Clubs Are Well Served By Tactical Non-Disclosure

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The politics of disclosure and non-disclosure play a discreet but increasingly important role in today's private club industry.

While the finances of private equity clubs have traditionally never found their way into the public domain (these are "private" clubs, after all), neither have the finances of private equity, or member-owned, clubs ever been so dire.

Of the 4,000 private equity clubs in America, conservative estimates peg those carrying dangerous levels of debt at more than 50 percent.

Every week we see evidence of these clubs making attempts to get out from under this debt. Some go semi-private. Others sell off to real estate developers. Still more resort to third-party management or convert to the non-equity model, whereby a professional owner/operator recapitalizes the club and retires the debt.

No matter which direction these indebted clubs choose to go, it's imperative they consider and ultimately manage this change in the most discreet fashion possible. *Externally*, this means insisting on non-disclosure agreements at the earliest practical stage of discussions. *Internally*, it means maintaining strict discipline when it comes to discussing club finances and any potential transaction.

Clubs that fail to take these steps simply aren't adequately protecting their own investments.

Let's first examine this process as it pertains to external parties, and let's be candid: Today, nine times out of 10, debt is the thing necessitating these dealings. It's the reason private clubs are seeking management or funding solutions from external parties such as an owner/operator of private clubs, a third-party management firm, or a potential individual investor.

Accordingly, clubs should seek non-disclosure agreements (NDA) at the earliest possible moment. How early? The subject should be raised during the introductory call or meeting, and it goes without saying that said call or meeting should be kept brief and businesslike, disclosing no financial or membership information.

This, we can agree, is straightforward and prudent. Reputable, experienced owner/operators, third-party management firms and individual investors have been down this road before – they will welcome the discretion. Indeed, dealing with external parties in this way is easy part.

Maintaining internal discipline is far more complicated.

There are several important, internal safeguards that should precede contacting a third party and signing an NDA. Too often, they don't get taken care of because a member of the board, or a concerned member, has reached out to external parties on their own.

We all know how word gets around when you sell a house. Somehow, all your neighbors find out. You don't need a sign on the lawn – everybody knows!

Smart clubs designate a board member or subcommittee for the expressed purpose of exploring these various management, ownership and capitalization options – before any calls go out to external parties. This is the ideal.

If an individual member or some cohort of members (not official board representatives) has already contacted someone on their own, their efforts can be funneled through this subcommittee.

If discussions are broached without anything in place, it's really important that a special, dedicated committee is formed immediately – and only the members of this subcommittee are made aware of the options being considered.

This is not subterfuge or unnecessary secrecy. It is investment protection for each and every member of that club.

Here's a real-world example. When negotiating with an exclusive private club in Florida, a consultant, who suggested a non-equity conversion, referred the board to us.

Instead of forming a small subcommittee to carefully explore this alternative in a discreet and confidential way, board members quickly called a series of all-member meetings to have open discussions about this and other capitalization options.

Unfortunately, word got out and now it's all over town. Members have left. Competing clubs are moving in, intent on plucking away a few more.

I'm confident this deal will get done, because it makes too much sense for all parties. But the club's equity position and negotiating position has been damaged by the loss of these members, by the rumors now swirling around the community. What's more, when and if the transaction is finalized, it will be hard work to win the members back or replace them.

Again, this is not subterfuge for the sake of subterfuge. Clubs need to protect their standing in the marketplace, at all times, but especially when they are mulling how they are going to confront debt issues. Indeed, the mere acknowledgement of debt issues is enough to scare off potential members!

Discussions about the potential recapitalization of your club are just that…discussions. It's perfectly appropriate that they be conducted in a controlled, discreet environment.

Companies never conduct all-employee meetings about prospective mergers, IPOs or sale transactions – not until after the deal team or board has carefully crafted a deal under strong non-disclosure agreements.

Ever wonder why you don't read about debt refinancing and mergers until *after* they've happened? This is why.

If club discussions don't result in a formally proposed transaction, there is no reason the entire membership needs to know. Broad disclosure of mere discussions does nothing but place each member's investment at risk.

Further, members ultimately will have their say in this process. Typically, the special subcommittee reports back to the board on whether the club should move forward with the transaction, or not.

If not, then club life goes on as before, without any ill effects stemming from rumor and anxiety amongst members, and in the larger marketplace.

If a subcommittee does recommend approval, the board then votes on the matter. If approved, the board will execute the documents *subject to ratification by the members.*

Club bylaws typically require a 51 percent or 67 percent vote of the members (with varying definitions of a quorum) to approve a major transaction such as a sale or recapitalization of the club, or transition to non-equity status.

The board will notice a special meeting to consider the proposed transaction, and make available a summary for all members to review and consider. At the special meeting, the board will present the rationale for the transaction and the board's evaluation of its alternatives.

The club investor/operator will typically be invited to make a brief presentation of their qualifications and the terms of the non-equity transition – focusing on the covenants to protect the membership and the planned capital improvements to be undertaken.

Members will have many questions, and a Q&A session is useful to air these discussions. The membership vote to ratify the transaction is usually held at the special meeting or within the week following, depending on the bylaws.

Some deals get done, others do not. Ultimately, club members are the arbiters. What matters before that vote is whether the club has protected its current membership, their investments and the club's reputation in the local market, while exploring and perfecting these sensitive debt and capital discussions. BR

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