Portfolio Media. Inc. | 230 Park Avenue, 7th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

How To Navigate The FTC's New Private Equity Frontier

By **William Roppolo, Mark Weiss and Ashley Eickhof** (October 19, 2023, 5:04 PM EDT)


William Roppolo


Mark Weiss


Ashley Eickhof

Last year, we warned that the Federal Trade Commission was starting to go after directors, owners and private equity firms in control of entities that violated American antitrust laws.

That has now proven true. On Sept. 21, the FTC filed a 106-page complaint in the U.S. District Court for the Southern District of Texas against U.S. Anesthesia Partners Inc. and its private equity investor, Welsh Carson Anderson & Stowe XI LP.[1]

Generally speaking, the FTC contends that Welsh Carson established USAP to strategically acquire anesthesia practices throughout Texas to monopolize the market and stifle competition. According to the FTC's allegations, since 2012, USAP has grown to over 4,500 anesthesia providers and performed 2.5 million anesthesia procedures at 1,100 health care facilities.

The complaint alleges that USAP and Welsh Carson engaged in anti-competitive conduct through a series of illegal roll-up acquisitions made over several years and price-setting agreements between USAP and its competitors.

The complaint details several notable acquisitions of anesthesia companies in certain Texas markets — Dallas, Houston and Austin. The commission also challenges USAP's acquisition of one anesthesiology practice in each of Tyler, Amarillo and San Antonio.

Although these transactions did not alter the market concentration in these local markets and would not on their own support a challenge under the Clayton or Sherman Acts, the FTC contends that USAP's ability to leverage its acquisitions to apply supra-competitive rates in these markets makes those acquisitions actionable.

Because this lawsuit contains some claims brought solely under Section 5 of the FTC Act, it will permit the FTC to test the bounds of its stand-alone authority under this legal provision.

This lawsuit will also be an early test of the newly proposed draft merger guidelines where the FTC and the Antitrust Division of the U.S. Department of Justice have explained that they will review transactions they consider to be "part of a firm's pattern or strategy of multiple acquisitions" and examine "the cumulative effect of the pattern or strategy."[2]

This case represents a new frontier for the FTC, which has not previously based a federal court litigation on a roll-up transaction. This means it is also a new challenge for defendants and their counsel.

In large part, the case will serve as a testing ground for the FTC to determine the degree to which courts will accept these and similar claims against private equity investors. There are several defenses that USAP, Welsh Carson and similar companies in their positions may assert in litigating these types of claims.[3] The article addresses each in turn.

The FTC has brought claims against the USAP and Welsh Carson under Sections 1 and 2 of the Sherman Act, Section 5 of the FTC Act, and Section 7 of the Clayton Act.

More particularly, the FTC asserts that USAP and Welsh Carson violated:

- Section 1 of the Sherman Act by agreeing to charge higher rates and allocating the market with another anesthesiology services provider;

- Section 2 of the Sherman Act by monopolizing and conspiring to monopolize the commercial insured hospital-only anesthesia services market in Dallas and Houston;

- Section 5 of the FTC Act by engaging in a scheme to reduce competition in the Texas anesthesia market, including entering into price-setting agreements; and

- Section 7 of the Clayton Act and Section 5 of the FTC Act by acquiring various anesthesia clinics in the specific Texas markets, which increased USAP's concentration levels in the affected markets and reduced competition.

As an initial matter, a roll-up transaction takes place when a business, such as a private equity firm, acquires several businesses or assets in the same or related markets. This practice, in and of itself, is not illegal.

It may become the subject of an enforcement action where, as alleged here, the series of transactions resulted in the acquisition of substantial market or monopoly power, allowing one entity to gain ownership and control of the majority of the market.

The FTC's Section 1 claim can be broadly categorized into two theories. First, USAP colluded with competitors to establish purported price-setting arrangements. Second, USAP entered into a market allocation agreement with another large anesthesia services provider.[4]

The defendants could take the position that USAP's agreements with competitors, assuming such agreements exist, were economically justifiable and not illegal.

Regarding the alleged price-setting arrangements, the FTC casts them as a scheme to apply higher prices to third-party services without providing any commensurate benefits, but the claim warrants further investigation by the defendants.

The FTC alleges that the arrangements were "styled as 'collaboration,' 'professional services,' or 'independent contractor' agreements," and it remains possible that in the light of further discovery, these arrangements were exactly that — legitimate business collaborations to which the alleged price-setting arrangements were fairly priced and legal agreements to reflect rendered services.

Regarding the FTC's allegations of higher pricing, the defendants could potentially argue that the higher cost of anesthesiology services does not stem from illicit agreements among competitors, but rather from rising costs in the industry.

