ALERTS

Private Equity Update: Final Merger Guidelines Released

January 2, 2024

What happened?

The Antitrust Division of the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") jointly released the 2023 Draft Merger Guidelines ("Draft Guidelines") on July 19, 2023. Although the Draft Guidelines were touted as "business-model agnostic," we reported in our previous *Alert* several issues of potential concern for the private equity industry, including increased scrutiny of serial or roll-up acquisitions, transactions resulting in partial control or common ownership and board appointments.

On Dec. 18, 2023, the agencies released the final 2023 Merger Guidelines ("Final Guidelines"), which modify the Draft Guidelines to address comments from the public, as well as feedback received during three Merger Guidelines Workshops. The Final Guidelines replace both the 2010 Horizontal Merger Guidelines and the 2020 Vertical Merger Guidelines and are effective immediately.

The changes reflected in the Final Guidelines are minimal, and no changes were made to the sections most relevant to private equity firms that we discussed in our previous *Alert*.

What changes did the Final Guidelines make to the Draft Guidelines?

Even the more significant changes reflected in the Final Guidelines are more form than substance. The Final Guidelines reduce the number of analytical frameworks, termed “Guidelines” by the agencies, from 13 to 11 (although the substance of the deleted Guidelines is incorporated elsewhere[1]), soften somewhat the prescriptive language of the Guidelines,[2] clarify that all Guidelines can be rebutted or disproved,[3] and reincorporate the economic and evidentiary analyses (previously relegated to the appendices) into the main text.[4]

The final 11 Guidelines are as follows:

1. Mergers raise a presumption of illegality when they significantly increase concentration in a highly concentrated market.
2. Mergers can violate the law when they eliminate substantial competition.
3. Mergers can violate the law when they increase the risk of coordination.
4. Mergers can violate the law when they eliminate a potential entrant in a concentrated market.
5. Mergers can violate the law when they create a firm that may limit access to products or services that its rivals use to compete.
6. Mergers can violate the law when they entrench or extend a dominant position.
7. When an industry undergoes a trend toward consolidation, the agencies consider whether it increases the risk a merger may substantially lessen competition or tend to create a monopoly.
8. When a merger is part of a series of multiple acquisitions, the agencies may examine the whole series.
9. When the merger involves a multi-sided platform, the agencies examine competition between platforms, on a platform or to displace a platform.[5]
10. When a merger involves competing buyers, the agencies examine whether it may substantially lessen competition for workers, creators, suppliers or other providers.
11. When an acquisition involves partial ownership or minority interests, the agencies examine its impact on competition.

The Final Guidelines state that Guidelines 1-6 describe distinct frameworks the agencies use "to identify that a merger raises prima facie concerns," and Guidelines 7-11 explain how to apply those frameworks in specific settings. The Final Guidelines also signal more openness to rebuttal evidence than the Draft Guidelines, clarifying that "[i]n all of these situations, the Agencies will also examine relevant evidence to determine if it disproves or rebuts the prima facie case and shows that the merger does not in fact threaten to substantially lessen competition or tend to create a monopoly."

What do the Final Guidelines mean for private equity?

Both the FTC and the DOJ repeatedly have sounded the alarm on private equity with regard to multiple issues: (1) private equity roll-up strategies; (2) the potential for private equity investments to chill competition (particularly in the healthcare space); (3) the lack of capacity or interest of private equity divestiture buyers in using divested assets to their full potential; (4) interlocking directorates (where a firm has representatives on the boards of competing companies); and (5) supposed filing deficiencies when private equity firms submit notifications pursuant to the Hart-Scott-Rodino ("HSR") Act. We discuss each of these issues in more detail in our previous *Alert* on the Draft Guidelines.

In that *Alert*, we also examine the portions of the Draft Guidelines most relevant – and concerning – to private equity. Those sections are largely unchanged in the Final Guidelines. Although they are not legally binding, the Final Guidelines represent the current views of the agencies toward mergers and acquisitions. Accordingly, and regardless of whether the courts ultimately will agree with the agencies' interpretation of precedent (rejecting over four decades of jurisprudence based on the consumer welfare standard to do so), private equity firms should expect increased regulatory scrutiny of their transactions (even if not HSR-reportable), portfolios and board appointments. The top issues of concern are noted below and discussed more thoroughly in our previous *Alert*.

