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Join the Club?

Guidelines to Avoid Litigation in the LBO Bidding Process

Recently, a Massachusetts federal judge issued another blow to the private equity firms that are the subject of an antitrust lawsuit brought by former interest holders of companies acquired by the private equity firms as part of leveraged buyouts (LBOs). The court significantly expanded the scope of the lawsuit to include an additional ten LBO transactions, bringing the total number currently under investigation to 27.[1] The lawsuit against the private equity firms, ongoing since 2007, focuses on "club deals," where two or more private equity firms join together to bid jointly on a target company. Club deals became an increasingly popular trend among private equity firms as a means to accomplish some of the largest LBOs in history, including the largest LBO to date (and reportedly one of the additional LBO transactions under scrutiny as a result of last month's decision)[2]—the 2007 buyout of TXU Corp. by Kohlberg Kravis Roberts, Texas Pacific Group, and Goldman Sachs Capital Partners for approximately $44 billion. Specifically at issue is the plaintiffs' claim of an "overarching conspiracy" by which the private equity firms depressed the purchase prices by "(1) submitting sham bids, (2) agreeing not to submit bids, (3) granting management certain incentives, and (4) including 'losing' bidders in the final transaction."[3]

While the current lawsuit focuses primarily on larger LBO transactions, such as the buyouts of Harrah's Entertainment, Univision, Clear Channel, and Toys"R"Us,[4] it remains to be seen what impact, if any, this exercise will have on small and midsized transactions, where the threat of collusive behavior appears smaller due to the much larger pool of private equity firms with the resources to competitively bid on such transactions and an even larger number of potential targets. In the world of large LBO transactions, only a small handful of private equity firms have the resources to competitively bid on multibillion-dollar transactions. When these firms form clubs to bid on target companies, the result is twofold. On the one hand, clubs allow the private equity firms to share in the bid price (arguably enabling the target company to fetch a collectively larger bid than any single firm in the club could make unilaterally and increasing the number of private equity firms able to participate in a large-cap transaction), to minimize risk by allocating the risk among several firms, and to obtain more favorable financing. But, on the other hand, clubs present concerns for target companies seeking to maximize value, such as the removal of competitive bidding among those firms that choose to form a club and the risk that clubs will monopolize financing and other resources that prevent other potential buyers from placing competitive bids.

Although the nature of the small and midsized LBO markets lends itself to a more competitive bidding process (because another potential bidder or target is almost always around the corner), the following are some suggested guidelines that bidders/buyers and sellers, in anticipation of or in response to club deal bidding structures, may wish to consider following to avoid finding themselves in costly and time-consuming litigation:

BIDDER'S/BUYER'S GUIDELINES

- Take steps to evaluate individual competitiveness and, if desirable, form a club as early as possible in the auction process.
- Clearly establish and document the structure and purpose of the club and how each member of the club contributes to that purpose (for example, how to minimize risk, find financing opportunities and alternatives, and obtain industry expertise).
- At the outset of any club formation, set ground rules among the members with respect to prohibited activities, including, but not limited to, information sharing with competitors. Both club members and solo bidders may wish to consider refraining from sharing information with competitors regarding proposed bid price, bidding strategy, valuation methods, financing sources, and any nonpublic or confidential information regarding the target company.
- Refrain from adding additional club members that were losing bidders in the same auction (unless there is a legitimate and procompetitive purpose for doing so).
- Consider alternative financing sources that enable competitive bidding without the need to form a club.

SELLER'S GUIDELINES

- Implement club deal restrictions or limitations to enable both the buyer(s) and seller to reap the benefits of the club deal structure while also lessening its anticompetitive effects (for example, limit the size of clubs in terms of number of members and aggregate fund size to prevent the bidder pool from becoming too small and the biggest players from teaming up to constrain resources such as financing options).
- Include injunctive relief and monetary damage provisions in confidentiality and nondisclosure agreements to deter potential buyers from sharing or discussing target confidential or proprietary information with competitors.
- Restrict the ability of losing bidders to join the winning bidder's club to minimize the risk of underbidding or agreements to have bidders withdraw from the auction.

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[1] *Dahl v. Bain Capital Partners, LLC*, 2011 U.S. Dist. LEXIS 100825 (D. Mass. Sept. 7, 2011).
[2] Peter Lattman, "Judge Widens Antitrust Suit against Private Equity Firms, *New York Times* (Sept. 8, 2011).
[3] *Dahl v. Bain Capital Partners, LLC*, 589 F. Supp. 2d 112, 114 (D. Mass. 2008).
[4] Lattman, supra.

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