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Antitrust

Rising Risks for PE Firms to Monitor Amidst Changing Antitrust, Whistleblower and Sanctions Landscape

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The Biden administration has been very focused on PE firms and has invoked previously unused enforcement tools to target the industry, including lawsuits based on conduct by a firm's portfolio company. With greater public scrutiny of PE firms generally, and their investments in industries like healthcare in particular, firms should be aware of new legal risks from regulators and private plaintiffs alike.

Firms seeking to avoid regulatory scrutiny or enforcement actions – and the potentially steep legal fees or penalties that accompany them – should be particularly aware of new developments in the areas of antitrust, False Claims Act violations and Office of Foreign Assets Control (OFAC) sanctions compliance. This article details the recent threats posed via each of those avenues and offers scenarios that GCs and CCOs of PE sponsors should avoid to mitigate those risks.

For other risks that PE sponsors face, see "2024 SEC Examination Priorities: New Approaches to Old Areas of Concern" (Dec. 14, 2023); and "SEC Risk Alert and Accompanying Checklist Explains Examinations Process and Identifies Key Documents to Have Ready" (Nov. 2, 2023).

Antitrust

Antitrust Exposure Resulting From Roll-Ups

Federal Trade Commission (FTC) and U.S. Department of Justice (DOJ) leadership have repeatedly expressed concerns about PE-backed roll-up acquisition strategies. In 2020, then-FTC Commissioner Rohit Chopra voiced reservations in a public statement about PE's involvement in the healthcare industry in particular. Those sentiments were echoed in a public statement issued by three of the five FTC commissioners in June 2022, who said that "serial acquisitions or 'buy-and-buy' tactics" by PE firms can "enabl[e] them to accrue market power and reduce incentives to compete, potentially leading to increased prices and degraded quality." The joint statement was issued

with an FTC complaint targeting a PE fund's acquisition of multiple veterinary practices. Further, in mid-2022, FTC Chair Lina Khan announced in a television interview that the FTC's and DOJ's Antitrust Divisions were both closely scrutinizing roll-up strategies.

In September 2023, the FTC made headlines when it filed a suit against U.S. Anesthesia Partners (USAP), the largest anesthesiology provider in Texas, and its PE sponsors, represented by Welsh, Carson, Anderson & Stowe (WCAS). The complaint alleges the company and its sponsors formed a monopoly through a roll-up – *i.e.*, by acquiring nearly every large anesthesia practice in Texas – and then used that market dominance to extract monopoly profits. The complaint also alleges the company entered into price-setting and market-allocation contracts with independent providers, which were also anticompetitive. The FTC seeks an injunction against similar conduct in the future and "structural relief" (*i.e.*, unwinding the roll-up).

There are two notable features of the suit against USAP and WCAS. First, the FTC's theories of harm rely on dynamics that can be alleged about many markets for healthcare services. The FTC's proposed geographic and service markets are narrow and concentrated. Further, the FTC alleges barriers to competition caused by providers' long-term contracts with hospitals and in-network status with insurers. Those are the same theories that competitor healthcare systems and consumer classes have relied on in suits alleging similar theories – that a hospital system or provider group accrued monopoly power by acquiring other practices, and then used that monopoly power to charge supracompetitive prices.

Second, the FTC used ordinary activities by WCAS' affiliates to pull the firm into the case. For evidence of intent to monopolize, the complaint relies primarily on WCAS executives' statements about "captur[ing] significant synergies" by way of USAP's acquisitions of other anesthesia practices. The FTC alleges that "synergies" is a euphemism for monopoly prices. But otherwise, the complaint mostly alleges that:

- directors affiliated with and appointed by WCAS devised and implemented the roll-up strategy;
- WCAS-affiliated personnel participated in managing USAP; and
- WCAS ultimately profited from its involvement with USAP.

The FTC imputes all of this to WCAS itself by claiming the WCAS affiliates "operate[] as a common enterprise."

It remains to be seen whether WCAS will find a way out of the case before discovery. The defendants have moved to dismiss, and the motions should be fully briefed by the end of February 2024. But private plaintiffs – two employee benefit plans based in Texas – have already brought an antitrust class action against USAP and WCAS based on the same conduct alleged in the FTC complaint.