- *Roll-up acquisitions.* When reviewing a transaction that is part of a roll-up strategy, the agencies may consider the cumulative effect on competition of the entire series of transactions, even if prior transactions were not HSR-reportable (Guideline 8). The agencies also may factor into their analysis an industry trend toward consolidation (Guideline 7). The agencies may examine the firm's history and current or future strategic initiatives, and historical evidence may include the markets at issue and other markets.

- *Partial control or common ownership.* The agencies may consider the competitive effect of acquisitions of less-than-full control (Guideline 11), such as those resulting in cross-ownership (where a market participant holds a non-controlling interest in a competitor) and common ownership (where individual investors hold non-controlling interests in competing firms). The Final Guidelines explicitly recognize that cross-ownership and common ownership "can reduce competition by softening firms' incentives to compete, even absent any specific anticompetitive act or intent."

- *Lowered market share and concentration thresholds.* The Final Guidelines substantially lower the market share and concentration thresholds at which the agencies will presume a transaction substantially lessens competition or tends to create a monopoly, setting the threshold for presumed illegality at a level that would have been considered only potentially problematic under the previous 2010 Horizontal Merger Guidelines that they replace.[6] The Final Guidelines also retain the presumption of unlawfulness for any horizontal merger resulting in an increase of 100 HHI to a market share of over 30 percent. The formal market share presumption for vertical mergers was removed, but a footnote states that the agencies will infer a firm "has or is approaching monopoly power" when it would have a 50 percent or greater market share, and that mergers resulting in lower market shares may still substantially lessen competition, "particularly when [the] related product is important to its trading partners."

- *Potential competition.* The Final Guidelines back away from the Draft Guidelines' proclamation that "[t]he antitrust laws reflect a preference for internal growth over acquisition," but they note that, in general, "expansion into a concentrated market via internal growth rather than via acquisition benefits competition." A merger may be illegal if it eliminates an "actual" potential competitor (e.g., where the possibility of entry or expansion by one or both parties would have resulted in new or increased competition in the market in the future) or a "perceived" potential competitor (e.g., where there is "current competitive pressure exerted on other market participants by the mere perception that one of the firms might enter").

- *Competition for workers.* The agencies may examine how deals will affect workers (e.g., a combined firm's power over a labor market may lead to "lower wages or slow wage growth, worsen benefits or working conditions, or result in other degradations of workplace quality"). Under an administration that has prioritized enforcement against anticompetitive conduct in labor markets, the potential to lower prices to consumers through "efficiencies" or "synergies" resulting from the elimination of worker redundancy likely will carry little weight.
- *Higher bar for efficiencies arguments.* The Final Guidelines significantly raise the evidentiary burden for efficiencies arguments. To be recognized as cognizable efficiencies, merging parties must satisfy all of the following criteria: (1) merger specificity,[7] (2) verifiability,[8] (3) prevents a reduction in competition,[9] and (4) not anticompetitive.[10] The efficiencies "must be of a nature, magnitude, and likelihood that no substantial lessening of competition is threatened by the merger in any relevant market."

Enforcement track record

The Final Guidelines are consistent with the aggressive enforcement agenda of the agencies. These aggressive policies will be tested in court, and it remains to be seen whether courts will abandon over 40 years of jurisprudence based on the consumer welfare standard to embrace the agencies' novel legal theories, particularly given the conservative majority on the Supreme Court.

Although the agencies largely have come up short in litigated merger cases, with only one win in court and a number of deals called off due to the threat of litigation at the time the Draft Guidelines were published, they have since added a couple of notches in their belt. Just a few days before the Final Guidelines were issued (and just in time to be referenced multiple times in those guidelines), the Fifth Circuit issued an opinion siding with the FTC in its fight to stop Illumina, a biotech company specializing in gene-sequencing technology, from acquiring Grail, a manufacturer of cancer tests, leading to Illumina's decision to divest Grail. This marks the FTC's first successful litigation to block a vertical deal.

