. Assuming the HSR thresholds are met and no exemptions apply, the change of control of AV I from PE Fund I to PE Fund II will require an HSR filing. This analysis may come as a surprise to the PE firm, which may view this type of transaction as a simple reorganization. Therefore, PE firms should always confirm with experienced antitrust counsel whether an HSR filing is required when it moves or reallocates its investments.

A Portfolio Company's Stock-for-Stock Transaction

Another scenario that PE firms often face is a stock-for-stock transaction by a portfolio company. For example, if a PE fund owns even a small percentage of a highly valued portfolio company and that portfolio company enters a merger agreement whereby it will be acquired and its shareholders will receive stock in the merged company or its parent, an HSR filing may be required for the PE fund's acquisition of shares in the merged firm or its parent if valued above $94 million. PE firms may not anticipate an HSR filing in this scenario because they only have a small, minority investment in the portfolio company and may have had no role in the merger.

Similar facts led to civil penalties for three Third Point funds in August 2019.[18] The funds agreed to settle charges that they failed to file under the HSR Act in connection with the Dow/DuPont merger.[19] When the deal closed, the three funds' shares of Dow Inc. converted to shares of the newly formed DowDuPont Inc.[20] As a result of that conversion, the Third Point funds were required to submit HSR filings and observe the waiting period for their acquisition of shares in the merged entity, but failed to do so.[21] The funds collectively paid a civil penalty of $609,810.[22]

To avoid potential violations of the HSR Act, counsel for merging firms in stock-for-stock transactions should always consider whether any shareholders of the acquired firm will acquire shares of the merged firm or its parent in excess of the HSR threshold, and notify any relevant shareholders. Likewise, as soon as they become aware of stock-for-stock transactions by their portfolio companies, PE firms should consult with experienced antitrust counsel. Exemptions may apply to such acquisitions, but it is imperative to consult with counsel to make the proper determination.

The Narrow Investment-Only Exemption

Other HSR issues, such as the investment-only exemption, have also landed PE firms in the antitrust agencies' crosshairs. The HSR Act provides an exemption for acquisitions of voting securities, solely for the purpose of investment, as long as the securities held do not exceed 10 percent of the issuer's outstanding voting securities.[23] Alone, this language might be read broadly to exempt PE firms' acquisitions of less than 10 percent. However, the agencies' interpretation of this exemption is very narrow. The HSR rules define "solely for the purpose of investment" to mean that the investor has "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer."[24] FTC officials have further elaborated that an investor must intend to be "purely passive" to fall within the exemption.[25]

Over time, the agencies have continued to narrow the exemption by focusing more on contemporaneous evidence of an investor's intent and less on particular conduct. For example, when the exemption was enacted, the agencies identified certain conduct as evidence that may be inconsistent with investment intent, including:

- Holding a board seat or nominating a candidate for the board of directors;
- Proposing corporate action that requires shareholder approval;
- Soliciting proxies;
- Being an officer of the issuer; and
- Being a competitor of the issuer.[26]

However, more recent enforcement actions, such as *ValueAct* in 2016 and *Third Point* in 2015, demonstrate the agencies' view that an investor does not qualify for the investment-only exemption if it considers taking action that would influence management, even if the investor has not engaged in any of the specific conduct listed above.

In *ValueAct*, the DOJ sued the company for failing to report its acquisition of shares in two competitors that had announced plans to merge—Halliburton Company and Baker Hughes Incorporated.[27] The DOJ complaint alleged that ValueAct acquired these shares intending to influence the companies' business decisions regarding the merger.[28] In particular, at the time of the acquisition, ValueAct was advocating the deal to management, helping to negotiate new terms, and developing a back-up plan to sell pieces of Baker Hughes if the deal encountered "regulatory issues."[29] The DOJ stated that "ValueAct acquired substantial stakes in Halliburton and Baker Hughes in the midst of our antitrust review of the companies' proposed merger, and used its position to try to influence the outcome of that process and certain other business decisions."[30] ValueAct paid a civil penalty of $11 million to settle the charges.[31]

In *Third Point*, the agencies brought an action against three Third Point investment funds for acquiring Yahoo stock through open market purchases.[32] Third Point did not file notification because it claimed each fund intended to acquire less than 10 percent of Yahoo's outstanding stock solely for the purpose of investment.[33] The Third Point funds, however, took the following actions during the period they acquired Yahoo stock:

