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TO CLUB OR NOT TO CLUB? IMPLICATIONS OF THE D.O.J.'S PROBE OF PRIVATE EQUITY DEALS FOR ANTICOMPETITIVE PRACTICES

Private equity firms take notice as the New York Regional Office of the U.S. Department of Justice turns its watchful regulatory eye on the potential anticompetitive effect of "club" deals.

The October 10, 2006, edition of the *Wall Street Journal* reported that the New York Regional Office of the U.S. Department of Justice (the "DOJ") has inquired into possible anticompetitive behavior by some of the biggest players in the private equity world. According to the article, the DOJ has sent out a series of letters to KKR, Silver Lake Partners, Carlyle, and others—and possibly more top-tier private equity firms—to notify them that the DOJ has turned its keen regulatory eye toward how these firms put together their transactions, in particular their "club" deals. The practice of "clubbing," in which two or more firms combine their capital and efforts in the common pursuit of one target, appears to have raised the hair on the back of the DOJ's neck because of potentially anticompetitive effects. The stakes are high. Antitrust violations may be prosecuted under the Sherman Act or state antitrust laws as civil or criminal offenses punishable by fines of up to \$100 million and imprisonment of up to 10 years.

Clubbing deals have increased in popularity as private equity firms pursue larger acquisitions, attempt to spread deal risk as opposed to going it alone, and seek to recognize efficiencies in shared expertise and access to financial backing. This can make strategic sense, and collaboration incident to a legitimate joint venture is certainly not prohibited. Nevertheless, there are several effects and practices of clubbing that may chill competition and, in certain circumstances, be illegal.

The DOJ's apparent concern in launching its probe is the possibility of collusion among bidders when bidders agree with other bidders to drop from an auction for a target, only to join the remaining, winning bidder in the final buyer group. Antitrust complications may also arise where two or more bidders are improperly sharing confidential information about the target giving them a competitive advantage. Clubbing may, at least in theory, depress prices for a target, because the target receives a single consolidated bid from a group of firms (as opposed to separate competing bids from each firm) or as a result of a club locking up sector advisors and financial backers (thereby depressing prices as other bidders lose alternatives for financial backing or advisors).

Practical Implications:

To minimize antitrust risk, private equity firms should:

- avoid "naked" agreements among bidders, such as agreements whereby one bidder pays consideration to another bidder to drop out of an auction;
- carefully monitor all direct and indirect communication with other private equity firms (e.g., as to diligence, negotiation, or bidding strategies) to avoid inferences of collusion or other anticompetitive behavior;
- carefully consider antitrust issues in documenting relationships within consortia and drafting clubbing agreements;
- carefully consider overall deal negotiation strategy to avoid, if possible, separately bidding on a target before forming consortia; and
- avoid sharing confidential information (especially information that may impact deal pricing or certainty to close) with other private equity firms irrespective of whether nondisclosure agreements are in place, absent due consideration of antitrust issues or without the target's consent.

This article is a periodic publication of Holme Roberts & Owen LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances, nor is it intended to address specific disclosure or compliance issues that may arise in particular circumstances or provide an exhaustive discussion of the topics discussed herein. The contents are intended for general informational purposes only, and you are urged to consult counsel concerning your own situation and any specific legal questions you may have. For further information regarding the topics described herein, please contact Hendrik Jordaen at 303.866.0456, hendrik.jordaen@hro.com or Sean Odendahl at 303.866.0267, sean.odendahl@hro.com.

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