Antitrust Exposure Through Acquisitions

PE firms also face potential exposure to antitrust risks by acquiring a company engaged in allegedly anticompetitive conduct. The *Packaged Seafood* antitrust litigation is a prominent example. The plaintiffs in that long-running class-action case allege that canned tuna providers engaged in price fixing. The private litigation followed a DOJ criminal investigation that resulted in criminal charges against and plea agreements with Bumble Bee and StarKist, as well as guilty pleas or convictions of several executives. In *Packaged Seafood*, PE firm Lion Capital was dragged into the antitrust litigation because the firm acquired Bumble Bee, one of the tuna producers.

Lion Capital initially succeeded when it moved to dismiss the claims against it. On reconsideration, however, the court decided the plaintiffs had sufficiently alleged that Lion Capital discovered Bumble Bee's allegedly anticompetitive agreements before the acquisition, and encouraged Bumble Bee's anticompetitive behavior after it. As to both, the allegations included facts common to any acquisition (*e.g.*, access to financial records and company executives, and knowledge of the downward pressure on prices in the industry) and facts common to any PE management scenario (*e.g.*, close management of the company and installing firm executives on the company's board).

Lion Capital argued, after spending substantial time and money defending the litigation, that none of that discovery showed that it and its affiliates were even aware of wrongdoing by Bumble Bee. The district court rejected that argument, pointing to the plaintiffs' allegations and additional evidence developed during discovery, including:

- a whistleblower letter;
- communications Lion Capital received from Bumble Bee management and its board sharing competitors' pricing; and
- meetings Lion Capital executives had with Bumble Bee's competitor.

The trial is scheduled for July 2024.

For similar risks in other jurisdictions, see our three-part series on parental liability in the E.U.: "'Undertakings' and Potential Scope of Risk for PE Sponsors" (May 21, 2019); "Rebuttable Presumption of Decisive Influence and Four Misconceptions About Avoiding Liability" (Jun. 4, 2019); and "Mitigating Liability at Various Stages of Portfolio Company Ownership" (Jun. 11, 2019).

Interlocking Directorates

The Biden administration has been both vocal and active in unwinding interlocking directorates that it determines are illegal under the Clayton Antitrust Act of 1914 (Clayton Act). An interlocking directorate (or "interlock") exists when the same "person" serves on the boards of competing corporations. Under Section 8 of the Clayton Act, 15 U.S.C. §19, interlocks that do not meet safe-harbor requirements are per se violations of the antitrust laws – *i.e.*, illegal even if there is no evidence they harmed competition. That statute was passed out of a concern that shared directors could create an opportunity for competitors to coordinate or exchange competitively sensitive information.

In June 2022, Andrew Forman, one of the top deputies to the head of the DOJ's Antitrust Division, said in a keynote speech: "To the extent that [PE] investments in competitors lead[] to board interlocks in violation of Section 8, the division is committed to taking aggressive action." Later, the head of the Antitrust Division, Jonathan Kanter, announced in a March 2023 speech that the DOJ had 17 active Section 8 investigations. In several of those investigations, the common "person" was a representative of a PE firm, including Thoma Bravo, Brookfield and Apollo. Since then, the DOJ has announced that more directors have resigned in response to its anti-interlock enforcement campaign, for a total of 15 directors from 11 boards.

See "How PE Firms Can Prepare for the DOJ's Section 8 Crackdown on Interlocking Directorates Across Portfolio Companies" (May 18, 2023).

Despite the flurry of enforcement activity over the last two years, there are significant open questions about the scope of the prohibition in Section 8. For example, although it is clear that the same flesh-and-blood person cannot serve on the boards of two competing companies, it is less clear whether two different people affiliated with the same firm are the same "person" for interlock purposes. Courts have both permitted and declined to reach that theory, but in cases that are now quite dated. Perhaps most notably, the DOJ has raised a concern about a potential interlock when two directors of a company were both affiliated with a PE fund, and the same fund proposed to acquire all of a competitor company's assets – suggesting the DOJ thought the directors were the same "person" because they were affiliated with the same fund, even though the fund had thousands of employees.

There is also significant ambiguity in deciding when companies are competitors. That question is not difficult if the DOJ is concerned about Coca-Cola versus Pepsi, but the answer is less obvious for companies that operate in different parts of the country or sell differentiated products or services. It is also unclear whether the prohibition applies to potential as well as actual competitors and, if so, at what point competition is sufficiently imminent or robust to trigger Section 8.

