Private equity and competition law

CONSORTIUM BIDS

One of the trends contributing to the success of private equity is the strategy of bidding as part of a consortium; a strategy known in the United States as "clubbing". This note briefly considers the recent focus on consortium bids from an antitrust perspective, and provides some key advice for private equity firms considering bidding as part of a consortium.

Consortium bids involve at least two firms joining forces to purchase a company, thereby allowing them to purchase larger targets collectively than they could individually. Participating firms will typically enter into a consortium agreement, the terms of which may include exclusivity, bidding strategy, the role of management, financing structure, allocation of expenses, governance rights, board representation and committee membership, voting and veto rights, exit strategy, and so on.

Consortium bidding first came under scrutiny in the United States when, in October 2006, the Department of Justice launched an inquiry into the potentially anticompetitive behaviours of various private equity firms which had engaged in "clubs" to purchase huge corporate targets in the early 2000s. Although the inquiry did not result in any regulatory action, a class action lawsuit was launched against 13 private equity firms in 2007 and remains ongoing today (*Kirk Dahl et al. v Bain Capital Partners LLC et. al*). The claimants allege that the defendant firms engaged in bid-rigging and market-allocating in 17 leveraged buy-outs from 2003 to 2007, resulting in lower purchase prices for the target companies. The United States district courts have limited the scope of the claims that will proceed to trial and the number of defendants, but many of the largest names in private equity remain in court. It remains to be seen whether the claimants will have any success.

Issues around consortium bidding can also arise in circumstances where there is no publicly acknowledged consortium or collaboration. A recent Australian case, *Norcast S.ár.L v Bradken Limited* (*No. 2*), involved a seller pursuing a civil suit against a buyer under the country's bid-rigging and cartel laws. Norcast S.ár.L., the owner of the target (*Norcast Wear Solutions - NWS*), brought proceedings against the Australian company Bradken Limited, and also against Castle Harlan (a New York based private equity firm), claiming that the two had entered into a bid-rigging arrangement.

Bradken had coordinated closely with Castle Harlan regarding the proposed purchase of NWS. The two parties had entered into a consultancy agreement and Bradken was provided with confidential information about NWS under a non-disclosure agreement. Castle Harlan eventually purchased NWS for US$190 million on 6 July 2011 and, later that day, the private equity firm sold NWS on to Bradken for US$212.4 million.

The Australian Federal Court found in favour of Norcast in March 2013, holding that Bradken and Castle Harlan had contravened Australian bid-rigging laws. Norcast was awarded US$22.4 million in damages, being the difference between what Castle Harlan paid Norcast for the business, and what Bradken then paid to Castle Harlan for the on-sale.

Competitive Analysis

In the United States, the Federal Trade Commission has set out a multi-stage antitrust analysis to determine whether an arrangement is unlawful. The courts will first consider whether an arrangement is "inherently suspect". If it is not, then the traditional American "rule of reason" applies. This involves the courts attempting to strike a balance between pro-competitive and anti-competitive behaviour. The courts will have a wide discretion in this balancing exercise.

As long as consortiums are not merely shams designed to exercise buyer power and exclude competition, or used to rig bids, then they should not be "inherently suspect" from a competition law perspective. This would only be the case for a consortium that was formed with the sole motivation of driving down a purchase price.

Central to any rule of reason analysis would be the combined market power of the participating private equity firms. Generally, low market shares would correlate to low market power – but a high market share would not necessarily result in a consortium being considered uncompetitive. The courts would look at the number of potential buyers in the market; both private equity firms and corporate buyers who might reasonably be expected to compete. If a consortium is too powerful, and effectively prevents anyone else from bidding, then it arguably constitutes an unlawful restriction on competition. In addition, courts would look for evidence of competitive harm – namely, evidence that shareholders were harmed by a lower purchase price than would have been possible absent the consortium.

Lastly, the courts would consider any efficiencies arising from the consortium. There are many possible efficiency-enhancing justifications. Consortiums result in more available finance, making collective acquisitions possible where individual buyers would not be able to compete. They also allow private equity firms to disperse the risks attached to large transactions and to pool their expertise; for example, across different industry sectors.

KEY ADVICE

Fundamentally, private equity firms should ensure that any collaboration with competing bidders serves a legitimate purpose, and that the seller is aware of it.

Written consortium agreements should be signed at the outset, rather than firms relying on oral agreements. Within the agreement, the firms should spell out the reasons for forming the consortium, and should be clear on why these are pro-competitive reasons.

It should be also be clear how sensitive information will be handled within the consortium, and any issues should be openly discussed with the seller.