COVID-19 and Club Deals: An Alternative to Debt Financing for Acquirors

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As the COVID-19 pandemic continues to cause turmoil in the global economy and financial markets, debt financing sources are tightening their grip on available liquidity while reassessing existing facilities and lending practices in light of these new market conditions. Many companies have drawn down existing revolvers as a source of liquidity to ride out the downturn. These factors have limited the availability of acquisition financings and resulted in more lender-friendly terms for any newly issued debt, including increased borrowing costs and stricter financial covenants. In light of the current economic circumstances, acquirors who wish to pursue new opportunities could consider a club deal as an alternative to debt financing and a way in which they may pursue larger targets, stretch their available dry powder, and spread their risk across a wider number of investments.

Club Deals

A club deal, also known as a consortium, is when two or more private equity firms, family offices or other investors jointly purchase a business. There are a number of reasons why an acquiror may consider a club deal in today's market. First and foremost is access to additional capital, especially when access to debt may be limited and/or only available on very lender-friendly terms. Teaming up with one or more parties allows joint acquirors to pursue larger transactions than they otherwise may not have had the capital to pursue. In addition, sellers typically prefer an all-equity transaction because it generally can be executed quicker and offers greater deal certainty than a debt-financed deal (though this deal certainty may be offset somewhat by concerns a seller may have with a deal with joint bidders, as described below). Addressing another important concern in today's market, club deals allow the joint acquirors to spread their risk over a number of investments rather than committing a large amount of capital to one target. Finally, certain partners can bring unique industry experience and synergy opportunities to the consortium that it may not otherwise have, making it a more appealing buyer, allowing it to pay more for the asset and enhancing the chances of success of the target following the acquisition.

Structuring a Club Deal

In order to execute on a club deal, the joint acquirors should be prepared to address a number of issues related to the operation of the consortium throughout the transaction process and beyond. One upfront concern is ensuring that the confidentiality agreement entered into with the target

permits a consortium bid. Sellers will often restrict the formation of bidding consortia and the sharing of the target's confidential information with other sources of equity financing. A party may need to pursue an amendment to the confidentiality agreement if it has pivoted to a club deal as a new bid strategy following its execution or get specific approval from the seller to pursue a joint bid. A seller may also be hesitant to approve a club bidding arrangement that limits the number of individual bidders. In these circumstances, the consortium and its advisors could argue that the consortium will have access to more capital and can pay a higher price for the asset. Another, and more aggressive, tactic for joint bidders to use to convince a seller to approve a consortium arrangement is to tell the seller that the bidders will either bid together or not at all.

Once the confidentiality agreement is addressed and members of the consortium have been identified, the members should consider addressing a number of other issues, such as governance, management and decision-making during the bidding process and post-closing; appointing advisors; how to resolve disagreements among members; required equity contributions from the members; expense sharing; withdrawal of members; and breaches and defaults. Sometimes these types of issues are decided upfront and documented in a joint bid or interim consortium agreement. Other times, these issues are not formally documented at the bidding stage, especially if there is a lot of trust among the members; however, it is good practice to at least discuss them among the members so they can get aligned.

Key Considerations

Club deals involve a number of additional unique issues joint acquirors should consider. Most important among these is the need for an acquiror to be comfortable owning less than all or substantially all of a target company. Working with one or more partners also adds complexity to a transaction that would not otherwise be present. A party should carefully evaluate its options, as entering into a consortium could limit its ability to make a competing bid outside of the consortium. Further, a party should diligence potential partners to determine whether any regulatory issues could subject the transaction to additional risk. Finally, the consortium will need to determine the method in which it will interact with the seller, potentially selecting a lead representative for negotiations, as the seller will want to know which parties it is negotiating with to streamline the process.

Antitrust Concerns

In 2007, a class of shareholders claimed a group of large private equity firms conspired to suppress bid competition and prices paid to shareholders in a number of leveraged buyouts through the use of club deals. The plaintiffs alleged that the private equity firms violated the Sherman Act by forming an illegal market allocation by agreeing on a division of the market among themselves and, thus, suppressing competition. Although it can be very difficult for a plaintiff to provide direct proof that such collusion exists, plaintiffs typically attempt to present other "plus factors" supporting its existence. In the 2007 case, the plaintiffs relied largely on auction theory to show inefficiencies in the leveraged buyouts as well as communications within and between the defendant firms. The case ultimately settled in 2015 for nearly $600 million dollars.

An acquiror must be sensitive to these issues and consult with antitrust counsel early in the process to address any potential concerns.

Conclusion: A Viable Option with Unique Benefits in a Downturn

Considering the difficulty in obtaining acquisition financing in today's market, a club deal is certainly a viable alternative for acquirors who wish to pursue acquisition opportunities. As with any deal structure, however, the club deal is not free of issues, but many can be mitigated with careful planning and negotiation among the consortium members early in the process.