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THE INVISIBLE CONGLOMERATE: HOW BELOW-THRESHOLD SERIAL ACQUISITIONS BUILD PORTFOLIO POWER BEYOND COMPETITION LAW'S REACH

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ABSTRACT

The article discusses the problem of sub-threshold serial acquisitions, during which firms obtain significant market power due to purchasing several small companies, which individually remain below the level of mergers notification thresholds. Even though competition laws mostly focus on reviewing major mergers, it is quite challenging for them to recognize an accumulative effect of many small transactions changing the market structure and weakening competition.

The author demonstrates how firms conduct various schemes, such as horizontal roll-ups in highly fragmented industries and acquisitions of emerging rivals, which can potentially compete in the future. The fact that every single transaction undergoes separate analysis prevents regulators from seeing the trend in consolidation, resulting in a high level of market concentration after integration of acquisitions.

Such problems manifest themselves in health services industry through acquisitions of physician practices and healthcare organizations, leading to greater concentration and higher costs. Another industry, which suffers from similar issues, is the digital economy, where tech companies buy up smaller startups, talents, intellectual property, and data.

This article considers some potential solutions, such as the use of transaction thresholds, market inquiries, sector-specific regulation, and mandatory reporting of serial acquirers. The author's conclusion is that successful regulation depends on switching from transaction-based regulation to programme-based regulation.

INTRODUCTION

The antitrust story goes something like this. The dangerous transaction is big, splashy, and conspicuous. Two giants in an industry declare a merger. The regulators assess market shares, entry barriers, and an alternative counterfactual reality absent the transaction. The review process gets set in motion. Yet this story, satisfying in its clarity, has grown increasingly outdated. In its place, a new approach has developed, one that accomplishes the same effect through a series of small and seemingly insignificant deals, each structured to keep beneath the level at which a notice threshold would require regulatory attention.

This is the model of the serial acquirer under the threshold. It has no defining moment of market control. Rather, it builds, target by target, quarter by quarter, a collection of complementary and adjacent products, a portfolio of possible disruptors, all of which combine to form a type of market power that falls beyond the structural reach of competition law.

The paper studies how this tactic works, the reason why the architecture of merger control makes it possible due to the existence of the blind spot, and the sectors in which this tactic has become evident. This paper also considers some solutions and the flaws in them.

THE ARCHITECTURE OF THRESHOLDS AND THE GAP THEY CREATE

All major systems of merger control are based on thresholds for triggering notifications. The reason for that is the principle of proportionality. It would not make sense to examine every single transfer of a company's asset. Therefore, a certain threshold (expressed through the turnover of the undertaking, deal amount or the acquired company's asset volume) had to be set above which the transaction had to be notified.

As an example, according to Article 4(3)(a) of the EU Merger Regulation, notification to the European Commission should be made if the combined worldwide turnover of all undertakings involved exceeded €5 billion, and if the EU-wide turnover of at least two undertakings was above €250 million.[1] Other thresholds may apply in national legislation if the above figures are not reached. For example, German Bundeskartellamt uses the transaction value threshold of €400 million for cases in which the target does not have enough domestic turnover, but there is still competitive significance to that transaction.[2] In the US, the Hart-Scott-Rodino Act mandates pre-merger notification in cases of transactions

[1]Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), Art 1(2), OJ L 24/1.

[2]Act Against Restraints of Competition (Gesetz gegen Wettbewerbsbeschränkungen — GWB), 9th amendment (2017), s.35(1a).

exceeding the size-of-transaction threshold (adjusted annually; approximately $119.5 million in 2024) and the size-of-person criteria.[3]

Such thresholds are not, in themselves, unreasonable. However, they establish a structural weakness: an acquirer that successfully keeps every single transaction beneath the relevant threshold theoretically could conduct an endless series of acquisitions without having to go through a review process. Antitrust was meant to stop the elephant in the room; serial acquirers are like flocks of sparrows.