- Reached out to potential candidates to be the CEO or a board director;
- Assembled an alternate slate of board directors that it publicly announced Third Point would propose at the next annual meeting;
- Informed Yahoo that Third Point was prepared to join the Yahoo Board; and
- Internally discussed the possible launch of a proxy battle for directors.[34]

Despite taking these actions, Third Point had not actually held a Yahoo board seat or nominated a candidate for Yahoo's board of directors. Nonetheless, the agencies found that the Third Point funds were not eligible for the investment-only exemption, and Third Point agreed to certain injunctive relief to settle the charges.[35]

At the time the agencies filed the Third Point settlement, the FTC issued a blog post stating, "[A]ny investor who is considering engaging with management or any person considering taking a board seat should proceed with caution when relying on the investment-only exemption."[36] Given this narrow view of the investment-only exemption, PE firms should be especially careful when attempting to rely on it. To demonstrate its eligibility for the exemption, the PE firm should not even consider taking actions to influence management or hold a board seat and should document its intent to be a purely passive investor.

PE Firms' Creation of Transaction Documents

PE firms not only must be careful to determine when a filing is required, but must also be aware of the documents that will be produced to the agencies with their HSR filings or, potentially, as part of an investigation (even if an HSR filing is not required). PE firms (and their third-party advisors) that want to exit an investment at the most opportune time or to justify the valuation of a potential investment often employ exaggerated language in transaction documents in an effort to maximize return or gain support for an investment. Such language can lead to unnecessary inquiries by the antitrust agencies and delay the deal. A PE firm also may have a misconception that a deal is not likely to generate competitive concerns because it is a financial buyer rather than a strategic buyer. When exiting an investment a PE firm may also overlook the issues of selling to a strategic buyer. It is important to remember, however, that the competitive analysis varies depending on the particular facts of the transaction, including the buyer's other investments or activity in the market.

PE firms are well-advised to remember that certain documents will need to be provided to the agencies with the HSR filing—i.e., all documents created by or for those exercising the functions of officers or directors of the acquiring fund (for example, the General Partner or Investment Committee),

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and portfolio company, for the purpose of analyzing the proposed acquisition with respect to market shares, competition, competitors, markets, potential for sales growth, or expansion into product or geographic markets.[37] Confidential Information Memoranda, company overview presentations, and synergies documents also generally need to be provided to the agencies with the HSR filing.[38] These documents are often referred to as "Item 4" or "4(c) and 4(d)" documents.

Because the content of the parties' Item 4 documents often trigger FTC and DOJ investigations, preliminary inquiries by the agencies could be avoided entirely if the parties were more accurate when describing the transaction in their documents. In many cases, documents that describe "dominant" firms often fail to mention that the relevant firm competes against many other alternatives, or that purported "high barriers to entry" are genuinely not so high and entry and expansion by competitors is relatively easy and likely if the merged firms would try to raise prices. It is important that the merging parties describe the transaction accurately and avoid exaggerated language that might be misinterpreted by the antitrust agencies. Bankers and third-party advisors may be especially prone to exaggerated language.

Preliminary inquiries require the parties to engage with the investigating agency to varying degrees, and therefore, can result in costs (e.g., additional time dedicated from company management and increased legal fees), as well as potential extensions of the HSR waiting period. It is difficult to know the frequency and impact of such preliminary inquiries because they are not public. If such an inquiry comes at the end of the initial 30-day HSR waiting period, however, the acquirer may need to pull and refile its HSR filing to try to avoid a Second Request. Using this type of language, especially when combined with the agencies' skepticism of PE firms, leads to unnecessary costs and delays. For these reasons, PE firms and their third-party advisors should exercise caution when creating their transaction documents and, to the extent possible, have these materials reviewed by counsel prior to finalizing them or presenting them to the board.

Combining Portfolio Companies May Trigger an Antitrust Investigation

In addition to being aware of whether the HSR Act applies to certain types of transactions, PE firms should know that these same transactions may face substantive antitrust investigations. For example, PE firms should be aware that combining majority-owned subsidiaries could trigger substantive antitrust investigations, regardless of HSR reportability.

