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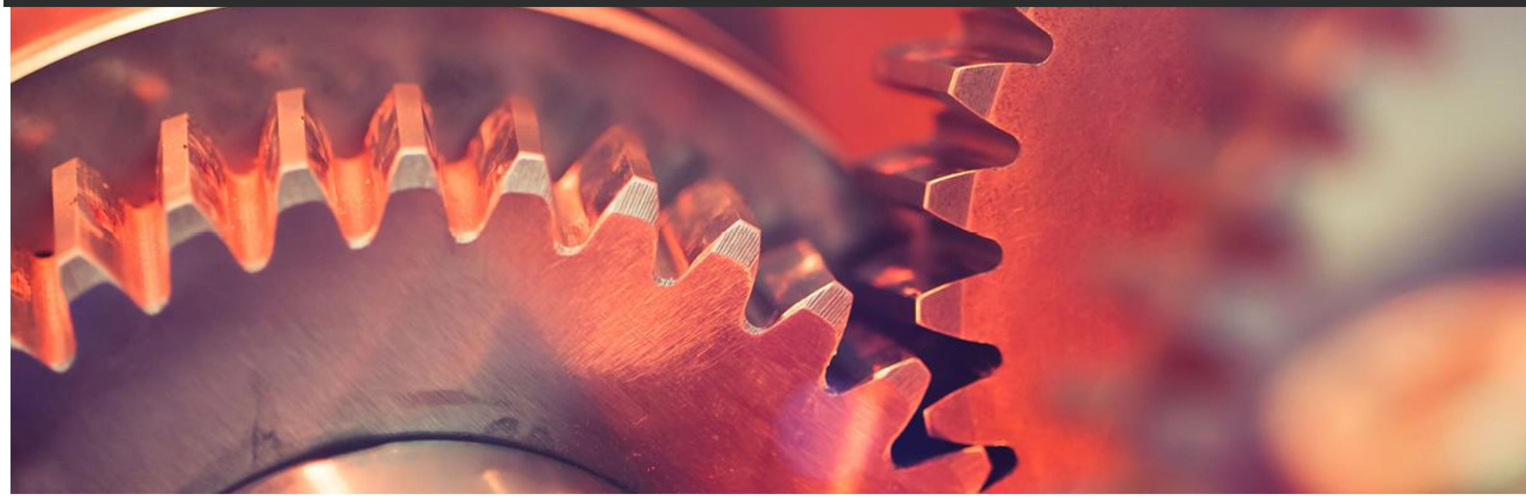

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FTC Sues Private Equity Fund and U.S. Anesthesia Partners Over Alleged 'Roll Up' Acquisitions, 'Anticompetitive Scheme'

For the first time, the FTC has focused merger enforcement action on the so-called "roll up" strategy often employed by private equity firms investing in the health care space, rather than challenging a specific individual deal, as an anti-competitive monopolization scheme.

Go-To Guide:

- The unique facts of the case made it a compelling one for the agency to bring in challenging a roll up strategy, as well as to test the bounds of its ability to combat "unfair methods of competition" under Section 5 of the FTC Act.
- But not all roll up strategies are anticompetitive, and this case does not implicate many commonly employed M&A programs called "roll ups."
- Private equity firms may be liable for the actions of their portfolio companies, even when selling down their investments below a control level.
- Post-merger efficiencies and the nature of synergies obtained from transactions remain pertinent in the FTC's consideration of when to bring a challenge.

The Federal Trade Commission (FTC)'s scrutiny of mergers, acquisitions, and other conduct in the health care space is not new. But the FTC's recently filed lawsuit has, for the first time, focused enforcement action on the so-called "roll up" strategy often employed by private equity firms investing in the space, and perhaps even more frequently cited by the regulators, both FTC and the Antitrust Division of the U.S. Department of Justice (DOJ) (the "Agencies"), as a potentially anticompetitive scheme and one that has to this point escaped review.

On Sept. 21, 2023, the FTC filed a 106-page complaint against private equity fund Welsh Carson, its affiliates,[1] and its investment company, U.S. Anesthesia Partners (USAP)[2] in the Southern District of Texas. The FTC alleged that Welsh Carson and USAP engaged in anticompetitive conduct through (a) a series of "roll up" acquisitions that USAP made over several years, (b) price-setting arrangements between USAP and at least three of its competitors, and (c) an agreement between USAP and one of its competitors to allocate markets.

