Unit 5. Allocating Antitrust Risk in Merger Agreements

Merger Antitrust Law

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Note on terminology

- Buyers, sellers, and targets
  - Parties
    - *Buyer*: The side that takes control of the combined company after the closing
    - *Seller*: The side that gives up control to the buyer for some purchase consideration
    - *Target*: The part of the seller's business that the buyer will acquire
      - May be a subsidiary corporation, an unincorporated line of business, or specific assets
  - Standard case: S sells T to B
    - S is the seller
    - T is the target (in many agreements called the *Company*)
    - B is the buyer (in many agreements called the *Parent* if a subsidiary of the buyer is the actual party involved in the transaction)
- M&A agreements
  - Sloppiness in naming agreements prevails
  - Unless the context indicates otherwise, in this course the following terms are synonymous:
    - M&A agreement
    - Merger agreement
    - Purchase agreement
    - Sale and purchase agreement

Party objectives in M&A agreements

- Sellers
  - Three goals
    1. Obtain the highest purchase price possible
       - Get the buyer to pay as close as possible to its reservation price (i.e., the highest price the buyer is willing to pay to do the deal)
         - The buyer's reservation price will be determined by the expected value of its next best alternative to doing the deal (i.e., its opportunity cost)
       - In other words, extract in the purchase price all of the gains from trade that the buyer expects to obtain from the deal
    2. Close the transaction
       - Called *certainty of closing*
       - Sellers do deals in order to get paid
       - No matter how high the purchase price, the seller does not get paid unless the deal closes
         - If the purchase price is all cash, the seller does not care what value the buyer loses in order to close
         - If some of the consideration includes the buyer's stock, then a loss in the transaction value to the buyer that materially affects the value of the buyer's stock can be a concern to the seller
           - Special case: Merger of equals
       - Seller tends to lose value during pendency of the transaction
         - Loses going concern value (the "damaged goods" problem)
           - Often lack strategic direction and focus during pendency of transaction
           - Key employees often leave company for jobs in other companies
         - Purchase price in a second auction after a failed transaction typically much less even after accounting for damaged goods problem

Party objectives in M&A agreements

- Sellers (con't)
  - Three goals
    3. Minimize the delay between signing and closing
       - Usually a very minor concern to sellers compared to the purchase price and certainty of closing
       - Unless the delay affects the probability of closing, in an all-cash deal the cost of delay is only the time value of money
         - But delay can in some circumstances affect the probability of closing. Two examples—
           - If the delay exceeds the merger agreement's "drop-dead" date, allowing the Buyer to terminate the agreement and walk away from the deal
           - If the delay jeopardizes the buyer's financing for the deal

Party objectives in M&A agreements

- Buyers
  - Three goals
    1. Obtain the lowest purchase price possible
       - Get the seller to accept a sale price as close as possible to its reservation price (i.e., the lowest amount the seller is willing to accept to do the deal)
         - The seller's reservation price will be determined by the expected value of its next best alternative to doing the deal (i.e., its opportunity cost)
       - In other words, retain in the purchase price all of the gains from trade that the buyer expects to obtain from the deal
    2. Close the transaction provided the deal generates sufficient value; otherwise, walk away from transaction without loss of value
       - Buyers do deals to generate value above their opportunity costs
       - "Value" is expansively defined
         - Usually means that the deal will be financially accretive (increases earnings per share)
         - But can include other considerations (e.g., keeping the target from being acquired by a competitor)
       - If the deal cannot generate value, the buyer wants to be able to terminate the purchase agreement without further loss of value (e.g., paying the seller a termination fee)
    3. Minimize the delay between signing and closing
       - Usually a more important consideration to buyers than to sellers
       - Buyer wants to—
         - minimize loss in target's value during pendency of deal
         - obtain control of the target in order to begin reaping gains from the deal
         - free up buyer management resources to pursue other opportunities

Possible outcomes in DOJ/FTC reviews

1. Close investigation

- Waiting period terminates at the end of the statutory period with the agency taking enforcement action
- Agency grants early termination prior to normal expiration

2. Litigate

- DOJ: Seeks preliminary and permanent injunctive relief in federal district court
- FTC: Seeks preliminary injunctive relief in federal district court
  Seeks permanent injunctive relief in administrative trial

