

Beware FTC's Expanded Focus On Private Equity, Individuals

By **William Roppolo, Ashley Eickhof and Annasofia Roig** (November 21, 2022)

In the wake of U.S. Supreme Court precedent in the 2021 AMG Capital Management LLC v. Federal Trade Commission decision,[1] the FTC is doubling down and expanding its enforcement efforts to target executives, directors and owners, including private equity, in an effort to hold accountable anyone profiting from anti-competitive conduct or conduct harmful to consumers.



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To do so, the FTC is building new enforcement avenues through novel interpretations of its existing authority. This expanded focus could have far-reaching implications for future private equity acquisitions and it also has the potential to discourage executives from taking top positions at companies.



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While overseeing and participating in anti-competitive or harmful consumer conduct is based on straightforward theories of personal liability, historically, the FTC has not held the C-suite personally liable.[2]

But, in a Sept. 20 statement before the U.S. Senate Judiciary Committee, the FTC said it was "updating [its] tools to better correspond to new market realities,"[3] and spearheading an effort to pursue individual liability.



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The FTC is also "looking upstream at the firms that are enabling and profiting from this conduct," according to the statement.[4]

Within this framework, the FTC intends to hold liable new ownership that may have profited from buying a company at a discount due to an ongoing investigation. The new ownership — oftentimes a private equity group — can become subject to liability through a successor liability theory.

The FTC has confirmed that it is more concerned with acting swiftly than with getting it right. Rather than play it safe, its focus is on curbing anti-competitive conduct quickly.[5]

Even if FTC enforcement actions are struck down as overreach, "there are huge benefits to still trying," FTC Chair Lina Khan said during the University of Chicago Stigler Center's Antitrust and Competition Conference.[6]

Inaction sends the signal that the FTC sees no problem, but a failed challenge sends a signal to lawmakers of the need for change.[7] What the FTC ignores is that mere threats of litigation are extremely costly and can be hugely detrimental to a company.

In recent enforcement actions, the FTC has obtained lifetime bans and significant monetary awards against C-suite executives, even in cases where the executives did not play an active role in the misconduct.

Those cases demonstrate the FTC's ongoing efforts to pursue cases against not only companies that it believes act anti-competitively or against consumers, but also the

individual actors and entities that facilitate and profit from the conduct. The FTC plans to continue expanding its reach of individual liability to officers, directors and ownership.[8]

These prosecutions, however, are not limited to the FTC. The FTC has expressed continued support for holding individual executives responsible for their companies' unlawful conduct, either in criminal prosecutions by the U.S. Department of Justice or in FTC actions.

At the University of Chicago's conference, Khan said that "naming individuals is incredibly important" regardless of who brings the action or whether the challenge is successful.[9]

Though the Supreme Court attempted to narrow the FTC's powers,[10] it has responded by interpreting the reach of other statutes more broadly. The FTC has attempted to tap into additional powers, such as the Restore Online Shoppers' Confidence Act and Section 5 of the FTC Act.[11]

After the Supreme Court limited the scope of the FTC's reach under the FTC Act, in June of 2021, the FTC went after MoviePass under a novel theory of ROSCA violations.[12] Although ROSCA deals generally with a company's billing disclosures and consent mechanism, the FTC used it against MoviePass for its failure to disclose the limits of its purportedly unlimited service.[13]

Further, in a Nov. 10 policy statement, the FTC declared that it was broadening its interpretation of the scope and meaning of "unfair methods of competition" under Section 5 of the FTC Act to include, inter alia, "incipient violations" of antitrust laws and conduct that violates the "spirit" of antitrust laws.[14]

The FTC is acutely focused on punishing executives, owners and boards of directors overseeing the alleged misconduct and profiting from the activities. And it is intent on heavily scrutinizing private equity acquisitions, which it alleges hamper market competition.