In 2015, two construction material suppliers, Norbord Inc. and Ainsworth Lumber Co., backed by the same PE firm, underwent a three-month DOJ merger investigation prior to obtaining antitrust approval of their merger.[39] This transaction followed an investigation less than a year earlier of a proposed combination of Ainsworth and Louisiana-Pacific Corp., which the parties abandoned in the face of DOJ concerns. In its press release announcing that Ainsworth and Louisiana-Pacific had abandoned their transaction, the DOJ alleged that the proposed deal would have resulted in the combination of two of only three principal producers selling oriented strand board (OSB), widely used in the construction and remodeling of homes in the Upper Midwest.[40] The three producers selling into the Upper Midwest were Ainsworth, Louisiana-Pacific, and Norbord.

Given the DOJ's view of concentration in this market, a proposed Norbord/Ainsworth transaction would receive similar scrutiny and concerns from the DOJ. A key factual difference between Norbord/Ainsworth and Louisiana-Pacific/Ainsworth is that Norbord and Ainsworth were both owned by the same PE firm. It is unclear whether this difference led to the ultimate clearance of the transaction, but PE firms need to be aware an antitrust investigation may be looming when attempting to combine two portfolio companies, especially if the two are held in different funds, triggering an HSR filing. Even though the Norbord/Ainsworth deal ultimately proceeded, it still was subject to a costly and significant three-month antitrust investigation despite the fact that the same PE firm owned both companies.

In *Copperweld v. Independence Tube Corp.*, the Supreme Court stated that a parent and subsidiary always "share a common purpose whether or not the parent keeps a tight rein over the subsidiary."[41] This is so, according to the Court, because "the parent may assert full control at any moment if the subsidiary fails to act in the parent's best interests."[42] Moreover, as the Supreme Court notes, the assessment is not one determined by current business preferences. Indeed, one basis and deliberate outcome of the Supreme Court's decision was the freedom of businesses to conduct and structure themselves as they see fit.[43] For example, under *Copperweld*, subsidiaries that share a common parent cannot collude with one another.

In the PE context, *Copperweld* may be applicable in two scenarios: (1) reorganization or combination of majority-owned portfolio companies held by the same fund (i.e., the same ultimate parent entity under the HSR rules) and (2) reorganization or combination of portfolio companies held by separate funds within the same PE firm. In the first scenario, *Copperweld* counsels that these reorganizations should not raise antitrust concerns because the reorganization or combination would represent the fund (i.e., the parent) restructuring itself as it sees fit. On the other hand, it is less clear how *Copperweld* applies to the second scenario because,

[T]he antitrust agencies closely evaluate PE purchases of divested assets required as part of an FTC or DOJ decree conditioning merger approval. . . . The FTC has been taking a tougher stance where PE firms are potential divestiture buyers.

under the HSR rules, the funds would not share the same ultimate parent entity. In any event, such reorganizations or combinations of portfolio companies held by separate funds within the same PE firm may raise questions from the agencies. PE firms that combine majority-owned portfolio companies that enjoy strong market positions should be aware that the agencies may investigate whether the proposed combination is likely to result in a substantial lessening of competition in a properly defined antitrust market.

Common Ownership

Not only can combinations of majority-owned competing portfolio companies trigger antitrust investigations, but also minority ownership of competing companies. The U.S. antitrust authorities define common ownership as "the simultaneous ownership of stock in competing companies by a single investor, where none of the stock holdings is large enough to give the owner control of any of those companies."[44] In the PE context, common ownership most often arises from a PE firm holding minority investments in two competitors. Whether or not common minority ownership could, in fact, lead to antitrust harm (i.e., an increase in price or reduction in output) is the subject of continued debate.[45] PE firms should be aware that such investments, even if passive, could lead to antitrust investigations or prolong HSR approval of certain acquisitions of minority holdings.

The arguments about common ownership focus on two potential concerns: (1) common ownership may increase the risk that there will be a reduction of competition between two firms that share a common minority owner (e.g., decrease incentives to compete) and (2) common ownership may serve as a means to facilitate sharing of non-public competitively sensitive information between two competitors.[46] In the PE context, these concerns can arise when a PE firm makes a minority investment in two or more rivals whereby the PE firm could facilitate the lessening of competition or the sharing of competitively sensitive information.

