December 20, 2022

FTC and DOJ Signal Increased Scrutiny of Private Equity Firms

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The United States antitrust agencies continue to increase the pressure on private equity firms.[1] The Federal Trade Commission ("FTC") has amplified its position that rollups will get much harder looks, even if they are below the threshold requiring advance reporting under the Hart-Scott-Rodino Act. Meanwhile, the Antitrust Division of the Department of Justice ("DOJ") recently announced interlocking directorate investigations that resulted in the resignation of seven board members of various companies. These developments underscore the need for private equity companies to take particular care in observing U.S. competition laws.

FTC Unfair Competition Focuses on Rollups

A key element of FTC enforcement is Section 5 of the FTC Act, which proscribes "[u]nfair methods of competition in or affecting commerce."[2] The FTC has taken the view that Section 5 allows it to bring enforcement actions against conduct that may not violate other U.S. antitrust laws. This expansive view of "unfair methods of competition" is particularly important to the current FTC, as one of the first acts of the FTC under its current chair, Lina Khan, was to withdraw a 2015 policy statement that it considered too narrow. The Commission wrote, in its July 2021 withdrawal statement, that the 2015 statement "contravenes the text, structure, and history of Section 5 and largely writes the FTC's standalone authority out of existence" and "abrogates the Commission's congressionally mandated duty."[3]

The FTC's new policy statement, which was released last month, reflects its substantially broadened view of its enforcement power under Section 5. It now contends that conduct may be actionable (i) if it is "coercive, exploitative, collusive, abusive, deceptive, predatory, or involv[ing] the use of economic power of a similar nature, . . . [or] otherwise restrictive or exclusionary, depending on the circumstances" and (ii) if it "tend[s] to negatively affect competitive conditions," which determines whether the conduct may generate negative consequences.[4] There is no requirement of actual harm.

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[1] *See* John Roberti et al., *FTC Consent Decrees Underscore Skepticism and Scrutiny of Private Equity Firms*, COHEN & GRESSER LLP (July 5, 2022), https://www.cohengresser.com/app/uploads/2022/07/FTC-Consent-Decrees-Underscore-Skepticism-and-Scrutiny-of-Private-Equity-Firms.pdf.

[2] 15 U.S. Code § 45.

[3] FED. TRADE COMM'N, STATEMENT OF THE COMMISSION ON THE WITHDRAWAL OF THE STATEMENT OF ENFORCEMENT PRINCIPLES REGARDING "UNFAIR METHODS OF COMPETITION" UNDER SECTION 5 OF THE FTC ACT (2021), https://www.ftc.gov/system/files/documents/public_statements/1591706/p210100commnstmtwithdrawalsec5enforcement.pdf.

[4] FED. TRADE COMM'N, POLICY STATEMENT REGARDING THE SCOPE OF UNFAIR METHODS OF COMPETITION UNDER SECTION 5 OF THE FEDERAL TRADE COMMISSION ACT (2022), https://www.ftc.gov/system/files/ftc_gov/pdf/P221202Section5PolicyStatement.pdf.

The FTC also highlighted its right to enforce against "incipient violations," including "conduct by respondents who have not gained full-fledged monopoly or market power" and "conduct that has the tendency to ripen into violations of the antitrust laws." It also reserved the right to condemn conduct "that violates the spirit of the antitrust laws" but "may not be covered by the literal language of the antitrust laws." Notably, the FTC warned that "the analysis [of such conduct] may depart from prior precedent based on the provisions of the Sherman and Clayton Acts."

The policy statement includes a long list of examples that could violate the antitrust laws, with an emphasis on rollups. The examples include:

- "a series of mergers, acquisitions, or joint ventures that tend to bring about the harms that the antitrust laws were designed to prevent, but individually may not have violated the antitrust laws,"

- "mergers, acquisitions, or joint ventures that have the tendency to ripen into violations of the antitrust laws," and

- "mergers or acquisitions of a potential or nascent competitor that may tend to lessen current or future competition."

These changes bring an additional level of uncertainty regarding the types of conduct that will be challenged under Section 5.

Interlocking Directorates

Section 8 of the Clayton Act prohibits competing companies from having interlocking directorates. While the antitrust agencies have rarely expended resources to enforce Section 8, compliance with Section 8 is important to avoid government scrutiny, reputational harm, and the disruption that can come with changing out board members.

Interlocking directorate concerns can arise for a private equity firm when the firm purchases a minority stake in a company that competes with an existing portfolio company and when it is represented on both boards. It also can occur when an existing portfolio company expands into a line of business that competes with another portfolio company. Under either scenario, if an interlock occurs, there is a one-year grace period for the director or officer to resign.[5]

In October, the DOJ announced that seven individuals had resigned from boards as a result of its investigations of five different pairs of firms, including three individuals who represented technology-focused private equity firm Thoma Bravo on one or both boards of competing companies. Although there is limited authority on the issue, the DOJ relied on an interpretation of the Clayton Act to take the position that if an entity appoints a board representative to competing boards, Section 8 is implicated even if the board members are different people.[6]

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[5] 15 U.S.C. § 19(b).

[6] *See* Michael E. Blaisdell, Interlocking Mindfulness (June 26, 2019), https://www.ftc.gov/enforcement/competition-matters/2019/06/interlocking-mindfulness (stating Section 8 prohibits "one firm from appointing two different people to sit as its agents as officers or directors of competing companies, subject to a few limited de minimis exemptions"); *Reading Int'l, Inc. v. Oaktree Cap. Mgmt. LLC*, 317 F. Supp. 2d 301, 331 (S.D.N.Y. 2003).

The investigation reveals that interlocks are an agency priority. The October announcement is part of a "broader review of potentially unlawful interlocking directorates" as other companies have received similar letters, and the DOJ has warned that "[c]ompanies, officers, and board members should expect that enforcement of Section 8 will continue to be a priority for the Antitrust Division."[7] In addition, the FTC's recently issued policy statement provides, as an example of conduct that may violate Section 5, having "interlocking directors and officers of competing firms not covered by the literal language of the Clayton Act." Notwithstanding the one-year grace period and the fact that enforcement actions are typically resolved through resignations, without additional penalty, both the DOJ and FTC remain focused on enforcement of interlocking directorates as a means to provide greater oversight of private equity.

Conclusion

As long as the current antitrust enforcers are in place, private equity firms should be prepared for additional scrutiny. There will be greater scrutiny of private equity firms as buyers of assets and more aggressive regulation of board representation. It will be wise to redouble compliance efforts in both areas.

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[7] Press Release, U.S. Dep't of Justice, Directors Resign from the Boards of Five Companies in Response to Justice Department Concerns about Potentially Illegal Interlocking Directorates (Oct. 19, 2022), https://www.justice.gov/opa/pr/directors-resign-boards-five-companies-response-justice-department-concerns-about-potentially#:~:text=WASHINGTON%20%2D%20The%20Justice%20Department%20announced,Act's%20prohibition%20on%20interlocking%20directorates.

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