Private Equity: Beware of Successor Liability

As part of its new wave of enforcement, the FTC has begun closely scrutinizing private equity acquisitions. The FTC has, for example, expanded merger reviews under the Hart-Scott-Rodino Act beyond initial inquiries and is increasingly using second requests to look into the private equity funds behind the deals and the entities owned by those funds.[15]

The FTC is targeting these deals because of its perspective that private equity deals contribute to anti-competitive practices by driving consolidation of companies across various industries.[16]

In a 2021 memorandum, Khan said the agency must be "vigilant and assertive [because] the ongoing merger surge" has resulted in rampant consolidation of entities and has enabled the dominance of particular firms across markets.[17]

Further, the DOJ seemingly agrees with the FTC's approach toward reviewing private equity deals. Speaking at the American Bar Association's 2022 Antitrust in Healthcare Conference, DOJ Deputy Assistant Attorney General Andrew Forman said the agency is "thinking a lot about" enhancing antitrust enforcement around issues in private equity.[18]

In furtherance of its efforts to crack down on private equity deals, the FTC is now requesting due diligence documents for transactions occurring during an ongoing investigation.

Due diligence reports can serve as a road map demonstrating that new ownership was aware of the misconduct and the corresponding potential liability prior to the acquisition. Despite knowing of these liabilities, the argument goes, the new ownership group ignored the conduct, accepted the risk, assumed the liabilities, and purchased the violating entity — all for a discounted price.

Because the FTC and DOJ are looking at these transactions more scrupulously, it follows that there will be an increase in the prosecution of purchasers on a successor liability theory. Successor liability is an equitable doctrine under which new ownership assumes responsibility for the liabilities of the acquired entity.[19]

Generally, when a company or private equity firm acquires a company, the successor entity assumes the liabilities of the predecessor.[20]

Courts use many factors to determine whether successor liability applies, and it is difficult to avoid — even structuring a purchase as an acquisition of only assets is insufficient. Successor liability is uniquely difficult to avoid in antitrust cases.

Under federal common law — which applies in antitrust cases brought by the FTC because they are federal claims being prosecuted by a federal entity in federal court — courts apply successor liability "if the successor had notice of the potential claim before the acquisition and there is substantial continuity in the operation of the business before and after the sale," the U.S. District Court for the Northern District of Ohio wrote in its 2007 decision in *Whelco Industries Ltd. v. United States*.[21]

As stated by the U.S. Court of Appeals for the Seventh Circuit in its 1994 decision in *Equal Employment Opportunity Commission v. G-K-G Inc.*, substantial continuity exists when there are "no major changes" in the operation of the business "before and after the sale." [22]

There are typically substantial continuity acquisition cases where the company was acquired to continue performing the same services in the same industry.

This makes it particularly difficult, and unlikely, for acquiring companies or firms to avoid successor liability for antitrust law violations. Criminal corporate conduct is even more difficult for a purchaser to avoid following an acquisition. As Mihailis Diamantis wrote in the *Yale Journal on Regulation* in 2019:

The law of successor criminal liability is simple — corporate successors are liable for the crimes of their predecessors. Always. Any corporation that results from any merger, consolidation, spin-off, etc., is on the hook for all the crimes of the corporations that went into the process.[23]

And companies cannot use ignorance of the conduct as a defense, especially given that the FTC is now demanding due diligence reports.

Executives and Board of Directors: Beware of Personal Liability

The FTC's trend of seeking to hold executives individually liable has been gaining traction since at least 2019 and is likely going to continue. After *Musical.ly Inc.* — now known as *TikTok Inc.* — settled with the FTC and the DOJ for its violations of the Children's Online Privacy Protection Act, two commissioners issued a statement, which said in part that moving forward, the FTC should look to hold officers and directors personally liable for

unfair and deceptive practices.[24]

They said that the FTC "should prioritize uncovering the role of corporate officers and directors and hold accountable everyone who broke the law." [25] In the years since, the FTC has only furthered its push for stricter and broader enforcement means, including individual liability.

The standards the FTC must satisfy to go after individuals depends on the jurisdiction and the type of relief sought — injunctive versus monetary — Regardless, the standards are broad, permitting the FTC wide decisional latitude.