The U.S. agences apply Section 7 of the Clayton Act and the HSR regime to mergers and acquisitions that may have adverse unilateral or coordinated competitive effects (e.g., price increases or output reductions). The acquisition of a minority holding is generally reportable under the HSR Act if it exceeds certain specified thresholds.[47] Although the agencies have not litigated an acquisition of a minority interest based on a common ownership theory to date, such acquisitions may nonetheless be investigated for anticompetitive effects. FTC Commissioner Noah Phillips has noted that "many factors, like the nature and extent of common ownership in the relevant market, its structure and other variables, all impact whether and to what extent common ownership might cause an anticompetitive harm in any given market."[48]

The agencies will look closely at common ownership issues, especially in instances where the investor takes large minority stakes or is not passive.[49] PE firms should be aware that the scholarship around the competitive impact of common ownership is still developing and be on the lookout for any new studies that suggest common ownership could lead to the lessening of competition.[50] PE firms should be prepared to show the agencies that a market is competitive, that common minority ownership will not lead to anticompetitive effects, and that the firm will prevent the flow of competitively sensitive information it receives as a minority investor.

Board Interlocks

Because PE firms may obtain board seats in their portfolio companies, they need to be aware of Section 8 of the Clayton Act, which prohibits board interlocks between competitors. Typically, the antitrust laws focus on businesses' interaction with consumers, but Section 8 extends the antitrust laws into the structure of the boardroom. This statute prohibits what are known as "interlocking directorates"—situations where an individual or entity serves on the board or as an officer of two competing corporations. Notably, the definition of "competition" under Section 8 may be viewed more broadly than antitrust laws in other contexts and could capture nascent competition by would-be competitors. The purpose of Section 8 is to ensure firms do not coordinate their activity or share competitively sensitive information through a common board member or officer.

Section 8 states:

> No person shall, at the same time, serve as a director or officer in any two corporations . . . that are (A) engaged in whole or in part in commerce; and (B) by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws.[51]

Parsing each element is crucial because Section 8 is a highly technical statute. The statute is interpreted by the antitrust enforcement agencies to apply not only to natural persons or individuals, but also to a firm. Thus, a violation can arise if one firm appoints different individuals to sit as its agents on the boards of two competitors. This sometimes arises when a PE fund invests in multiple entities in a common industry and tasks individuals to serve as board members across these entities.

Moreover, Section 8 is a strict liability offense—that is, liability for a violation of Section 8 may attach no matter the intent behind, or the effect of, the interlocking directorate. While treble damages are theoretically available to any enter-

prising private plaintiffs who could use the fact of the interlock to search for potentially anticompetitive conduct between the competitors, historically the agencies and private plaintiffs have simply sought an injunction to remove the interlock.

There are, however, a number of exemptions under the statute that may relieve any liability. Specifically, the statute does not apply to banks, banking associations, and trust companies, or to firms that are not engaged in interstate commerce. Also, it does not apply if each of the firms falls below certain capital, surplus, and undivided profits thresholds that are adjusted annually. Nor does it apply if the "competitive sales" of the interlocked firms fail to meet certain thresholds.

Although the statute applies only to "corporations," the agencies also may investigate and attempt to apply Section 8 to interlocks between non-corporate entities. In May 2019, Assistant Attorney General Makan Delrahim said that while courts have not directly addressed whether Section 8 applies to non-corporate interests, "[DOJ] believe[s] the harm can be the same regardless of the forms of the entities."[52] Notably, interlocking directorates that do not implicate Section 8—either because they do not come within Section 8's prohibitions or because a specific exemption applies—may still be subject to liability under other antitrust laws that prohibit improper collusion. Even if the technical requirements of Section 8 are not met, a director may nonetheless facilitate an agreement between the companies that violates Section 1 of the Sherman Act, which imposes significant civil and even criminal penalties.

As PE firms make investments and are represented on the boards of their investments, they should be aware of potential Section 8 violations. As noted, Section 8 violations are strict liability offenses, so PE firms should seek counsel before taking board representation in two or more rivals.

Skepticism of Private Equity Divestiture Buyers

In addition to scrutinizing deals involving PE firms when they are principal buyers and sellers in a transaction, the antitrust agencies closely evaluate PE purchases of divested assets required as part of an FTC or DOJ decree conditioning merger approval. This potential focus dovetails with concerns expressed in recent years by other FTC representatives lamenting how poorly certain divestitures to PE firms had fared in the marketplace (e.g., in recent rental car, grocery, and dollar store divestitures to PE firms), and may explain why some FTC Commissioners have taken a tougher stance on divestitures to PE firms). The FTC has been taking a tougher stance where PE firms are potential divestiture buyers.

