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COLUMBIA LAW SCHOOL'S BLOG ON CORPORATIONS AND THE CAPITAL MARKETS

Skadden Discusses What Regulatory Focus on Consolidation May Mean for Private Equity Buyers

By Maria Raptis and Ann Beth Stebbins May 3, 2022

Comment

Merger control authorities in many jurisdictions are taking a more aggressive and expansive approach when reviewing industry-consolidating transactions, and some are using the merger clearance process to advance policy objectives involving areas far beyond those of traditional competition. In addition, more than 50 countries have implemented regimes giving antitrust regulators discretion to review any transaction, regardless of minimum revenue or asset thresholds. As a result, companies need to provide for the possibility that their deals will draw regulators' attention, even when the targets have little or no revenue.

In the U.S., the Biden administration and congressional leaders are exerting influence on the agendas of antitrust agencies, resulting in a broader set of issues raised in merger reviews under new theories of enforcement. For example, merger parties are now routinely asked to provide information regarding the potential effects of consolidation activities on all stakeholders, with a particular focus on employees.

These broader probes have significantly extended the timeline for certain transactions. Meanwhile, new theories of competitive harm advanced by the agencies add uncertainty to the ultimate outcomes of reviews, which no longer focus exclusively on consumer price effects.

In addition, U.S. regulators have expressed an unwillingness to consider remedies to address concerns about a deal's impact on competition. The agencies are skeptical about the effectiveness of divestitures and behavioral remedies, and have professed greater readiness to block any transaction they believe may lessen competition.

If the agencies will not entertain remedies, more transactions involving companies in the same or adjacent sectors may be abandoned unless the parties aree willing to litigate against the regulator — a process that could involve significant costs and time delays, and may not ultimately be successful.

Opportunities for Private Equity Buyers

Regulatory aversion to transactions involving corporate consolidation could favor private equity buyers with no other investments in the sector.

U.S. antitrust regulators believe that many industries have become too concentrated because of record levels of merger activity in recent years, along with decades of relaxed merger enforcement. Regulators' belief that continued consolidation is harmful, combined with their new interest in factors well beyond a merger's effect on consumer prices, may make it more challenging for corporations to pursue inorganic growth through consolidation. Although the current regulatory environment may chill the M&A ambitions of some corporate buyers, a desire for growth will continue to fuel deal activity for parties willing to accept longer timelines and closing uncertainty.

Corporations will continue shedding noncore operations and pursuing sales that maximize stockholder value. But sellers will face new challenges in order to complete a transaction once it is announced. A seller may not choose the highest price in a sale process if an alternative transaction has greater certainty of closing or is more likely to close without delay. Private equity buyers can use this dynamic to their advantage when competing with bidders in the same industry as the target company.

Historically, transactions involving private equity buyers did not get a lot of attention from antitrust regulators unless the transaction involved the acquisition of a controlling interest in a target that had a direct competitive overlap with a portfolio company of the buyer. Regulators are now asking more questions about private equity transactions involving the acquisition of a target in the same industry as other portfolio companies of the buyer, including with respect to the effect a transaction will have on the target's employees. Regardless, if a private equity buyer and its affiliated funds do not have investments in portfolio companies that compete with the target, the risk that the deal will be blocked or significantly delayed remains low when compared to corporate buyers in the same industry.

Private equity buyers should expect regulatory scrutiny when making multiple acquisitions in the same sector.

U.S. regulators have expressed concerns about the business model of private equity firms, particularly when they buy or invest in multiple companies in the same or adjacent sectors. Acquisitions made as part of a "roll-up" strategy — acquiring and combining businesses to gain scale and efficiencies — will receive increased regulatory scrutiny, even if the target company does not directly compete with other portfolio companies of the private equity sponsor, and regardless of whether existing portfolio investments are held in the same or different funds. The agencies have stated that private equity roll-up transactions will be an area of focus in revised merger review guidelines expected to be adopted later this year.

Private equity sponsors pursuing a roll-up strategy therefore may face additional information requests from regulators that could extend transaction timelines. However, guidelines do not have the force of law. Without a change in law, it will be challenging for U.S. antitrust regulators to block a transaction based on novel enforcement theories. We recommend that private equity sponsors considering multiple acquisitions in a single sector consult antitrust counsel in the early stages of a transaction to identify any potential hurdles or delays.

This post comes to us from Skadden, Arps, Slate, Meagher & Flom LLP. It is based on the firm's memorandum, "Regulatory Focus on Consolidation May Present Opportunities for Private Equity Buyers," dated April 21, 2022, and available here.