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Private Equity Alert

March 2008

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District Court Dismisses Antitrust Suit Against Private Equity Bidders

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In late February, the U.S. District Court for the Western District of Washington at Seattle dismissed an antitrust lawsuit against two private equity firms that jointly acquired a publicly traded corporation. In rejecting the claim that the agreement to jointly acquire the target was an unlawful restraint of trade in violation of U.S. federal antitrust laws, the decision provides some clarification for private equity firms who desire to form bidding consortia to pursue acquisitions.

The Allegations

In *Pennsylvania Avenue Funds v. Edward J. Borey*, No. C06-1737RAJ (W.D. Wash. Feb. 21, 2008), a shareholder of WatchGuard Technologies Inc. ("WatchGuard") alleged that Francisco Partners L.P. ("FP") and Vector Capital Corporation ("Vector") entered into an unlawful conspiracy and agreement to restrain trade in violation of Section 1 of the Sherman Act when they agreed to jointly acquire WatchGuard.

The court explained that while fifty parties expressed interest in WatchGuard, the field of potential suitors ultimately was narrowed down to FP and Vector. The two private equity firms each made more than one formal bid and, on June 26, 2006, FP bid $4.60 per share and Vector bid $4.65.

The plaintiffs alleged that following these June 26 bids, Vector agreed to stop pursuing WatchGuard in order to allow FP to make a lower bid. Shortly thereafter, FP lowered its bid to $4.25 per share, and WatchGuard's board accepted the offer. In August, Vector announced that it had agreed to fund half of FP's acquisition of WatchGuard in exchange for a 50% interest in the company.

The complaint alleged that the agreement between Vector and FP was a *per se* violation of Section 1 of the Sherman Act and sought treble damages, costs, and fees from the defendants.

The Court's Decision

In dismissing the plaintiff's antitrust claim, the court found that they had not stated a proper claim under Section 1 of the Sherman Act. For purposes of the motion to dismiss, the court noted that it accepted as true the allegation that Vector and FP agreed to fix the offer price for FP, and that, as a result, WatchGuard shareholders received less consideration for their shares than if Vector and FP had continued to compete.

First, the court found that plaintiffs had not alleged conduct that is *per se* unlawful – meaning that the conduct would be unlawful, regardless of any purported justification – under the antitrust laws. The decision stated that no court has applied the *per se* rule to antitrust cases involving contests for corporate control.[1]

This decision provides some clarification for private equity firms who desire to form bidding consortia to pursue acquisitions.

After determining that the alleged conduct would not be considered *per se* illegal, the court found that the plaintiffs failed to allege a Section 1 violation under a rule of reason analysis. The court's decision stated that the plaintiffs had not demonstrated that FP and Vector had market power in the alleged relevant market for corporate control over WatchGuard. In fact, the court noted that as many as fifty suitors expressed some level of interest in the company, and that Vector and FP's alleged "stranglehold" over WatchGuard was only the result of all the other potential suitors refusing to make bids.

According to the court, the plaintiff shareholders incorrectly focused their allegations on the final stages of the bidding contest rather than on the entire universe of possible bidders that might top FP's and Vector's bids throughout the corporate control contest. The court stated that "[t]he illusion of market power arose not from Defendants' anticompetitive conduct, but from the lack of market interest in WatchGuard."

By finding that the plaintiffs had not stated a claim under Section 1 of the Sherman Act, the court declined to decide whether the securities laws preempted the application of the antitrust laws to the facts of the case. Instead, the court stated that while the SEC may require the disclosure of bidding agreements among suitors of a target company, it is unclear whether the SEC has the authority to regulate the terms and existence of such agreements.

Practical Implications

While *Pennsylvania Avenue Funds* generally has been considered a victory for private equity firms, the court's decision is tailored to the particular facts of the case and does not provide a *carte blanche* for so-called "club deals". For instance, other unrelated cases are pending in the District of Massachusetts that also allege club deals violate the antitrust laws. With a different complaint, that court may ultimately make different conclusions. Further, it is unknown what the status is of the previously reported inquiries by the Department of Justice into consortium bidding or how the Department may approach the analysis.

Nevertheless, the *Pennsylvania Avenue Funds* court recognized that agreements among private equity firms in a contest for corporate control are not, in general, anticompetitive. The court noted that in some cases, bidders combining forces actually can promote competition, rather than suppress it. For example, joint bids may allow bidders with less available capital to participate in a contest for corporate control where they otherwise might not. In addition, joint bids may facilitate the spreading of risk, thereby enabling a bid that might not otherwise occur. Private equity bidders always should assess the extent of such procompetitive reasons when deciding whether to submit a joint bid.

Another important factor that the court considered was the alleged relevant market. In *Pennsylvania Avenue Funds*, the court found that plaintiffs had not successfully alleged that FP and Vector had market power in the market for corporate control. The court noted that in this relevant market, not only could any other potential suitor have made a topping bid, but that WatchGuard's shareholders could have rejected the merger had they believed the offer price was too low.

1 *See Finnegan v. Campeau Corp.*, 915 F.2d 824 (2d Cir.1990); *In re Lukens Inc. S'holders Litig.*, 757 A.2d 720, 726 (Del. Ch. 1999).

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