In addition, the risk of private suits also remains a question given that the Clayton Act permits private plaintiffs to file interlock suits. Although the remedies awarded in those cases have been for the compromised director to resign, creative private plaintiffs may find a way to assert monetary damages, too.

See our three-part series on sponsor-appointed directors of portfolio company boards: "Conflicted Transactions, MNPI and Other Risk Areas" (Aug. 4, 2020); "Best Practices to Mitigate Risk in Multiple Scenarios" (Aug. 11, 2020); and "Common Risk Scenarios Triggering Conflicts and Fiduciary Breaches" (Aug. 25, 2020).

False Claims Act

The federal False Claims Act, 31 U.S.C. §§ 3729-3733, imposes civil liability – including treble damages – for knowingly or recklessly submitting false or fraudulent claims to the U.S. government. For example, if a nursing home overbills Medicare for services, those overcharges are actionable under

the False Claims Act. Cases can be brought by the federal government, or by an individual whistleblower (called a relator). A successful plaintiff can recover its legal fees and treble damages. Many states also have similar false claims statutes.

PE firms should be aware that there is risk even if the allegedly false claims are presented by the fund's portfolio company and not by the PE firm itself. Both the government and private whistleblowers have successfully argued that PE companies can cause their portfolio companies to make false claims. That means PE firms can be held liable, too.

Like antitrust enforcement, False Claims Act enforcement has been a focus of the Biden administration. In his 2022 State of the Union address, President Biden called out "Wall Street firms" for taking over nursing homes and promised to "look at that closely." Around the same time, the White House issued a fact sheet asserting that resident outcomes were significantly worse at nursing homes owned by PE firms. Although the False Claims Act applies to any false or fraudulent claims submitted to the government, the enforcement actions brought against PE firms recently have all been in the healthcare context.

Most of the recent cases brought by prosecutors and private whistleblowers involved allegations of the following series of circumstances:

- a portfolio company was submitting false claims before it was acquired by the PE firm;
- the firm either knew or should have known about the false claims; and
- the firm failed to halt the false claims after the acquisition.

In many cases, allegations about the PE sponsor's knowledge are based on its involvement in managing the business, rather than actual knowledge of the improper payments. As in antitrust cases, plaintiffs in whistleblower cases often point to PE firms' own statements about the depth of their knowledge about the industry – and their rigorous pre-acquisition investigation process – to support an inference that the PE firm discovered or should have discovered the alleged misconduct during that investigation, but still decided to acquire the company anyway.

Whistleblower Exposure Through Acquisitions

In one example of potential sponsor liability through an acquisition, a private whistleblower sued H.I.G. Growth Partners and H.I.G. Capital (together, H.I.G.) over allegedly fraudulent billing by the firms' portfolio company, South Bay Mental Health Center. The whistleblower alleged that H.I.G. discovered the misconduct during its pre-acquisition diligence process, and either knew or should have known that it continued after the acquisition. The Commonwealth of Massachusetts eventually joined the suit to pursue parallel claims against H.I.G. under Massachusetts law. H.I.G. eventually settled for almost $20 million after it lost both a motion to dismiss and a motion for summary judgment.

In another example that began through a private whistleblower suit, in November 2020, the U.S. Attorney's Office in Philadelphia reached a multi-million-dollar settlement with Therakos, an immunotherapy company, and The Gores Group, the PE company that acquired it. The suit alleged the

parties improperly marketed Therakos's lymphoma drug for use by children, which resulted in false claims being submitted to Medicaid and other federal programs. The suit also alleged that when The Gores Group acquired Therakos, the company was engaging in improper sales and product promotion practices, and those practices continued under The Gores Group's ownership. Therakos's prior owner paid $10 million in the settlement; The Gores Group paid $1.5 million.

See "How PE Sponsors Can Avoid Being Targeted by the DOJ for Parental Liability Under the False Claims Act" (Dec. 15, 2020).

Whistleblower Exposure Through Management

There have also been cases brought based primarily on a PE firm's management of a company, rather than its acquisition. For example, in a set of six cases brought in Texas, the government alleged that medical testing company Alliance Family of Companies LLC (Alliance) submitted false claims that included kickbacks to referring physicians or payment requests for work not performed.

