A unique view of the American litigation landscape

A Q&A with private equity researcher Aslihan Asil

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The Hart-Scott-Rodino Act disproportionately permits private-equity-backed mergers to go unreported compared to those funded by public equity, according to a **study** published last month by Washington University professor John Manuel Barrios, University of Chicago professor Thomas Wollmann and Yale doctoral student Aslihan Asil. GCR USA spoke with Asil about potential concerns from transactions that the US antitrust agencies might not know exist.

What did you set out to find in your study?

Private equity has become a prominent topic in antitrust. It repeatedly features in the agendas of antitrust regulators, and there has been significant coverage of PE deals in the news. Despite this attention, to the best of my knowledge, enforcement against PE deals has not been equally prominent.

Discussions on antitrust law usually revolve around the contours of the substantive law and its application to certain businesses and deals. Instead, we wanted to concentrate on the Hart-Scott-Rodino Act's Premerger Notification Program, a procedural component of the US antitrust law, and how it applies to **private equity** deals. Our concern was that maybe there exists a problem in the detection of potentially anticompetitive PE deals, rather than in enforcement.

There has been previous work by my co-authors showing that in many economically important US industries, the contours of the substantive antitrust law are, practically speaking, equivalent to the contours of the Premerger Notification Program. In other words, if one can avoid an HSR filing, then one may avoid agency scrutiny altogether. In light of this finding, we examined whether the Premerger Notification Program treats public and private equity transactions differently.

To our surprise – hopefully, to most people's surprise – the Premerger Notification Program exempts many private equity deals that would otherwise be reportable. This paper provides the legal reasons why this occurs and then supports our hypotheses through data.

What do you see as the primary antitrust concerns with these transactions going unreported?

There are three basic causes for concern. First, if a large set of economically important transactions are exempt from the Premerger Notification Program, then they are likely to escape enforcement. Not only does this have a direct effect on whether anticompetitive mergers are completed, but it also reduces deterrence – it might encourage competitors to merge that wouldn't have otherwise attempted to do so.

Second, the sheer scale of private equity acquisitions has soared over the past two decades and especially since the pandemic. PE deal value, which was around $100 billion in 2001, rose to $1.25 trillion in 2021.

Third, private equity roll-ups appear to disproportionately involve especially important industries, such as software and healthcare. If there are deleterious effects, then they might manifest themselves in slower innovation or reduced quality of care.

Do you think the US agencies are paying adequate attention to this topic?

Authorities at the Department of Justice and the Federal Trade Commission made public remarks on the importance of private equity for antitrust regulation. In 2020, the FTC **published** an Advance Notice of Public Rulemaking to gather information about potential reforms to HSR rules. Among the topics included were acquisitions of interests in noncorporate entities, which are common in PE. Also in 2020, the agencies also proposed rules acknowledging the importance of common management links for the definition of control.

However, both proposals expired without any rulemaking. And although the latter rule would have brought closer the HSR Act's aggregation of control to economic reality, it still would not have directly addressed certain issues that arise with respect to acquisitions of noncorporate entities like limited liability companies and limited partnerships, or co-investment vehicles, both of which feature prominently in private equity investment structures.

To be clear, you are not suggesting these private equity firms are violating the HSR Act?

We are not. The law simply treats private equity transactions differently. Disparate treatment arises because the HSR Act's definition of control, which plays a pivotal role in the determination of reportability, is misaligned with economic reality. When the act's definition of control interacts with business organisation structures commonly employed by private equity sponsors, many transactions become exempt. The standard business structure observed in PE, which has multiple co-managed entities, arises out of legitimate business needs, such as tax purposes or risk-sharing purposes. But when these structures interact with the HSR Act and its rules on reportability, many PE deals are treated more leniently.

And you're arguing that US antitrust enforcers should be looking for ways that these transactions are reportable?

In our view, there aren't good economic reasons why one would want to treat transactions backed by public and private acquirers so differently. Policy prescriptions involve complicated tradeoffs – costs and benefits that the agencies have much better information about than we do. Our goal is to clearly and concisely describe the potential problems that arise from the way the HSR Act handles control.

Overall, the Premerger Notification Program is an integral part of antitrust enforcement in the US. In light of the increasing importance of PE acquisitions, particularly roll-ups of many portfolio companies within a single market, exemptions from the Premerger Notification Program create the possibility of reduced deterrence and insufficient enforcement. Once the act's disparate treatment of public and private equity is removed and agencies are notified about PE deals, antitrust authorities can then decide whether these deals require further investigation or enforcement.

Did you try to quantify how many private equity deals should be getting notified that are not?

We use early termination requests and show that PE-backed acquisitions are reported at significantly lower rates – 25 percentage points lower for transactions whose values are above the HSR Act's notification thresholds.

To further show the HSR Act's more lenient treatment of PE deals, we look at the delay between a deal's initial announcement and its completion. When a deal is subject to premerger notification, there is a lag between those two events. In contrast, if a deal is exempt from the HSR Act, the deal is announced and completed almost simultaneously. We find that public equity deals disproportionately experience completion delays compared to their private equity counterparts.

Both findings are achieved by comparing private and public equity deals of similar values. The latter finding, similar to the former one, suggests that many private equity deals, unlike public equity deals, are exempt from the Premerger Notification Program.

Do these deals go unreported because ownership control does not change?

It depends on how "control" is defined, and the crux of the problem is the misalignment between the HSR Act's definition of control and economically meaningful control. Under the Act, control hinges on who owns the entity, and in PE, ownership interests are spread out among different investment vehicles that themselves are owned by numerous investors. In a PE-backed

acquisition of a portfolio company, ownership of the portfolio company is transferred to distinct investment vehicles that are not co-owned. Although ownership changes, the HSR Act does not consider this change to be competitively significant because ownership interests are distributed among different investment vehicles.

However, economically meaningful control depends on who manages the productive assets. In PE, limited partners of investment vehicles delegate decision-making power to the general partner, and different investment vehicles can be managed by the same PE firm through these general partners. When the Act focuses on ownership, it fails to recognise that the managerial power concentrates on a single entity, namely the PE firm. Hence, meaningful control arises out of management, not ownership. Common management of different portfolio companies can have important consequences for competition, especially if private equity firms engage in "add-on" deals in a concentrated industry.

What did one of your co-authors discover when he previously analysed so-called "roll-ups" in the dialysis industry that did not require HSR reporting?

In prior work, Tom Wollmann introduced the notion of "stealth consolidation", referring to competitively important acquisitions that nevertheless fall below the HSR Act's notification thresholds and, as a result, escaped antitrust enforcement. One important setting he studied was US dialysis. He found that premerger notifications are essential to antitrust enforcement. For example, facility acquisitions that result in market-level monopolies and duopolies are blocked about 80% to 90% of the time when they are reported to the FTC, but they are almost never blocked when they are not reported.

Further, Wollmann showed that when mergers involving large Herfindahl–Hirschman index changes escape enforcement, they increase hospitalisation rates and mortality. In his paper, he also studies the effects of the elimination of HSR exemptions arising out of transaction value thresholds. He finds that this policy change saves lives and the benefits far exceed the additional costs of enforcement.

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