A recent FTC enforcement action illustrates this skepticism. In particular Commissioner Chopra stated in his dissent, "I would have preferred to include additional protections for the public to safeguard against risks often posed by the private equity buyer interest in the divested assets," including prior Commission approval to subsequently sell the acquired divested assets.[53] On the other hand, Chairman Joseph Simons has stated that the FTC does not want to discourage potential PE buyers: "Private equity buyers can be very effective in providing both financing and management expertise. There are some really large, well-run, well-financed, private equity firms and those, in particular, I would not want to keep out of the process."[54]

In light of these differing views within the FTC in particular, PE divestiture buyers should be prepared for an extra level of scrutiny and will likely be required to disclose typical hold periods for its investments and exit plans, and may even be required to hold the divested assets for a certain period of time following the acquisition. Therefore, when seeking to purchase to-be-divested assets, PE buyers should be prepared to explain their investment thesis and strategy, how they have typically realized gains out of past investments, whether they plan to invest more of their own equity capital into the business or rely on debt financing, and when and how do they intend to exit the investment.

Lessons for PE Firms

The application of the HSR Act and other antitrust laws can present certain challenges for PE firms. To avoid these pitfalls, PE firms should be sure to abide by the following practical tips:

- Before reallocating investments among funds, PE firms should consult counsel to determine whether an HSR filing is required.
- Where a portfolio company is engaging in a stock-for-stock transaction, a PE firm should consider whether it will receive shares in the combined company in excess of the HSR threshold (currently, $94 million). Be sure to consult with counsel to determine whether any exemptions could apply.
- Be aware that the investment-only exemption is very narrow. Where a PE firm is acquiring less than 10 percent of an issuer and will be purely passive, it may potentially rely on the exemption. The PE firm should not consider later taking actions to influence management or hold a board seat and should document its intent to be a purely passive investor. Be sure to consult counsel to confirm the investment will be less than 10 percent under HSR rules and that the facts support relying on the exemption.
- When creating transaction-specific documents about the deal, be sure to describe the transaction accurately and avoid exaggerated language that is likely to raise questions about whether the acquisition will reduce competition. To the extent possible, have materials reviewed by counsel prior to finalizing them or presenting them to the board.
- Keep in mind that combining portfolio companies, even when owned by the same PE firm, can trigger antitrust concerns. Do not assume that two portfolio companies can be merged without significant antitrust risk before consulting counsel.

- PE firms should not be surprised if the FTC shows interest in common ownership investments and should be prepared to explain why common minority ownership won't lead to antitrust concerns.
- Be sure to seek counsel before taking board representation in two or more rivals. Competition may be viewed more expansively under Section 8 than other antitrust laws. Section 1 may apply even when Section 8 does not apply.
- When attempting to acquire divestiture assets, be prepared for extra scrutiny. PE buyers should be prepared to explain their investment thesis and strategy, how it has typically realized gains out of past investments, whether it plans to invest more of its own equity capital into the business or rely on debt financing, and when and how it intends to exit the investment. ■

[1] *Global Private Equity Report 2019*, BAIN & COMPANY, https://www.bain.com/contentassets/f7daf9c1ab3f4dde850672597e82277f/bain_report_private_equity_report_2019.pdf.

[2] *Id.*

[3] Michael Katz, *Private Equity Funds Raise Nearly $600 Billion in 2019*, CHIEF INVESTMENT OFFICER (Jan. 14, 2020), https://www.ai-cio.com/news/private-equity-funds-raise-nearly-600-billion-2019/.

[4] Pallavi Guniganti, FTC Commissioner Hits Out at Private Equity, GCR (Sept. 28, 2018).

[5] Fed. Trade Comm'n, Statement of Commissioner Rohit Chopra in the Matter of Sycamore Partners II, L.P., , Staples, and Essendant 4 (Jan. 28, 2019), https://www.ftc.gov/system/files/documents/public_statements/1448335/181_0180_staples_essendant_chopra_statement_1-28-19_0.pdf.