The government also sued PE firm Ancor Holdings LP (Ancor), a minority shareholder of Alliance. The government alleged that, through Ancor's two seats on Alliance's board and the monthly fees it received under a management services agreement, Ancor "caused" the false billings for the purpose of False Claims Act liability. The government also alleged that Ancor discovered the kickbacks and fraudulent billing during its pre-investment diligence, yet allowed the practices to continue after entering into an agreement to manage the company. In June 2021, the parties settled, with the company paying $13.5 million and the PE sponsor paying $1.8 million.

In another example, PE firm RLH Equity Partners (RLH) and its portfolio company, compounding pharmacy Patient Care America, settled allegations that they violated the False Claims Act by participating in a kickback scheme to generate referrals of prescriptions of expensive creams and vitamins, regardless of patient need, which were reimbursed by the federal health care program for military members. The government alleged that RLH knew about and agreed to the plan to generate the prescriptions, and financed the kickback payments to the marketers. The company and sponsor together paid $21.4 million.

OFAC Sanctions Compliance

Compliance with sanctions issued by OFAC also remains an enforcement priority for the Biden administration. OFAC administers and enforces economic and trade sanctions put in place based on U.S. foreign policy and national security goals. There are two types of sanctions:

- those that prohibit dealing with the people or companies listed on OFAC's "Specially Designated Nationals and Blocked Persons" or "SDN" list; and
- those that block the transfer of assets or trade with entire countries.

Sanctions violations are punishable with civil monetary penalties (with maximums set based on the statutory basis for the sanction, and which range from $16,000 to $1.7 million) or criminal prosecution.

See our three-part series on sanctions: "How Sanctions Regimes Work" (Sep. 13, 2022); "Their Impact on Private Fund Investors and Investments" (Sep. 20, 2022); and "How to Comply With Them" (Sep. 27, 2022).

Regulators encourage companies, including PE firms, to have a robust OFAC compliance framework to prevent violations. Firms should diligence portfolio companies' customers, supply chain, intermediaries and counterparties. Compliance programs are important not just to prevent violations, but also to demonstrate good faith to regulators. When the DOJ evaluates whether to investigate a company, bring charges, or offer a plea or other agreement, one factor it considers is "the adequacy and effectiveness of the corporation's compliance program at the time of the offense."

See "SEC, NFA and OFAC Shed Light on Their AML Enforcement Efforts and Priorities" (May 4, 2017).

For example, in 2019, OFAC reached a settlement with Acteon, an oil and gas provider, and KKR, a PE firm and its former owner, for allegedly violating sanctions against Cuba and Iran. While under KKR ownership, Acteon's subsidiaries allegedly rented equipment to customers who used the equipment in Cuban and Iranian territorial waters. Because Acteon voluntarily self-reported, and OFAC determined the alleged violations were "non-egregious," OFAC only fined KKR approximately $200,000.

The Acteon case is significant for two reasons. First, it shows that even a handful of improper transactions by a portfolio company's subsidiary is enough to create potential sanctions liability for its PE sponsor. And second, PE firms and their portfolio companies benefit enormously from robust sanctions compliance programs. In the Acteon case, KKR's discovery of the violations and voluntary disclosure led OFAC to impose a relatively low fine.

Compliance programs are not only important for helping avoid civil penalties, but also potential criminal liability. Under the International Emergency Economic Powers Act, willful sanctions violations can be punished with fines and imprisonment. Criminal enforcement is a priority of the Biden administration. As Lisa Monaco, the second-ranking official at the DOJ, recently put it: "For anyone who seeks to evade sanctions, the warning is simple: the [DOJ] is coming for you."

See "DOJ Incentivizes Self Disclosure Once More With Guidance for U.S. Attorneys' Offices" (Apr. 20, 2023).

Conclusion

Increased scrutiny of PE firms by the Biden administration has led to greater enforcement risks when it comes to antitrust, False Claims Act and sanctions cases – for both portfolio companies and sponsors. Especially as to antitrust and whistleblower cases, private litigation often lags behind

government enforcement. PE firms should therefore remain vigilant about their potential exposure in these areas and bolster their compliance practices accordingly.

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