For example, an increase in drug prices or inflation. Indeed, studies have found that hospital costs have increased substantially during the pandemic years, including an increase in drug costs of 36.9% and medical supply expenses of 20.6% from prepandemic times,[5] and an increase in per-patient labor costs of 37% from 2019 to March 2022 due to increased contract labor expenses.[6]

Such sizable exogenous changes to hospital costs could certainly be a substantial contributor to the higher costs alleged by the FTC and have nothing to do with the alleged conduct.

Turning to the Section 2 allegations, defendants can challenge both the geographic market and the service market. First, the defendants could challenge the scope of the geographic market as defined by the FTC's complaint.

While the FTC likely assessed all of USAP's acquisitions throughout the entire state of Texas, the FTC's claims focus only on its acquisitions in Houston, Dallas and Austin — a limited subset of the market.

Utilizing this subset, USAP's share of the market will undoubtedly appear greater than it is in actuality. The defendants could further argue that the relevant geographic market should be broader than the three submarkets on which the FTC is focused, assuming there is evidence to do so.

The FTC's own allegations acknowledge that hospitals can switch their exclusive providers of anesthesia services by considering both "[e]xisting local providers" and "more distant alternatives" — suggesting that competitive anesthesia providers compete well beyond the alleged geographic markets of local Texan metropolitan statistical areas.

Second, defendants can also challenge the service market. The FTC alleges the service market consists of hospital-only anesthesia services sold to commercial insurers and their insured members, encompassing all inpatient anesthesia services and any other anesthesia services provided in a hospital setting.[7]

Here, that market should include all facilities in which anesthesia is administered, including, but not limited to, outpatient facilities and surgery centers.

The FTC seeks to justify the alleged markets based on the principle that patients typically do not shop for hospital services and utilize the nearest medical facility. However, the FTC alleges an input market for available anesthesia services.

When viewed this way, the relevant question is where hospitals can find competitive providers of anesthesia services — and in this case, hospitals do have options.

While the FTC may be correct that in-hospital services may not compete with many services performed outside a hospital, like at private pain-management facilities, the anesthesiologists at both providers are all trained medical professionals who are capable of working in or out of hospital settings.

This suggests that the market is unreasonably constrained and excludes viable alternative providers of anesthesia services that can compete with the USAP and Welsh Carson entities.

In response to the FTC's claim that USAP and Welsh Carson have created a monopoly in the Houston, Dallas and Austin markets, the defendants can alternatively argue that this is not an unlawful monopoly.[8]

The formation of a monopoly or near-monopoly is not illegal where the acquisition or growth is the result of superior skill or business acumen. The defendants could defeat the Section 2 claim on the grounds that their monopoly is the result of the fact that the practitioners who work for them have superior skills or business acumen.

Because of that fact, smaller providers are inclined to negotiate with and be acquired by USAP. With evidence, this defense would demonstrate that even if USAP has a disproportionate share of the market, however defined, there exists a legitimate reason.

Further, in at least the case of Austin, the FTC's allegations appear deficient to make out a case of monopoly power. The FTC alleges that USAP has 44.2% of anesthesia cases, and just over 50% of revenues.[9]

Courts have found that "[f]ifty percent is below any accepted benchmark for inferring monopoly power from market share," as per the 1995 Blue Cross & Blue Shield United of Wisconsin v. Marshfield Clinic decision in the U.S. Court of Appeals for the Seventh Circuit.[10]

The FTC's monopolization claims also remain vaguely defined. The allegations refer to exclusive providers, exclusive arrangements, exclusive agreements and exclusive contracts, but it is unclear if the FTC is premising its monopolization claims on exclusionary conduct and who or what exactly the FTC thinks is being excluded.

The FTC even admits that exclusive hospital providers come with valid procompetitive benefits — by allowing for higher staffing, 24/7 hospital coverage, and "guarantee[ing] treatment for less lucrative patients" — all while acknowledging that these contracts carry risks for the anesthesia providers that must staff a hospital even at nonpeak times.[11]

The FTC further admits that exclusive contracts are limited in duration and allow for active competition, and that hospitals sometimes do change providers.[12] What the FTC never alleges is that the underlying antitrust conduct has resulted in USAP and Welsh Carson providing deficient or low-quality anesthesia services.

At best, the FTC makes a repeated but unsupported allegation that the acquisitions have not resulted in "any clear quality improvements." Together, this suggests that the conduct underpinning the alleged monopolization claims is merely the acquisition of market power through a series of roll-up transactions, an argument we address in the following paragraphs.

With respect to the claims under Section 7 of the Clayton Act, USAP and Welsh Carson could assert an efficiencies defense. More specifically, the parties could contend that the efficiencies of USAP's acquisitions are such that they do not substantially lessen competition.

There are quantifiable efficiencies from the merger that are being passed on to hospitals and patients that outweigh the increase in the price of anesthesiology services. Part of this argument must be that these efficiencies are merger-specific.