It is important to define with more precision what is meant by "roll up" acquisitions. "Roll up" acquisitions often constitute systematic acquisitions, by a "platform" or anchor portfolio company of a private equity fund, of (often smaller) companies in adjacent geographic markets or in adjacent or complementary product areas as that initial "platform" or anchor portfolio company through which the private equity fund entered the space or began its implementation of its investment strategy to pursue the opportunity it identified in the space. The goal typically is to create a platform with a broad enough geographic and product reach to represent a compelling target for a future buyer. These types of "roll ups" have not to this point been challenged as problematic on their own. As described further here, the roll up strategy alleged to violate the antitrust laws involved successive acquisitions of companies engaged in the same service and geographic market, and which management viewed as direct competitors. Each such acquisition, with some limited exceptions, increased market share to levels considered problematic under the Agencies' existing Merger Guidelines.

This GT Alert provides an in-depth discussion of (1) the current regulatory backdrop, (2) the FTC's allegations against Welsh Carson and USAP, (3) the unique features of Texas's inpatient anesthesiology market, and (4) key takeaways for private equity firms and other companies engaged in "roll up" acquisitions.

I. The Current Regulatory Backdrop

In June 2022, Deputy Assistant Attorney General Andrew Forman remarked that private equity firms engaged in mergers and acquisitions activity in the health care space warrant additional scrutiny. Forman said: "[W]e are focused on potential antitrust enforcement on private equity 'roll-ups,' namely whether in particular circumstances a series of often smaller transactions can cumulatively or otherwise lead to a substantial lessening of competition or tendency to create a monopoly." In that same month, the FTC issued for public comment a proposed settlement with a private equity portfolio company in the veterinary care space, JAB Consumer Partners, acquiring a competitor that included, for the first time, a requirement that JAB provide the FTC with 30 days' prior notice for an acquisition of a specialty or emergency veterinary clinic located within 25 miles of a company-owned veterinary specialty or emergency clinic anywhere in the United States for any transaction not otherwise reportable under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended (HSR Act). The prior notice

[1] Welsh Carson as used herein incorporates all of the named defendants, including Welsh, Carson, Anderson & Stowe XI, L.P., WCAS Associates XI, LLC, Welsh, Carson, Anderson & Stowe XII, L.P., WCAS Associates XII, LLC, WCAS Management Corporation, WCAS Management, L.P., and WCAS Management, LLC.
[2] USAP as used herein incorporates all of USAP's corporate predecessors, successors, parents, subsidiaries, and affiliates.

requirements extend for 10 years.[3] The goal of the prior notice requirements was to capture "roll up" transactions that are not HSR Act reportable.

In November 2022, the FTC released a new policy statement interpreting its enforcement authority under Section 5 of the FTC Act, announcing, importantly, that it would no longer focus on the "rule of reason" framework commonly used in Sherman and Clayton Act enforcement to determine liability for "unfair methods of competition." Instead, the FTC stated that it intends to broaden its enforcement to address these "unfair methods of competition in their incipiency based on their tendency to harm competitive conditions." The November 2022 FTC statement aimed to decouple Section 5 standards from those used in Sherman or Clayton Act claims, with the rationale that Congress intended Section 5 to be a standalone authority that is "a central part of [FTC's] mandate," originally passing the FTC Act "because it was unhappy with the enforcement of the Sherman Act, the original antitrust statute," and saw a gap in the law that the FTC Act was intended to close.

According to the FTC's policy statement, use of Section 5 in policing unfair methods of competition will no longer focus on the balancing of procompetitive and anticompetitive effects under the "rule of reason" but will look at actions that "tend to negatively affect competitive conditions." Targeted conduct will therefore be judged under the per se standard, meaning they will be considered automatically illegal. Unfair methods of competition, the FTC's policy statement explained, are tactics that seek to gain an advantage while avoiding competing on the merits, and that tend to reduce competition in the market, and specifically may include "a series of mergers or acquisitions that tend to bring about the harms that the antitrust laws were designed to prevent, but individually may not have violated the antitrust laws."[4]

In May 2023, assistant attorney general for the DOJ, Jonathan Kanter, hinted that the DOJ is looking more closely at private equity transactions, in particular "roll up" acquisitions, noting that in some situations the purpose of a "roll up" acquisition is to "hollow out or roll up an industry and essentially cash out." This purpose, he said, is "very much at odds" with the antitrust laws and the DOJ's duty to protect competition.

Several weeks later, FTC Chair Lina Khan reiterated the antitrust harm that it perceives comes from private equity transactions, particularly in the healthcare industry. Khan reported that the FTC has empirical evidence of potential anticompetitive harm from private equity transactions.