Just the week before, Sanofi terminated a planned licensing agreement with Maze Therapeutics to develop treatments for Pompe Disease after the FTC announced it was seeking a preliminary injunction to block the deal. Also in the same timeframe, Adobe announced that it would abandon its proposed deal to take over Figma, a fellow competitor in the design software market, citing regulatory obstacles from the European Commission, the UK Competition and Markets Authority, as well as a potential challenge from the DOJ. The DOJ is awaiting the federal district judge's ruling on its case to block JetBlue Airways' proposed acquisition of Spirit Airlines.

Another litigation to keep an eye on is the FTC's suit against private equity firm Welsh Carson's alleged scheme to monopolize the anesthesiology market in Texas through a roll-up strategy. Most recently, Welsh Carson filed a motion to dismiss in November. The case is an important barometer for private equity given that it is the first litigated challenge to serial acquisitions and also the first to target a minority private equity investor.

What happens now?

As a practical matter, the Final Guidelines have not moved the needle much in the regulatory landscape for private equity. The Final Guidelines largely reflect the agencies' rhetoric in support of more aggressive merger enforcement and is consistent with their actions in and out of court since President Biden articulated the Administration's broad antitrust policy in his July 2021 executive order. Private equity firms should continue to expect increased scrutiny of their transactions (even if not HSR-reportable), portfolios and board appointments by the DOJ and the FTC under this Administration.

When considering a potential transaction (whether an acquisition of control or a partial acquisition), firms should engage antitrust counsel early in the process to assess antitrust risk, including analyzing competition and potential competition in horizontal, vertical and related markets, as well as evaluating potential labor market impacts. Antitrust counsel can help educate deal teams on document creation and the risks arising from, for example, overstating market share or improperly describing markets. In addition, given the substantially expanded HSR disclosure requirements proposed by the FTC in July (including provisions aimed at assessing serial acquisitions and identifying interlocking directorates), antitrust counsel can begin compiling the required information earlier in the process to minimize any HSR-related delays.

Authored by *Peter Jonathan Halasz* and *Ngoc Pham Hulbig.*

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

---

[1] The former Guideline 6 (relating to vertical mergers) has been combined with other Guidelines, and the former "catch-all" Guideline 13 now is an unnumbered caveat in the text.

[2] The Final Guidelines reflect changes to address commentators' concerns over the Draft Guidelines' apparent prohibition of certain types of transactions. For example, the final Guideline 3 softens the draft Guideline 3's prescriptive statement that "mergers should not increase the risk of coordination" to a more traditional warning that "mergers can violate the law when they increase the risk of coordination."

[3] The Final Guidelines clarify that the merging parties may present evidence to rebut any theories of harm, including those based on the enumerated Guidelines. The agencies also emphasized in their press releases that the Final Guidelines "do not predetermine enforcement action."

[4] The Draft Guidelines were largely criticized for their bifurcation of legal doctrine from the underlying economics supporting an effects-based analysis, with the economic and evidentiary tools relegated to the appendices. The Final Guidelines reincorporate the economic analysis into the body of the text in a section discussing the "analytical, economic, and evidentiary tools the agencies use to evaluate facts, understand the risk of harm to competition, and define relevant markets."

[5] Platform businesses provide different products or services to two or more different groups or "sides" who may benefit from each other's participation.

[6] A merger is presumptively unlawful if it has a post-merger market concentration – measured by the Herfindahl-Hirschmann Index ("HHI") – of 1,800 HHI and an increase in 100 HHI from pre-merger levels. Under these lower thresholds, in a market where seven participants have shares of 30 percent, five percent, 20 percent, 10 percent, five percent, five percent and five percent, a merger between the 10-percent player and a five-percent player would be presumed problematic.

[7] The merger will produce substantial competitive benefits that could not be achieved without the merger under review. The agencies will

consider alternatives such as organic growth of one of the firms, contracts between them, mergers with others, and a partial merger involving only those assets that give rise to the procompetitive efficiencies.

[8] The benefits "are verifiable, and have been verified, using reliable methodology and evidence not dependent on the subjective predictions of the merging parties or their agents."

[9] The merging parties must demonstrate that the efficiencies will prevent the risk of a substantial lessening of competition in the relevant market, and not just benefit the parties themselves.

[10] The efficiencies cannot result from the "anticompetitive worsening of terms for the merged firm's trading partners."

Related People

Peter Halasz
Of Counsel
New York

Attachments

Download Alert