Aggregation is the central question. No one transaction will necessarily have competitive significance. Yet the sum total of twenty acquisitions of small competitors, suppliers, related services firms, and potential rivals might result in a market structure that would have been forbidden had it been proposed as a whole. Unfortunately for the antitrust authorities, there is usually no way of consolidating that analysis after the fact. Each acquisition stands or falls on its own.[4]

THE MECHANICS OF BELOW-THRESHOLD SERIAL ACQUISITION

To explain how such a strategy operates, it has to be broken down into individual moves.

Firstly, target selection in a serial acquisition program usually employs one of two possible logics or both together. One is a horizontal roll-up when the acquirer makes incremental acquisitions of all the companies active on the same product and geography markets until it raises its share without reaching a critical level of any of the acquisitions. Such an approach is most effective in fragmented industries (dental services, veterinary care, funeral homes, independent pharmacies) since there are no dominating players and many small firms which could easily be acquired without raising suspicion.[5]

The other logic is the acquisition of killer/nascent competitors: purchase of innovative companies/start-ups which do not have substantial revenue and thus cannot trigger thresholds for turnover based on it but pose real competitive threat to the future market position of the acquirer. Such behavior was widely observed in pharmaceutical and digital industries. Acquisition of the Phase I or Phase II drug candidate by a pharmaceutical incumbent company for an amount less than the HSR threshold eliminates a future competitor without

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[3]Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. s.18a.

[4]Cunningham C, Ederer F and Ma S, 'Killer Acquisitions' (2021) 129(3) Journal of Political Economy 649, 651–52.

[5]Braun B and Deeg R, 'Strong Firms, Weak Banks: The Financial Consequences of Germany's Export-Led Growth Model' (2020) 48(1) Politics & Society 37.

triggering any reviewable event.[6] The mathematics are just as favorable for a platform company that buys out a little app having a couple of hundred thousand users.

The other aspect of the strategy is structural insulation. The savvy serial acquirer knows how the threshold works and builds his program around it. It could mean breaking up a potential big buy into several smaller purchases - buying the underlying assets rather than the entity itself; employing earn-out mechanisms so that the nominal value of the purchase is kept down; or purchasing through subsidiary companies with lower turnover. There are examples of acquirers deliberately reducing the reported turnover of the target company before announcing the deal to ensure threshold compliance.

Integration is the last and the most legally protected stage of this process. After an under-threshold takeover takes place and no review is done, the taken-over company usually becomes integrated into the operations of the take-over company, and therefore it becomes difficult to undo this integration from the standpoint of a regulatory body that finally recognizes the pattern. It is well-established in most countries that a merger that is already carried out, especially one that was not reported due to being under the threshold, can only be challenged through merger laws for a limited period of time.

THE SECTOR WHERE IT HAS BEEN MOST DEVASTATING: HEALTHCARE SERVICES

Competition literature has examined serial acquisition strategies in several sectors; however, the geographic incidence of this issue is far from uniform. It has had the biggest adverse impact on healthcare services, particularly the sectors of physician practice management, dialysis, home health, and behavioral health.

The physician practice management sector provides a vivid example of the strategy. Platform companies with private equity backing that pursue a “buy-and-build” investment strategy have purchased independently owned physician practices in fields ranging from anesthesia to emergency medicine, radiology, and dermatology. On a case-by-case basis, each individual purchase involves a single practice consisting of a small number of physicians earning revenues significantly below the threshold for merger filings. However, the portfolios that TeamHealth, Envision Healthcare, and USAP have built up through such acquisitions have established effective monopolies in providing specialty care within hospitals.

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[6] Cunningham, Ederer and Ma (n 4) 654–56.

The impact on competition and on consumers has been examined extensively. For instance, research in the Journal of Health Economics found that markets characterized by high levels of private equity consolidation in anesthesiology exhibited significant increases in the price paid by commercial insurance companies, with price hikes amounting to between 10% and 26% in highly concentrated markets.[7] This effect on prices was the result of an action that the competition laws did not examine since none of those acquisitions was big enough to warrant examination.