With these comments and agency actions setting the stage, in late June 2023, the DOJ and FTC jointly proposed widespread changes to the U.S. premerger notification form and its associated rules under the HSR Act. One such change—affecting private equity firms in particular—will require companies to provide information regarding all acquisitions made in the past 10 years regardless of the revenue threshold.

Shortly thereafter, in July 2023, the DOJ and FTC jointly issued updated draft Merger Guidelines for public comment. The Merger Guidelines reinforce the Agencies' increased focus on "roll up" or serial acquisitions, notably stating that the Agencies will evaluate not only the transaction at issue but also "a pattern or strategy of growth through acquisition by examining both the firm's history and current or future strategic incentives."

Following these updates, Chair Khan posited that the changes to the premerger notification rules and draft Merger Guidelines could give the Agencies "more visibility on the front end to be blocking any type of unlawful roll up scheme." Khan also has commented that "[h]istorically, there's been less attention paid

[3] See our July 2022 edition of Competition Currents for more details on Forman's comments and the JAB matter.
[4] See our December 2022 edition of Competition Currents for more details.

to stealth consolidation through serial acquisitions — or acquisitions, each one of which may not trigger concern." One reason why such consolidation has escaped the Agencies' review may be because of the "relatively small size of each acquisition." But Chair Khan says it is "incredibly important" that the Agencies scrutinize firms that "amass significant control over key services in local markets."

II. The FTC's Allegations Against Welsh Carson and USAP

The crux of the FTC's allegations against Welsh Carson and USAP is that the parties engaged in a "multi-year anticompetitive scheme to consolidate anesthesia practices in Texas, drive up the price of anesthesia services provided to Texas patients, and increase their own profits."

A. *USAP's "Roll Up" Acquisitions*

According to the complaint, USAP was founded by Welsh Carson in December 2012, and soon thereafter, acquired numerous anesthesiology practices throughout Texas, with each acquisition allegedly resulting in significantly higher reimbursement rates. FTC alleges—presumably, quoting company documents—that USAP's "founding purpose was to pursue an 'aggressive' strategy to 'consolidat[e] practices with high market share in a few key markets.'" Over the last decade, USAP allegedly has grown to over 4,500 anesthesia providers and performed 2.5 million anesthesia procedures at 1,100 health care facilities.

USAP's alleged scheme began when USAP purchased Greater Houston Anesthesiology, the largest anesthesiology practice in Houston, Texas. USAP then acquired three other practices in 2014, 2017, and 2020, respectively. After its initial acquisition, USAP controlled about 50% of the commercially insured hospital-only market in Houston by revenue. USAP's share increased to nearly 70% in 2021, with each acquisition resulting in an increase in HHI[5] of more than 200. As such, each transaction alone could have warranted antitrust scrutiny under the Agencies' existing Merger Guidelines. In addition, USAP's acquisitions allegedly resulted in significantly higher reimbursement rates at each practice. Despite having the highest prices in Houston, USAP was able to retain nearly all of its volume year after year. Today, USAP is allegedly "more than eight times larger than its next largest competitor in Houston in terms of revenue," with no adequate alternative providers.

USAP then, as described in the complaint, entered the Dallas region in 2014. USAP first acquired Pinnacle Anesthesia Consultants, the largest anesthesia group in Dallas, and allegedly sought to apply its Houston reimbursement rates to Pinnacle providers in Dallas. USAP ultimately was unsuccessful in raising Pinnacle's rates to match those in Houston, but USAP still obtained rates that were higher than those that existed before. To facilitate its alleged consolidation strategy, the FTC alleges, Welsh Carson hired a consulting firm that advised it to "acquire additional groups to help enter 'key [hospital] system facilities not served by Pinnacle' and secure more 'exclusive contracts over time.'" USAP acquired seven additional practices in Dallas, and each acquisition allegedly resulted in significantly higher reimbursement rates. After its initial acquisition, USAP controlled about 46% of the commercially insured hospital-only market in Dallas by revenue. By 2021, USAP controlled approximately 68% of the market. And at least two of USAP's acquisitions resulted in an increase in HHI of more than 200, indicating a highly concentrated market. Once again, despite its higher rates than other practices, USAP was able to retain nearly all of its volume. Today, USAP is allegedly "six times larger by case volume than the next-largest group in Dallas, and nine times larger by revenue."