In other words, the efficiencies would not be possible without acquiring the particular entities at issue. USAP acquired the smaller anesthesia companies in order to transfer efficiencies to consumers that would be impossible with a fragmented market.

The complaint alleges that despite alternative competitive anesthesia services and higher prices, "USAP's retention of hospital contracts had 'effectively been 100%.'"

The FTC blames this on lock-in effects, but the defendants very well may be able to gather third-party evidence from hospitals that corroborates a story that they provide excellent service and that service quality has improved as a result of the acquisitions, otherwise their retention would be substantially lower.

Any increase in rates, then, is the result of arm's length bargaining, including the hospital's preferences; it is not the result of any improper conduct by either USAP or Welsh Carson, and does not indicate anything impermissible on their part.

The FTC's complaint asserts, without explanation or support, that the defendants will be unable to show any efficiencies. The defense, if substantiated, has the potential to succeed against a Section 7 claim.

The defendants could additionally argue that each transaction should be analyzed individually, and that the series of acquisitions were not of the type and kind that would warrant enforcement. If each acquisition was properly evaluated independently, any action predicated thereon should fail.

Additionally, the FTC complaint challenges acquisitions dating back to 2012, and a number of other acquisitions between 2012 and 2018 — conduct that is five to 10 years old. Only one of the 13 acquisitions described in the complaint occurred within the applicable four-year statute of limitations.

While federal enforcement is not subject to a laches defense as a matter of public policy, similar actions brought by state attorneys general against Facebook were heavily criticized by U.S. District Judge James Boasberg in the U.S. District Court in the District of Columbia in the 2021 New York v. Facebook decision.

There, Judge Boasberg dismissed the state's claims on the basis of laches, stating that the challenged transactions "occurred over six years ago — before the launch of the Apple Watch or Alexa or Periscope, when Kevin Durant still played for the Oklahoma City Thunder, and when Ebola was the virus dominating headlines," according to the decision.[13]

Even if a laches defense is not available to the defendants, courts have acknowledged that already-consummated acquisitions are difficult to undo and often injunctive relief is inappropriate.[14]

In sum, though the FTC is pursuing several novel legal theories in an effort to explore the bounds of its enforcement authority, there are viable defenses available to defendants, including private equity companies.

Private equity companies should consult with counsel prior to engaging in roll-up acquisitions to ensure their actions do not land them in the FTC's spotlight. Roll-up transactions must be carried out deliberately and strategically to stave off similar litigation.

William Roppolo is a partner at Baker McKenzie, and the head of litigation and government enforcement for the firm's New York and Miami offices, and co-chair of the firm's North America trial team.

Mark Weiss is a partner at the firm.

Ashley Eickhof is an associate at the firm.

Baker McKenzie associate Annasofia Roig contributed to this article.

[1] https://www.ftc.gov/system/files/ftc_gov/pdf/2010031usapcomplaintpublic.pdf.

[2] Draft Merger Guidelines, U.S. Department of Justice and Federal Trade Commission, Guideline 9 (2023), https://www.ftc.gov/system/files/ftc_gov/pdf/p859910draftmergerguidelines2023.pdf.

[3] For the sake of clarity, the proposed defenses articulated in this article presuppose that there is a good faith basis for asserting such a defense, including, but not limited to, the existence of evidence that may later substantiate the defendants' positions. This article is not intended to serve as legal advice.

[4] Many of the market allocation allegations are redacted in the public complaint so we do not specifically address potential defenses to those claims.

[5] Am. Hospital Ass'n, Massive Growth In Expenses & Rising Inflation Fuel Financial Challenges For America's Hospitals & Health Systems (April 2022), https://www.aha.org/guidesreports/2022-04-22-massive-growth-expenses-and-rising-inflation-fuel-continued-financial.

[6] Kaufman Hall, Reliance on contract Labor During Pandemic Means Higher Hospital Expenses(May 11, 2022), https://www.kaufmanhall.com/news/reliance-contract-labor-during-pandemic-means-higher-hospital-expenses.

[7] Compl. ¶216.

[8]See United States v. Grinnell Corp., 384 U.S. 563, 570 — 71 (1966)(setting forth the elements of an unlawful monopoly under Section 2 of the Sherman Act).

[9] Compl. ¶ 295

[10] 65 F.3d 1406, 1411 (7th Cir. 1995).

[11] Compl. 53, 59.

[12] Compl. ¶¶ 53–54, 57.

[13] N.Y. v. Facebook 549 F. Supp. 3 (D.D.S.).

[14] United States v. Booz Allen Hamilton Inc., No. CCB-22-1603, 2022 U.S. Dist. LEXIS 198013, at *9 (D. Md. Oct. 31, 2022) ("Sorting assets post-acquisition may prove particularly challenging. The proverbial attempt to 'unscramble the eggs' is not so easy.").