Another example of this is the dialysis industry. DaVita and Fresenius together own around 80% of the dialysis business in the United States. They accumulated their shares through a series of acquisitions of dialysis centers that were individually below HSR thresholds when acquired.[8] Several large acquisitions of Fresenius were contested by the Federal Trade Commission; however, the below-threshold acquisitions that shaped the market structure were largely unnoticed.

DIGITAL PLATFORMS AND THE "AQUI-HIRE" PROBLEM

This problem also exists in the digital economy and has distinct characteristics. Platforms, especially those that rely on network effects, data generation, and ecosystem management, have engaged in serial acquisitions not in order to take out other companies but to add capabilities, talent, and adjacencies that enhance their dominant positions.

The "acqui-hire," whereby a major platform acquires a minor startup for the purpose of getting the startup's engineers and IP, creates little in the way of reviewable transactions since the target has virtually no revenue, the deal structure involves an asset sale under the deal-value test, and the significance of the acquisition is revealed only retrospectively through the addition of the acquired capability to a product that closes down a category.[9]

Even more troublesome is the way in which data assets have been accumulated via below-threshold acquisitions. A platform that makes twenty below-threshold acquisitions of small data brokers, analytics firms, or customer relationship management firms will collectively build a data asset that becomes a barrier to entry to any rival that cannot match it.

[7]Baker L C et al, 'The Price Effects of Cross-Market Hospital Mergers' (2022) 40(4) Journal of Health Economics 102519.
[8]FTC v Fresenius Medical Care AG & Co KGaA and NMC-Homco Inc, FTC Docket No 9250 (1996).
[9]Letina I, Schmutzler A and Seibel R, 'Killer Acquisitions and Beyond: Policy Effects on Innovation Strategies' (2023) 55(3) RAND Journal of Economics 630.

In this instance, the harm is not from the removal of any competitor but from the gradual creation of data access requirements for competing in the downstream market.[10]

The European Commission's investigation of Meta's purchase of Kustomer, alongside its wider investigation of the history of Google's acquisitions, is an example of a belated recognition of this issue on the part of regulators, although the investigations came about through single transactions rather than an examination of below-threshold acquisition programs.

POTENTIAL SOLUTIONS AND THEIR REACH

There have been several solutions proposed by academics, regulatory and legislative authorities to solve the problem of serial acquisitions. All of them solve some of the aspects of the failure, yet all are also constrained by something which limits the scope of the solution.

Transaction value thresholds are perhaps the most straightforward way to solve the issue. In 2017, the thresholds were introduced in Germany and Austria: notifications apply to transactions where the value of the deal is above €400 million (in Germany) or €200 million (in Austria), even if the turnover of the target is below the threshold, but it has substantial domestic activities.

The European Commission also developed a similar "referral" procedure according to Article 22 of the EU Merger Regulation; it has started implementing it with increased intensity since its guidance note of 2021, accepting referrals from member states in case of below-threshold deals having significant competitive impact. The problem of transaction value thresholds lies in the fact that they are poorly tailored to acquisitions of nascent companies with high potential, not current revenues or assets: $50 million start-up may be a more competitive threat than a $500 million mature company.

Market investigation powers, which give the competition agency the power to investigate market structures instead of focusing on single deals, are a much more systemic instrument. The United Kingdom Competition and Markets Authority has made use of its market investigation powers through the Enterprise Act 2002 to scrutinize concentrated markets and

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[10] Vestager M, 'Refining the EU Merger Control System' (Speech at the Fordham Corporate Law Institute Conference, New York, 11 September 2020). https://ec.europa.eu/commission/commissioners/2019-2024/vestager/announcements/refining-eu-merger-control-system_en.

impose structural solutions despite the lack of a reviewable merger taking place.[11] The CMA’s 2020 market study on online platforms and digital advertising has focused on the consequences of successive acquisitions made by Google and Meta over the last decade. The challenge with market investigation powers is that they are expensive and time-consuming (taking up to two years to be completed) and provide remedies for a static issue rather than preventing the future buildup of the competitive issue.