[6] *Id.*

[7] Brent Kendall & Jacqueline Palank, *How the FTC's Hertz Antitrust Fix Went Flat*, WALL ST. J. (Dec. 8, 2013), https://www.wsj.com/articles/how-the-ftc8217s-hertz-antitrust-fix-went-flat-1386547951.

[8] *The Loans and the Fury*, N.Y. TIMES (DEALBOOK NEWSL.) (Apr. 27, 2020), https://www.nytimes.com/2020/04/27/business/dealbook/small-business-ppp-loans.html ("The Premerger Notification Office estimates a nearly 60 percent reduction in reported transactions during the past month, compared with the historical average.").

[9] *Should There Be Deals During a Pandemic?*, N.Y. TIMES (DEALBOOK NEWSL.) (Apr. 29, 2020), https://www.nytimes.com/2020/04/29/business/dealbook/coronavirus-merger-ban.html.

[10] Chris Mills Rodrigo, *Warren, Ocasio-Cortez to Propose Big Merger Freeze Amid Pandemic*, THE HILL (Apr. 28, 2020), https://thehill.com/policy/technology/495000-warren-ocasio-cortez-to-propose-big-merger-freeze-amid-pandemic.

[11] *See The Loans and the Fury*, *supra* note 8 ("American consumers stand to gain from pro-competitive mergers, during and after the current crisis.").

[12] Revised Jurisdictional Thresholds for Section 7A of the Clayton Act, 85 Fed. Reg. 4984, 4985 (Jan. 28, 2020), https://www.ftc.gov/enforcement/premerger-notification-program/current-thresholds. The HSR Act's thresholds are adjusted annually.

[13] *Id.*

[14] *Id.*

[15] *See* 16 C.F.R. §§ 801.2(e)–(f) (2013).

[16] 16 C.F.R. § 801.1(a)(3) (2018).

[17] *Id.* § 801.1(b)(1)(ii).

[18] Note that this case is separate from the agencies' 2015 enforcement action against Third Point with regard to its acquisition of Yahoo! Inc. shares, discussed in more detail below. *See infra* text accompanying notes 32 & 35.

[19] Fed. Trade Comm'n, Cases and Proceedings, Third Point LLC (Dec. 18, 2019), https://www.ftc.gov/enforcement/cases-proceedings/181-0087/third-point-llc.

[20] Complaint at 7, United States v. Third Point Offshore Fund, Ltd., No. 1:19-cv-02593 (D.D.C. Aug. 28, 2019), https://www.ftc.gov/system/files/documents/cases/181_0087_tp_complaint.pdf.

[21] *Id.* at 8.

[22] Final Judgment, United States v. Third Point Offshore Fund, Ltd., No. 1:19-cv-02593 (D.D.C. Dec. 10, 2019), https://www.ftc.gov/system/files/documents/cases/12-10-19-third_point-ddp_final_judgment_signed.pdf.

[23] 15 U.S.C. § 18a(c)(9).

[24] 16 C.F.R. § 801.1(i)(1) (2018).

[25] *See* Marian R. Bruno, Prepared Remarks Before the Am. Bar Ass'n: Getting Your Deal Through the New Antitrust Climate (June 13, 2002), https://www.ftc.gov/public-statements/2002/06/hart-scott-rodino-25 ("Some of these large investors have sought to rely on the 'investment only' exemption despite seeking to influence the management decisions of an issuer. . . . Such activity is inconsistent with the purely passive intent necessary to rely on the exemption.").

[26] Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33,450, 33,465 (July 31, 1978).

[27] Complaint at 2, United States. v. VA Partners I, LLC, No. 3:16-cv-01672 (D.D.C. Apr. 4, 2016), https://www.justice.gov/atr/file/838076/download.

[28] *Id.*

[29] *Id.*

[30] Press Release, Department of Justice, Justice Department Obtains Record Fine and Injunctive Relief Against Activist Investor for Violating Premerger Notification Requirements (July 12, 2016), https://www.justice.gov/opa/pr/justice-department-obtains-record-fine-and-injunctive-relief-against-activist-investor.

[31] *Id.*

[32] Complaint at 2, United States v. Third Point Offshore Fund, Ltd., No. 1:15-cv-01366 (D.D.C. Aug. 24, 2015).

[33] *Id.* at 7.