For injunctive relief, for example, with respect to a CEO, the FTC must show that the individual "participated directly in the deceptive practices or had authority to control those practices, and ... had or should have had knowledge of the deceptive practices," the U.S. Court of Appeals for the Fourth Circuit wrote in the 2014 FTC v. Ross decision, adopting the standard used in every federal circuit to have decided the issue.[26]

The Fourth Circuit added that the second part of the standard — knowledge — can be established through actual knowledge, reckless indifference, or "awareness of a high probability of deceptiveness and [intentional avoidance of] learning the truth." [27]

As demonstrated by some case studies, in practice that is not a particularly high bar.

Most recently, the FTC has filed an action against Drizly, a beverage company, and its CEO. In its complaint, the FTC alleges that Drizly and its CEO failed to implement basic security measures, stored critical database information on an unsecured platform, neglected to monitor the Drizly network for security threats, and exposed customers to hackers and identity thieves.[28]

The allegations were based on a data leak of customer payment and account information. Essentially, the FTC included the CEO individually due to his purported failure to hire apt network security employees. The FTC's proposed order imposes lasting obligations on the CEO, even if he leaves Drizly and joins a different company.[29]

Should he leave Drizly for another senior company position within the next decade, the CEO will have to ensure that within 180 days of his start date, his new company has a comprehensive information security program. Additionally, any future CEO at Drizly will have to certify to the FTC each year for the next 20 years that the order is being carried out.

Notably, Commissioner Christine S. Wilson, who has repeatedly spoken out against the FTC's push for individual liability dissented from the FTC's inclusion of Drizly's CEO in its action against Drizly.[30]

She noted that a "substantial ... number of issues cross a CEO's desk on any given day," and that as a result, CEOs "have little to no involvement with, and no direct knowledge of, practices that are the subject of an FTC investigation." [31]

She went on to state that by naming the CEO, "the Commission has not put the market on notice that the FTC will use its resources to target lax data security practices. Instead, it has signaled that the agency will substitute its own judgement about corporate priorities and governance decisions for those of companies." [32]

In another case from earlier this year, the FTC sued ITMedia Inc., as well as its CEO and the general counsel individually.[33] The FTC alleged that since at least 2012, ITMedia created and operated at least 200 websites for consumers to complete online loan applications that it would then circulate to lenders for loan offers.[34]

These applications included personally identifying information, such as birthdates, Social Security numbers, and bank routing and account numbers.[35] ITMedia's websites represented that this information would only be used by lenders for loan offers.[36] The information, however, was sold to third parties for their use.[37]

Individual executives and general counsel were included in the action because, according to the FTC, they reviewed ITMedia's representations to consumers, negotiated or signed contracts to sell the information, and/or participated in lead distribution.[38]

Where the FTC could not establish that the individuals played an active role in the unlawful conduct, it alleged that they were willfully ignorant of the conduct.[39] This shows that lack of participation in the conduct is unlikely to be a valid defense.

But these are a small sampling of the cases involving individual liability. In 2021, the FTC secured a judgment against FleetCor Technologies Inc. and its CEO under Section 5 of the FTC Act for charging FleetCor's customers millions in "mystery fees" on the fuel cards the company provided.[40]

In 2019, the FTC sued UrthBox Inc. and its CEO for posting product customer reviews that were not independent.[41] Like with the Drizly CEO, the obligations ultimately imposed on UrthBox's CEO outlast his position with the company.[42]

This is only the beginning, and it can be expected that there are many more actions to come, particularly given the FTC's past successes in this arena.

Conclusion

The FTC appears to have no intentions of slowing its quest for individual executive liability, and is ramping up its efforts to go after private equity firms acquiring struggling companies.

In fact, the FTC will likely increase the number of cases it brings in the coming months and years — by targeting individuals and private equity acquisitions.

The FTC has proven that it is interested in pursuing as many companies and individuals as it can, even expanding its official interpretation of unfair methods of competition to encompass conduct that does not explicitly violate the letter of antitrust laws.