[5] HHI refers to the Herfindahl-Hirschman Index, which is a calculation the Agencies use to assess market concentration before and after an acquisition. Mergers that involve an increase in the HHI between 100 and 200 points often warrant Agency scrutiny and are often presumed to have enhanced the combined firm's market power.

The complaint goes on to detail several other notable USAP acquisitions in Texas, including its acquisitions of Lake Travis Anesthesia and Capitol Anesthesiology Association in Austin. FTC alleges that Capitol was a strategic target for USAP because it had "lucrative contracts with multiple hospitals in Austin, including exclusive contracts with five of the eleven hospitals in the Seton system, the largest hospital system in Austin, and a presence at five others" and "exclusive contracts at multiple other Austin-area hospitals." Further, USAP's acquisition of Capitol allegedly resulted in significantly higher reimbursement rates, increased USAP's market share in the Austin market to more than 50%, and increased HHI concentration in that market by more than 200. USAP was also able to retain nearly all its volume in Austin despite its high reimbursement rates.

As USAP acquired additional practices, USAP allegedly faced uncertainty as to whether its insurer contracts covered those newly acquired practices. USAP allegedly worked closely with Welsh Carson to craft a "tuck-in clause" that ensured USAP's existing rates would apply to any newly acquired physician groups. Despite its high rates, USAP is allegedly a "must-have" practice for insurers to have in-network because of its extensive, and often exclusive, presence at key hospitals throughout the state. USAP's acquisitions allegedly "hit Texans' wallets hard."

FTC alleges that USAP's acquisitions in Texas increased its negotiating leverage against insurers and drove up prices for hospital-only anesthesia services. Further, FTC alleges USAP has no "valid procompetitive justifications" or "cognizable efficiencies" from its "roll up" acquisitions, price-setting arrangements or market allocation, nor has USAP improved the quality of its services to justify the harm to competition. FTC alleges that USAP will continue to engage in similar conduct in the future, as the company is planning future acquisitions in Texas and has not made any assurances against such conduct.

B. *USAP's Alleged Price-Setting Arrangements*

In addition to USAP's alleged "roll up" scheme, USAP allegedly entered into anticompetitive price-setting arrangements with independent anesthesia practices—including Methodist Hospital Physician Organization, Dallas Anesthesiology Associates, and Baylor College of Medicine—to obtain higher rates and increase its profit. Through these agreements, USAP allegedly billed payors for the anesthesia services rendered by USAP and the collaborating independent anesthesia practice using USAP's provider or tax information. The resulting effect, as alleged, is that the practices billed payors at USAP's higher reimbursement rate and pocketed the income.

FTC claims that, even though these arrangements were labeled as "collaboration," "professional services," or "independent contractor" arrangements, the alleged price-setting arrangements "were not necessary for USAP to offer administrative services to non-USAP anesthesiologists or to collaborate with or hire them as subcontractors at facilities where USAP had an exclusive contract." FTC even quoted USAP executives that internally commented that the arrangements "seem[] odd from a compliance standpoint" and could cause "compliance issues related to pass through billing."

C. *USAP's Alleged Market Allocation*

FTC also alleges that USAP entered into a market allocation agreement with one of its competitors to avoid competition with the other leading anesthesia competitor in the Texas market. The allegations in FTC's complaint related to the alleged horizontal market allocation are heavily redacted, including the identity of the other party to the agreement, the alleged market, and anticompetitive effect.

D. *The Relevant Markets*

The relevant service market alleged in the complaint includes hospital-only anesthesia services and excludes anesthesia services provided at an outpatient or ambulatory surgery center. FTC supports this market definition by claiming that patients seeking inpatient anesthesia services often do not have the option to seek treatment elsewhere, and that there are specific requirements for inpatient anesthesia services that differ from those of outpatient services. This market definition is not surprising or unique—in the context of hospital mergers and acquisitions, the FTC often limits the alleged service market to inpatient-only services.

The relevant geographic market alleged in the complaint includes only the Houston, Dallas-Fort Worth, and Austin metropolitan statistical areas (MSA). FTC supports this market definition by claiming that patients tend to "seek hospital-only services close to where they live." In prior challenges to mergers and acquisitions of physician practices, FTC has limited a geographic market to physician practices within a certain mile-radius. Yet, it is not unusual for the Agencies to define geographic markets using MSA parameters.

