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Drafting Effective Joint Bidding Agreements For PE Funds

By **Sawyer Duncan** (December 6, 2018, 12:35 PM EST)

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Club deals involving one or more private equity funds are again becoming increasingly popular across the market. Recent large-cap deals involving high-profile, publicly traded targets have been the surest indicia of this trend. It was recently reported that Blackstone Group, Carlyle Group, Onex Corp. and Canada Pension Plan Investment Board formed a team to bid for the activist-addled aluminum maker Arconic. Earlier this fall, Blackstone, CPPIB and GIC Private Ltd. announced a joint deal for control of Thomson Reuters Corp.'s financial and risk management business. Johnson Controls recently sold its power solutions unit to a private equity consortium that included Brookfield Business Partners and CDPQ. We are also witnessing increased joint investment activity among fundless sponsors in smaller transactions. At the lower end of the market, we have recently seen many small-cap and regionally focused private equity firms teaming up for joint investments in local, privately held assets, especially where there is a prior history of co-participation between those sponsors in such industries.

Known interchangeably as "consortium deals" in European practice, club deals commence once two bidders agree to participate in an auction process together. The rights and duties of each participant should be clearly expressed in an initial transaction document known as the joint bidding agreement. Private equity counsel should be prepared to guide their clients as they continue to explore these types of arrangements. Navigating the initial interbidder dynamics will inspire client confidence from the outset of a club deal process, and a crisp joint bidding agreement is a critical first step in helping private equity funds win deals as a group. This article will discuss the purpose of such an agreement and highlight some of the issues that deserve particular attention at the joint bidding stage of a club deal auction.

Why Is a Joint Bidding Agreement Necessary?

Bidders may wonder why they need a formal, written joint bidding agreement at all. In theory, where there is a high degree of trust and cooperation among the consortium members, it is possible that two co-investment partners could proceed with a successful joint bid all the way from nondisclosure agreement to exclusivity without any contention or need for a formal agreement between them. Surprises, however, can always arise during an auction process, and in these situations, the joint bidding agreement clarifies the rules of the road for club members. The nature of the business that is up for auction can change substantially — e.g., from a 100 percent equity sale to a division carveout of only certain assets. A target's banker could materially modify the bid procedures in a sudden or unexpected manner. One club member could experience a change or event in its business that impacts the club's overall decision to proceed. Although they may appear to be aligned in their interests, individual investors within the consortium can have very different underlying motivations and risk tolerances. A well-drafted joint bidding agreement thus serves as a useful guidepost for participants in setting expectations, avoiding misunderstandings, and prohibiting unsavory conduct during a joint bid process. Here are a few key considerations in creating a thoughtful and effective joint bidding agreement for clients considering a club investment.

Common Issues in Joint Bidding Agreements

1. Permissibility of a Joint Bid

Often, a customary nondisclosure agreement prepared by the target or its advisers will restrict auction participants from disclosure or discussion of "evaluation material" about the target, except for communications with its "representatives" (and possibly other parties, such as governmental entities). "Representatives" are typically defined to include only various transaction advisers (and often debt financing sources), and it is not uncommon for other parties such as "co-investors," "partners," and "equity financing sources" to be specifically carved out from the definition of "representatives." In such a case, sharing evaluation material with potential third-party co-investors who are not acting in their capacity as a "representative" of one bidder could be a breach of the NDA. Read the transaction NDA and the auction process letter carefully to determine whether a client would be prohibited from using or discussing evaluation material with prospective consortium members. Before directly or indirectly alerting the sell-side team to the potential that a joint bid is under consideration or may be submitted, make sure to understand the auction procedures to ensure compliance with any nondisclosure agreements and avoid disqualification from the next round.

2. Club Transaction Structure

It is never too early to plan how exactly a group of co-bidders will consummate a joint investment transaction. Certain preliminary structuring questions may require lead time to address. Will a new joint investment acquisition vehicle be formed? Should each sponsor create its own wholly owned acquisition vehicle that will then participate in the joint investment acquisition vehicle? Should these entities be formed at the bid stage or only upon winning exclusivity with the target? Who among the group will be responsible for preparing the formation documents? How should equity participation be structured for tax efficiency and liability minimization? What should the governance structure of the acquisition vehicle(s) look like?

3. Exclusivity and Restrictive Covenants

It is customary for club members to agree to participate in an auction and make a bid only through the club structure, and not independently or with other nonmember parties. Confidentiality obligations and noncompetition covenants should be carefully thought through, and active, global private equity co-members should be wary of overbroad restrictive covenants in a joint bidding agreement that could be deemed to inhibit their operations outside of the club auction context. Presumably, the restrictive covenants in a joint bidding agreement should survive at least until an investment or other business combination transaction involving the target is consummated, but should they survive longer?