Private equity firms, in particular, should seek the advice of counsel when acquiring entities with possible antitrust violations. Otherwise, they could incur liability — and, potentially, criminal prosecution — for their firms, the newly acquired company, and the executives at the helms.

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[1] See generally *AMG Cap. Mgmt., LLC v. FTC*, 141 S. Ct. 1341 (2021).

[2] See Comm'rs Noah Joshua Phillips & Christine S. Wilson, Dissenting Statement, In re Resident Home LLC, Matter No. 2023179 (2021), https://www.ftc.gov/system/files/ftc_gov/pdf/2023179C4767ResidentHomeDissentStatement.pdf ("[A]s a practical matter, the government has the ability to extort that to which it is not entitled under law. As we have said on other occasions, though, just because we can does not mean that we should."); Comm'r Christine S. Wilson, Concurring Statement, *FTC v. Progressive Leasing, LLC*, Matter No. 1823127 (2020), https://www.ftc.gov/system/files/documents/public_statements/1571921/182_3127_prog_leasing_-_statement_of_commissioner_christine_s_wilson_0.pdf ("[T]he Commission traditionally has exercised its prosecutorial discretion" and not sought injunctive relief with respect to a CEO.).

[3] Fed. Trade Comm'n, Prepared Statement of the Federal Trade Commission Before the United States Senate Committee on the Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights "Oversight of the Enforcement of the Antitrust Laws" 1 (2022).

[4] *Id.* at 2.

[5] Stigler Center, FTC Chair Lina Khan in Conversation With Chicago Booth Professor Guy Rolnik, YouTube (May 9, 2022), <https://www.youtube.com/watch?v=hvXJi7p78jw>.

[6] *Id.*

[7] *Id.*

[8] See Oversight of Federal Enforcement of the Antitrust Laws Before the Subcomm. on Competition Policy, Antitrust, & Consumer Rights of the S. Comm. on the Judiciary 117th Cong. (2022) (testimony of Lina Khan, Chair, Fed. Trade Comm'n), <https://www.judiciary.senate.gov/meetings/oversight-of-federal-enforcement-of-the-antitrust-laws>; see also Prepared Statement of the Federal Trade Commission Before the Subcomm. on Competition Policy, Antitrust, & Consumer Rights of the S. Comm. on the Judiciary 117th Cong. (2022) (prepared statement of Lina Khan, Chair, Fed. Trade Comm'n), <https://www.judiciary.senate.gov/imo/media/doc/Testimony%20-%20Khan%20-%202022-09-20.pdf> (stating that the FTC is "willing[]" to seek individual liability for antitrust violations" and that corporate executives should be aware "that they may be held personally liable for antitrust violations that they direct and may be banned for life from certain industries").

[9] Stigler Center, *supra* note 5; see also Fed. Trade Comm'n, Commission Statement Regarding Criminal Referral and Partnership Process (2021), https://www.ftc.gov/system/files/documents/public_statements/1598439/commissi_on_statement_regarding_criminal_referrals_and_partnership_process_updated_p094207.pdf

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[10] See, e.g., *AMG Cap. Mgmt., LLC*, 141 S. Ct. 1341.

[11] See generally Fed. Trade Comm'n, Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act (2022), https://www.ftc.gov/system/files/ftc_gov/pdf/P221202Section5PolicyStatement.pdf.

[12] See generally Complaint, Fed. Trade Comm'n, No. C-4751, In the Matter of MoviePass, Inc., et al., https://www.ftc.gov/system/files/documents/cases/1923000_-_moviepass_complaint_final.pdf.

[13] See *id.* at 8, 10.

[14] Fed. Trade Comm'n, Policy Statement Regarding the Scope of Unfair Methods of Competition at 1, 12–16.

[15] See Memorandum from Chair Lina M. Khan to Commission Staff and Commissioners (Sept. 22, 2021), https://www.ftc.gov/system/files/documents/public_statements/1596664/agency_priorities_memo_from_chair_lina_m_khan_9-22-21.pdf.

[16] See *id.* at 2.