E. *Alleged Violations and Relief*

FTC has brought claims against Welsh Carson and USAP under Sections 1 and 2 of the Sherman Act, Section 5 of the FTC Act, and Section 7 of the Clayton Act. More specifically, the FTC claims that Welsh Carson and USAP have violated:

- Section 1 of the Sherman Act by leveraging its market power and agreeing to charge higher rates and allocate the market for commercially insured hospital-only anesthesiology services;
- Section 2 of the Sherman Act by attempting to monopolize the commercial insured hospital-only anesthesia services in Dallas and Houston;
- Section 5 of the FTC Act by engaging in conduct that allowed defendants to raise prices, amounting to unfair methods of competition; and
- Section 7 of the Clayton Act and Section 5 of the FTC Act, together, by limiting competition by way of acquisitions in the Austin, Dallas, and Houston anesthesia markets. As discussed above, the complaint alleges that either "individually or as a series" the acquisitions in Austin, Dallas, and Houston violate Section 7 because of the increase in concentration resulting from each acquisition.

The FTC seeks to permanently enjoin Welsh Carson and USAP and seeks "structural relief," potentially requiring the unwinding of some or all of Welsh Carson's prior deals, among other equitable relief.

Though most of the acquisitions alleged as illegal under the "roll up" strategy involve accretion of market share in a local market over the Agencies' existing Merger Guidelines thresholds, the Commission is also challenging USAP's acquisition of one anesthesiology practice in each of Tyler, Amarillo, and San Antonio under Section 5 of the FTC Act. These transactions did not alter market concentration in these local markets and so would not on their own support a challenge under the Clayton or Sherman Acts. However, as noted above, the FTC's policy statement on Section 5 of the FTC Act contemplated a unique cause of action for unfair methods of competition. Here, the FTC is alleging that USAP's ability to use its bargaining leverage gained through the totality of the other alleged illegal conduct to apply supra-competitive rates in these three markets makes those acquisitions actionable under Section 5. This complaint offers an opportunity for the agency to test in court the bounds of its "standalone" authority under Section 5.

III. The Unique Features of Texas's Inpatient Anesthesiology Market

There are several unique features of the inpatient anesthesiology market that help distinguish USAP's acquisitions from other companies' strategies for roll-up acquisitions, and may therefore limit the predictive and precedential value of this action.

- Anesthesiologists cannot easily increase their productivity and see additional patients, as there is limited operating room capacity and scheduling availability.
- Anesthesiology practitioners providing in-hospital care require postsecondary education, including either a graduate medical degree or a nursing degree, in addition to training and licensing.
- Patients have limited choice over their anesthesia providers, as their anesthesiologist is likely chosen by the patient's surgeon or randomly assigned to the operating room where the surgery occurs.
- Many hospitals enter exclusive contract agreements with anesthesia providers who provide coverage on a 24/7 basis—these arrangements help the hospital secure coverage overnight or during other off-peak hours and guarantee treatment for less lucrative patients.
- Anesthesiology practices hoping to win an exclusive contract must have enough local providers to be able to staff the hospital at all times. As a result, only large local anesthesia groups are viable options for large hospitals.
- Exclusive contracts are generally "sticky," as switching anesthesia provider groups interrupts the hospital's ability to schedule surgeries and may negatively impact the hospital's ability to provide proper patient care.
- Many patients insured by the largest insurers in Texas—Aetna, Blue Cross Blue Shield of Texas, Cigna and United—are administrative services only, meaning that patients and their employers bear the brunt of higher prices for anesthesia services, rather than insurers.
- Hospitals prefer to work with in-network anesthesia providers, as out-of-network patients may misattribute large bills for anesthesiology practices to the hospital.
- Insurers also prefer to work with in-network anesthesia providers to ensure that their members do not seek higher-priced out-of-network care.
- To discipline price demands, insurers may refuse to include anesthesia groups in their network. However, the complaint alleges that insurers were unable to do so here because there were limited alternatives to USAP in the local market. Further, USAP's acquisitions in other local markets across Texas, even when not increasing local concentration, provided further bargaining leverage to pressure insurers to accept higher rates, because it was too costly for an insurer to refuse to include USAP in multiple markets in Texas.

IV. Key Takeaways For Private Equity Firms And Other Companies Engaged In "Roll Up" Acquisitions

A. *The Unique Alleged Facts of This Case Present a Compelling Case for the FTC to Act on its Recent Comments Around "Roll Up" Acquisitions*

FTC alleges that USAP engaged in a multi-year strategy to roll up anesthesia practices in local markets to secure higher rates and greater profit, but coupled with alleged price-fixing and market allocation agreements. Further, the unique contours of the anesthesiology market permitted the defendants, as the complaint alleges, to successfully execute a strategy to apply rates for services above competitive levels across its local markets, whether or not any single acquisition on its own permitted the combined firm to do so through market share accretion.