The application of **sector-specific merger control** through sector-specific or reduced thresholds in sectors plagued by serial acquisitions is suggested as an intermediate step. Both the United States Federal Trade Commission and the Department of Justice have offered and in some instances applied sector-specific merger control guidance, especially in healthcare, in which the Federal Trade Commission has adopted the view that it would review below-HSR threshold consummated healthcare transactions under Section 7 of the Clayton Act.[12] This exercise of jurisdiction in such below-threshold consummated mergers has faced legal challenge in federal courts, but nevertheless has served as a deterrent.

Pre-notification requirement for serial acquirers – the most innovative and far-reaching proposal – would mandate the firms that had executed a specified number of acquisitions in a particular industry during a certain rolling time period to notify subsequent acquisitions in that same industry irrespective of the specific size of the latter acquisitions. One of the provisions introduced in the US Senate's merger reform package, the Competition and Antitrust Law Enforcement Reform Act of 2022, called for such pre-notification requirements for acquisitions made by the companies executing ten or more acquisitions over a five-year period.[13] The problem addressed in the proposal is most directly related to the serial aspect of the business strategy employed; at the same time, the issue of administrability of such regulation poses itself.

Portfolio-wide competitive assessment, i.e. competition analysis of the acquirer's overall portfoia status rather than the individual transactions, may well be the most intellectually consistent approach, but it is the furthest away from any existing framework. It would entail

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[11]Enterprise Act 2002, Part 4. For the platform markets study, see CMA, 'Online Platforms and Digital Advertising: Market Study Final Report' (1 July 2020).
[12]FTC, 'Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act' (10 November 2022); FTC and DOJ, 'Merger Guidelines' (2023), Guideline 7.
[13]Competition and Antitrust Law Enforcement Reform Act of 2022, S 3847, 117th Congress, s.6.

competition regulators maintaining comprehensive oversight of acquisition activity by key players, building models of overall market effect from acquisition series and formulating legal criteria of their intervention which would not hinge upon individual transactions being independent and anticompetitive. Some academics have suggested using the doctrine of "abuse of dominance" from EU law for addressing this problem, applying Article 102 TFEU instead of merger control.[14] This idea is only theoretical so far, as the criteria for proving dominance and abuse is quite difficult to meet, while the competition regulators are wary of extending Article 102 in such a way so as not to violate merger regulation.

TOWARD AN ARCHITECTURE OF CUMULATIVE REVIEW

All the proposals considered above have one thing in common: they are adaptations of tools intended for dealing with another problem. The thresholds on the basis of transaction value are still thresholds and can therefore be circumvented. The investigation after the fact is by definition retrospective. Sector-specific notice makes the triggering transaction smaller but doesn't solve the aggregation issue. The portfolio approach is logically compelling but poorly developed legally.

What the problem ultimately needs is a change of the analytical unit of the merger control process – from the transaction itself to the acquisition program. This isn't just an insignificant bureaucratic step. It means among other things that competition authorities will need to acquire skills in conducting longitudinal monitoring of markets, develop the framework for the assessment of the cumulative competitive effects and the notification requirements for programs instead of deals. It also means that courts will have to recognize, in terms of competition law theory, the possibility of the generation of an anticompetitive result by a series of legitimate small acquisitions.

None of the above is easy. However, it would be indefensible to persist in analyzing a strategy of systematic consolidation by viewing it from the point of view of an approach tailored for visible transactions. The invisible conglomerate exists. And competition law has not yet completely made up its mind about this.

[14] Petit N, 'Big Tech and the Digital Economy: The Moligopoly Scenario' (Oxford University Press 2020) ch 6; Hovenkamp H, 'Antitrust and the Design of Production' (2021) 105 Cornell Law Review 1155, 1198–1204.