[17] *Id.*

[18] See Andrew Forman, Deputy Assistant Attorney General, Dept. of Justice, Keynote Address at the ABA's Antitrust in Healthcare Conference (June 3, 2022), <https://www.justice.gov/opa/speech/deputy-assistant-attorney-general-andrew-forman-delivers-keynote-abas-antitrust>.

[19] Successor liability applies where "(1) [the successor] expressly or impliedly assumed the predecessor's tort liability, (2) there was a consolidation or merger of seller and purchaser [i.e., a de facto merger], (3) the purchasing corporation was a mere continuation of the selling corporation, or (4) the transaction is entered into fraudulently to escape such obligations." *New York v. Nat'l Serv. Indus., Inc.*, 460 F.3d 201, 207 (2d Cir. 2006).

[20] See Philip Urofsky, What You Don't Know Can Hurt You: Successor Liability Resulting From Inadequate FCPA Due Diligence in M&A Transactions, 1763 *PLI/Corp.* 631, 637 (2009) ("As a legal matter, when one corporation acquires another, it assumes any existing liabilities of that corporation, including liability for unlawful payments, regardless of whether it knows of them.").

[21] *Whelco Indus., Ltd. v. United States*, 503 F. Supp. 2d 906, 910 (N.D. Ohio 2007) (citing *EEOC v. G-K-G, Inc.*, 39 F.3d 740, 748 (7th Cir. 1994)).

[22] *G-K-G, Inc.*, 39 F.3d at 748.

[23] Mihailis E. Diamantis, Successor Identity, 36 *Yale J. on Regul.* 1 (2019).

[24] Comm'rs Rohit Chopra & Rebecca Kelly Slaughter, Joint Statement, In the Matter of Musical.ly Inc. (now known as TikTok), Matter No. 1723004 (2019), https://www.ftc.gov/system/files/documents/public_statements/1463167/chopra_a

nd_slaughter_musically_tiktok_joint_statement_2-27-19_0.pdf.

[25] Id.

[26] *FTC v. Ross*, 743 F.3d 886, 892 (4th Cir. 2014) (adopting the standard used in every federal circuit to have decided the issue—the First, Seventh, Ninth, Tenth, and Eleventh Circuits).

[27] Id.

[28] See generally Complaint, Fed. Trade Comm'n, In the Matter of Drizly, LLC, et al., <https://dd80b675424c132b90b3-e48385e382d2e5d17821a5e1d8e4c86b.ssl.cf1.rackcdn.com/external/202-3185-drizly-complaint.pdf>.

[29] See generally Decision, Fed. Trade Comm'n, In the Matter of Drizly, LLC, et al., https://www.ftc.gov/system/files/ftc_gov/pdf/202-3185-Drizly-Decision-and-Order.pdf.

[30] Comm'r Christine S. Wilson, Concurring and Dissenting Statement, Drizly Matter No. 2023185 2 (2022), https://www.ftc.gov/system/files/ftc_gov/pdf/2023185WilsonDrizlyStatement.pdf.

[31] Id.

[32] Id. at 3.

[33] Complaint, Fed. Trade Comm'n v. ITMedia Sols. LLC, et al., No. 2:22-CV-00073 (C.D. Cal. filed Jan. 5, 2022).

[34] Id. at 10–11.

[35] Id. at 14.

[36] Id. at 11.

[37] Id. at 14–17.

[38] Id. at 23–26.

[39] Id. at 26.

[40] See generally Complaint, Fed. Trade Comm'n, No. D-9403, In the Matter of FleetCor Techs., Inc., et al., https://www.ftc.gov/system/files/documents/cases/d-9403_fleetcor_complaint.pdf.

[41] See generally Complaint, Fed. Trade Comm'n, No. C-4676, In the Matter of UrthBox, Inc., et al., https://www.ftc.gov/system/files/documents/cases/c-4676_172_3028_urthbox_complaint_5-17-19_0.pdf.

[42] See Decision, Fed. Trade Comm'n, In the Matter of UrthBox, Inc., et al., https://www.ftc.gov/system/files/documents/cases/c-4676_172_3028_urthbox_decision_and_order_5-17-19_0.pdf.