4. Selection and Engagement of Transaction Advisers

By virtue of doing many deals over time, private equity firms often enjoy close relationships with their preferred external advisers, such as financial due diligence firms, buy-side financial advisers, legal counsel, insurance brokers, environmental consultants and others. Some can be quite picky about who they will work with, let alone who they might trust. Members of a private equity consortium are thus likely to have contrasting preferences about the most capable and most cost-effective advisers. Which club members will be responsible for appointing or engaging such advisers, and on what terms? Which entity exactly will be the contractual "client" of the advisers? On what grounds should club members be able to veto the engagement of a prospective adviser, if any? Must club members disclose in advance any potential conflicts of interests with prospective advisers or other counterparties?

5. Communications Protocol

A private equity consortium should aim to present a unified, organized presence to a target during an auction process. One way to present the impression of a seamless, cohesive bidding group is to proscribe a specific method by which the group may contact the target or its auctioneering bankers. Multiple inquiries, duplicative diligence requests, or communications that otherwise evince disarray or ineffective information flow between co-investors could lead a target to believe that such disarray might continue during the negotiation of the deal, thereby delaying the timing of a closing. Who among the consortium should serve as its "spokesperson"? And what types of information might the spokesperson be allowed to communicate to the target without the prior consent of all members? To what extent must the club's spokesperson relay its conversations with the sellers back to other club members? When it comes time to bid (or rebid), who will carry the message?

6. Cost Sharing

Determining whether or not to proceed with a bid can become expensive, especially where substantial financial, legal or tax due diligence is required. Who among the consortium will be responsible for stroking the initial checks to vendors for transaction expenses? And when must such expenses be paid? In what proportions should costs be shared — in equal pro rata proportions? Or in proportion to the parties' respective equity commitments? Should the joint bidding agreement prescribe a specific expense threshold and should there be a notice or consent mechanism by which all consortium members have the right to approve incurrences of any excess expenses? Should the allocation of costs and expenses among members be modified based on whether a transaction successfully closes or fails to close?

7. Joint Due Diligence, Disclosure and Confidentiality

Will the due diligence effort be divided among consortium members or will there be a lead member responsible for vetting the investment? What are the rights of the other members to perform additional diligence or to communicate further with the target in the event they are unsatisfied with the scope of the due diligence investigation for some reason? In the spirit of maintaining a unified front and avoiding the appearance of chaos among multiple bidders, an effective joint bidding agreement would centralize due diligence communication channels and minimize information asymmetry. If a club member performs due diligence independently from other members, must it share any material findings or proprietary information? What types of confidentiality obligations should attach to information received from the target or developed by the club members?

8. Termination and Withdrawal Rights

The joint bidding agreement should specify the circumstances under which members may withdraw from the consortium prior to the entry by the consortium into a definitive agreement with the target. Situationally appropriate "event-driven" withdrawal rights should be considered, but they should also be balanced against strictures of the auction rules, so that the withdrawal of one consortium member does not unduly jeopardize the continued participation of the other remaining bidders. If a consortium bid is ultimately unsuccessful, should the joint bidding agreement terminate in all respects or should certain limited obligations survive? Are there ever any situations in which a withdrawing member should conceivably be permitted to pursue the target independently outside of the consortium?

9. Next Steps

After a joint bidding agreement is executed and delivered, the club will work together toward finalizing a joint bid and possibly entering into a customary exclusivity agreement with the target or definitive transaction documentation. Upon reaching exclusivity with the target and once a definitive agreement is negotiated, new considerations within the club context arise that necessitate a more comprehensive interim consortium agreement. The interim consortium agreement will govern the club members' rights and duties through the consummation of the transaction, and this process presents many risk areas to the unwary, including in the context of equity and debt financing syndication, voting obligations (where applicable), establishing rights and liabilities in the event of a breach or violation of the consortium agreement, obtaining applicable regulatory approvals, establishing appropriate closing conditionality, and many others. At the joint bidding agreement stage, parties may (and often do) establish an attached framework agreement or draft term sheet addressing many of these largest issues in the interim period. Doing so avoids gridlock during a period when the club may otherwise need to proceed as quickly as possible toward closing.

Conclusion

As the landscape for investment opportunities becomes more competitive, club deals are returning to prominence in all segments of the market. Failure to consider the numerous unique mechanics of a club deal can dramatically inhibit investors' ability to realize value. Sponsors considering a club investment should be sure to select transaction advisers who have experience in managing the evolving dynamics of effectuating a successful joint investment.

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