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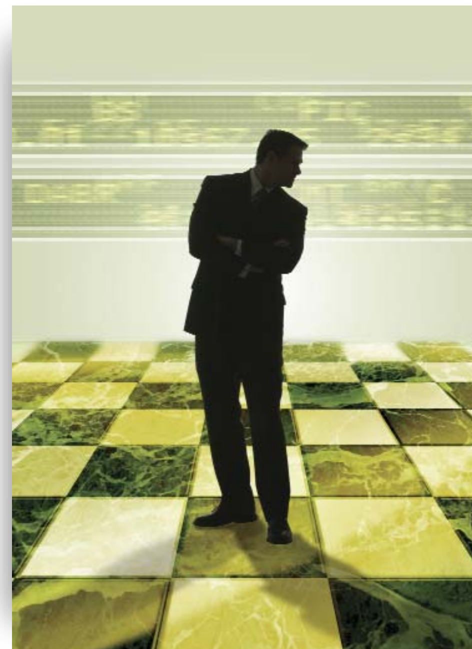
PoGo Alert

Federal District Court Rules That A Joint Bidding Arrangement By Private Equity Funds Did Not Violate Antitrust Laws



On February 21, 2008, the U.S. District Court for the Western District of Washington ruled that a joint bidding arrangement between competing private equity funds in a contest for corporate control did not violate the Sherman Act. This marks the first decision where a court affirmatively addressed antitrust and anticompetitive issues in collaborative bidding by private equity funds. Although the case itself may suggest an open door for such practices, this may not be the landmark case some are taking it to be.

The facts in Borey.

In *Pennsylvania Avenue Funds v. Borey, et al.,* the plaintiff, on behalf of a class of shareholders, brought suit against two private equity funds, Vector Capital ("Vector") and Francisco Partners ("Francisco"). The funds had made a joint bid for WatchGuard Technologies Inc., a publicly traded company ("WatchGuard"), and allegedly conspired to reduce the bid price. According to the complaint, a large pool of potential bidders, including Vector and Francisco, participated in an auction and submitted individual bids to acquire the stock of WatchGuard. As the selection process continued, Vector and Francisco emerged as the final two bidders. According to the complaint, Vector and Francisco allegedly conspired to artificially end the auction process by having Vector drop its bid to allow Francisco to purchase WatchGuard without a price war between the funds. In exchange, Vector funded half of Francisco's acquisition costs and received a 50% interest in WatchGuard.

The plaintiff alleged that this constituted anticompetitive conduct in violation of the federal antitrust laws. By design, the offering pursuant to the combined bid was lower than the price that would have been obtained had both funds submitted individual bids, and this constituted harm to the WatchGuard shareholders who did not receive full value for their shares. The plaintiff alleged this constituted bid rigging between the funds and was, therefore, per se illegal. In the alternative, the plaintiff alleged that the agreement restrained competition and, therefore, was at least a violation of the Sherman Act.

The reasoning by the court.

<u>Collaboration as per se illegal activity</u>. The court rejected the plaintiff's theory that the combined bid was illegal per se. The court found that joint bidding for corporate control is not an uncommon practice. In fact, the court noted that such collaboration can promote competition in certain circumstances by reducing risk compared with individual bidding and affording less wealthy bidders an opportunity to compete by combining resources. Under established antitrust precedent, for per se illegality to be an appropriate standard, the conduct must be of the type

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that "always or almost always tend[s] to restrict competition and decrease output." Considering these potential benefits from joint bidding, along with the fact no court has applied the per se standard to such joint bids, the court found that per se treatment was not proper under the circumstances.

Collaboration as a violation of antitrust laws. Having rejected the per se theory, the court also examined the plaintiff's antitrust claims under the rule of reason standard. Under this standard as it applies with regard to the Sherman Act, a plaintiff must establish that (i) a relevant market exists, (ii) defendant has a certain level of market power in that market, and (iii) defendant used that power in a way that resulted in anticompetitive effects. The court found that Vector and Francisco, though important for this individual bidding auction, constituted only a minor piece of the massive market that is private equity funding. Therefore, although a market does exist, the defendants did not possess sufficient power in that market. Furthermore, even if the market could be limited to the auction for WatchGuard, the defendants did not have the requisite market power simply because they were the final two bidders. The court noted that as many as fifty potential suitors existed, and these players must be considered part of the potential market. The plaintiff presented no evidence that the other suitors failed to remain in the bidding process because of any perceived market power of Vector, Francisco or some combination of the two. The court found that this did not constitute an anticompetitive, threatening situation and was more likely a lack of interest from the market.

The risks of collaboration after Borey.

There is little doubt that the *Borey* court's opinion could suggest that joint bidding arrangements are not unlawful without strong proof of anticompetitive effects; however, such a stance may be ill advised for several reasons. First, it is likely that this decision will be appealed. Even without an appeal, this opinion is not binding precedent for future decisions by other federal courts. Second, this case demonstrates that shareholder suits regarding collaborative bidding can go forward, creating a new potential source of risk for private equity bidders. Third, the court did not address what conduct would constitute illegal anticompetitive effects. Therefore, potential bidders should be cautious about relying on this decision and are advised to seek knowledgeable legal counsel before engaging in joint bidding arrangements. Although this case certainly marks a significant decision for the private equity legal world and may bring some comfort, the line between legal and illegal joint bidding arrangements likely remains uncertain.

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