[34] *Id.*

[35] Press Release, Federal Trade Commission, Third Point Funds Agree to Settle FTC Charges that They Violated U.S. Premerger Notification Requirements (Aug. 24, 2015), https://www.ftc.gov/news-events/press-releases/2015/08/third-point-funds-agree-settle-ftc-charges-they-violated-us.

[36] Debbie Feinstein et al., *"Investment-only" Means Just That*, FED. TRADE COMM'N COMPETITION MATTERS BLOG (Aug. 24, 2015), https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just.

[37] *See* Fed. Trade Comm'n, Antitrust Improvement Act Notification and Report Form for Certain Mergers and Acquisitions Instructions 6–7 (Sept. 25, 2019), https://www.ftc.gov/system/files/attachments/form-instructions/hsr_form_instructions_9-25-19.pdf.

[38] *Id.*

[39] Melissa Lipman, *DOJ OKs $667M Wood Merger After Blocking Earlier Deal*, LAW360 (Mar. 17, 2015).

[40] Press Release, Department of Justice, Louisiana-Pacific Corp. Abandons Its Proposed Acquisition of Ainsworth Lumber Co. Ltd. (May 14, 2014), https://www.justice.gov/opa/pr/louisiana-pacific-corp-abandons-its-proposed-acquisition-ainsworth-lumber-co-ltd.

[41] Copperweld Corp. v. Indep. Tube Corp., 467 U.S. 752, 771–72 (1984).

[42] *Id.*

[43] *Id.* at 773 ("[A] business enterprise should be free to structure itself in ways that serve efficiency of control, economy of operations, and other factors dictated by business judgment without increasing its exposure to antitrust liability.").

[44] OECD, Hearing on Common Ownership by Institutional Investors and Its Impact on Competition, Note by the United States 2 (Nov. 28, 2017), https://one.oecd.org/document/DAF/COMP/WD(2017)86/en/pdf.

[45] Noah J. Phillips, Comm'r, Fed. Trade Comm'n, Prepared Remarks, Taking Stock: Assessing Common Ownership (June 1, 2018), https://www.ftc.gov/system/files/documents/public_statements/1382461/phillips_-_taking_stock_6-1-18_0.pdf.

[46] *Id.* at 5–6. (citing Jose Azar, Martin Schmalz & Isabel Tecu, *Why Common Ownership Creates Antitrust Risks*, Competition Pol'y Int'l 6 (June 14, 2017)).

[47] 15 U.S.C. § 18a(a)(2).

[48] *See* Phillips, *supra* note 45, at 4–5.

[49] Speaking at a conference, however, Bilal Sayyed, Director of the Office of Policy Planning at the Federal Trade Commission, said, "I hasten to add that the theories are interesting but surveys of the literature find that the evidence of anticompetitive common ownership appears to be limited, but for a few empirical studies." Bilal Sayyed, Dir., Office of Policy Planning, Fed. Trade Comm'n, Prepared Remarks, Georgetown University Law Center (Sept. 10, 2019 (Sept. 10, 2019), https://www.ftc.gov/system/files/documents/public_statements/1544096/sayyad_-_georgetown_university_law_center_remarks_9-10-19_0.pdf.

[50] *See, e.g.*, José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. Fin. 1513 (2018); Einer Elhauge, *Horizontal Shareholding*, 129 Harv. L. Rev. 1267 (2016); Eric Posner, Fiona M. Scott Morton & Glen Weyl, *A Proposal to Limit the Anti-Competitive Power of Institutional Investors*, 81 Antitrust L.J. 669 (2017).

[51] The complete text of Section 8 of the Clayton Act is available online, although the FTC updates the applicable financial thresholds annually.

[52] Makan Delrahim, Ass't Att'y Gen. U.S. Dep't of Justice, Antitrust Div., Remarks at Fordham University School of Law (May 1, 2019), https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-fordham-university-school-law.

[53] Fed. Trade Comm'n, Statement of Commissioner Rohit Chopra in the Matter of Linde AG, Praxair, Inc., and Linde PLC 1 (Oct. 22, 2018), https://www.ftc.gov/system/files/documents/public_statements/1416947/1710068_praxair_linde_rc_statement.pdf.

[54] Ben Remaly, Simons Defends Divestitures to Private Equity, GCR (Nov. 16, 2018).