B. *Not All "Roll Up" Strategies Are Necessarily Anticompetitive*

USAP's acquisitions in this case may present an extreme example of a serial or "roll up" acquisition strategy resulting in anticompetitive harm.

First, USAP seemingly sought to purchase anchor anesthesia practices in local markets and next specifically target and acquire those practices' rivals in the same local markets. USAP has a presence in numerous other states, including Colorado, Florida, Indiana, Maryland, Nevada, Tennessee, and Washington. And even within Texas, USAP has a presence across the state. The FTC presumably investigated all of USAP's acquisitions, but the FTC's claims relate only to USAP's acquisitions in Houston, Dallas, and Austin.

Second, USAP specifically sought to acquire practices with existing exclusive clients to "lock up" all the hospitals in the local area and enable them to raise rates. Because such exclusive arrangements tend to be "sticky," and hospitals are reluctant to switch anesthesia providers, USAP was able to acquire exclusive contracts and employ its "tuck-in" clause in insurer contracts to ensure that all newly acquired practices would be reimbursed at USAP's existing and supra-competitive rates.

Third, FTC could have challenged a number of USAP's acquisitions individually, rather than as part of a series of "roll up" acquisitions. As discussed above, several of USAP's acquisitions in Houston, Dallas, and Austin resulted in an increase in the HHI of more than 200 points. HHI is a calculation the Agencies use to assess market concentration before and after an acquisition. Mergers that involve an increase in the HHI between 100 and 200 points often spur the Agencies' scrutiny and often are presumed to have enhanced the combined firm's market power. The FTC may have pursued the case against USAP for its "roll up" acquisitions because many of the underlying transactions could be seen as violating the antitrust laws on their own. When considered all together, USAP's series of transactions may have been anticompetitive, especially when, as here, the FTC has the benefit of retrospective knowledge that prices increased after each of USAP's acquisitions.

C. *Private Equity Firms May Be Liable for the Actions of Investment Companies, Even When They Do Not Have Direct Control*

Welsh Carson founded USAP in late 2012, and USAP has remained a portfolio company of Welsh Carson since then. At the outset, Welsh Carson owned just over 50% of the company. As alleged in the complaint, Welsh Carson has formal control over a portfolio company's major decisions if any of its funds directly owns more than 50%. But Welsh Carson's ownership stake in the company has decreased since USAP's founding and is now approximately 23%. Despite owning less than a quarter of the company, the FTC is alleging that Welsh Carson may be held legally responsible in connection with USAP's acquisition strategy and other conduct.

FTC alleges that, even after Welsh Carson's ownership stake dropped below 50%, the private equity firm maintained control over USAP because it had at least two guaranteed seats on USAP's board of directors, it held voting rights in almost all of USAP's other shareholders, and it "regularly provided USAP with strategic, operational, and financial support." In addition, USAP at times utilized personnel employed by Welsh Carson. FTC therefore concludes that Welsh Carson "formulated, directed, controlled, had the authority to control, dictated, encouraged, or actively and directly participated in" USAP's alleged anticompetitive conduct.

D. *Post-Merger Efficiencies and Synergies Remain Pertinent*

The Agencies' latest draft Merger Guidelines, published in July 2023, suggest a lessened importance on efficiencies and synergies as a viable defense to an otherwise anticompetitive merger. The draft Merger Guidelines will require merging parties to show that efficiencies are merger-specific, verifiable, will improve competition or prevent the threat that competition may be lessened, and are procompetitive.

Despite the perceived higher standard for efficiencies created in the draft Merger Guidelines, the FTC stated in its complaint that "there are no valid procompetitive justifications for or efficiencies from USAP's conduct" and USAP's claimed "synergies" are derived solely from the ability to extract higher rates. This inclusion in the FTC's complaint begs the question whether efficiencies arguments are not as "dead" as the draft Merger Guidelines may suggest.

V. Conclusion

The Agencies' leadership's recent remarks and the FTC's newly filed complaint against Welsh Carson and USAP have raised some concerns about the outlook for private equity and other companies engaged in "roll up" acquisition strategies. As discussed herein, there are unique features in the Texas anesthesiology market that must be considered. While the Agency may evaluate more acquisitions in combination with prior acquisitions in the future, this case does not indicate that all "roll up" acquisitions will be subject to antitrust scrutiny.

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