3. Settle w/consent decree

- Typical resolution for problematic mergers
- DOJ: Consent decree entered by federal district court
- FTC: Consent order entered by FTC in administrative proceeding

4. Parties terminate transaction

- Parties will not settle at agency's ask and will not litigate
- Agency concludes that no settlement will resolve agency concerns (AT&T/T-Mobile, NASDAQ/NYSE Euronext)

In outcomes 1 and 3, the deal closes (although it may be restructured through the consent decree)
In outcome 2, the deal may or may not close depending on the outcome of the litigation
In outcome 4, the deal does not close

Allocating antitrust risk in M&A agreements

- The purchase agreement
  - Sellers want the contract provisions to maximize the certainty of closing
  - Buyers want the contract provisions to enable them to terminate the agreement without loss of value if the closing is no longer in the buyer's interest
- Agreement can contain provisions that changes the probability of closing in light of antitrust risk
  - Can impose obligations on the buyer to propose and accept a consent decree to settle the investigation or litigation
    - *"Hell or high water" provision*: Imposes an unqualified obligation to fix any antitrust problem
    - *Qualified hell or high water provision*: Places limits on the buyer's obligation to fix any problems
  - Can impose obligations on the parties to litigate a government challenge
  - Can lengthen the amount of time to the "drop dead date" (the date on which either party can unilaterally terminate the agreement without cause) to giver the parties more time to negotiate a settlement or litigate
  - Can impose termination "penalties" on the buyer
    - *Antitrust reverse termination fee* (antitrust break-up fee): Requires the buyer to pay the seller some specified amount in the event the deal does not close for antitrust reasons
    - *Crown jewel provision*: Gives the seller the option to purchase certain of the buyer's assets (almost always at a below-market price) in the event that the deal does not close for antitrust reasons
    - "*Take or pay" provision*: Requires the buyer to pay the purchase price even if the deal does not close (but, not surprisingly very, rare)

Allocating antitrust risk in M&A agreements

- Effects on party objectives
  - Antitrust provisions can affect the expected value of the transaction to the buyer and the seller (in different ways) and so affect their reservation prices for the deal
    - A hell or high water provision (unqualified or qualified) will—
      - decrease the expected value of the transaction to the buyer, and
      - increase the probability of closing and hence increase the expected value of the deal to the seller
    - An antitrust reverse termination fee will—
      - Impose costs on the buyer for terminating the transaction and hence incentivize the buyer at the margin to fix the antitrust problem, lowering the expected value of the transaction to the buyer but increasing the probability of closing
      - Increase the expected value of the transaction for the seller
        - NB: Sellers negotiate for antitrust reverse termination fees to incentivize the buyer to fix the problem; recoupment of the seller's sunk costs in pursuing a failed transaction ("busted deal") is typically a very minor consideration.
    - An extended drop dead date can have an ambiguous effect
      - May increase the probability of closing (say through defeating a government challenge in litigation)
      - Can give the buyer a credible threat to put the agency to its proof and impose costs on the agency, increasing the buyer's bargaining position in settlement negotiations and so decreasing the costs of settlement and increasing the probability of closing
      - May cause further significant decline in the value of the target
        - Increasing the expected value to the buyer by weakening the target as a competitor if the buyer believes that the transaction ultimately will not close
        - Decreasing the going concern value of the target if the transaction ultimately does not close

Allocating antitrust risk in M&A agreements

- Other antitrust-related provisions
  - Relevant merger control filings
    - Which merger clearances should be disclosed?
    - Which merger clearances should be closing conditions?
  - Cooperation on regulatory matters
    - Where and when to make merger filings?
    - Agreement on specific tactics and timing for filings?
    - Who controls the defensive strategy?
    - Obligations of the parties to share information to defend the transaction?
  - Integration planning
    - What information must the seller share with the buyer to facilitate preclosing integration planning?
    - What else must the seller do to assist in integration planning?
      - E.g., Cooperate in designing IT integration between the two companies

M&A agreements

- Where are the antitrust provisions located in an M&A agreement?
  - Appear throughout the agreement depending on whether they are a—
    - Definition
    - Representation or warranty
    - Covenant
    - Condition precedent (sometimes called a *closing condition*)
    - Event or consequence of termination of the agreement
- Typical organization of M&A agreements
  - Definitions
  - The transaction (what is being acquired, acquisition structure, purchase consideration)
  - Representations and warranties of the seller
  - Representations and warranties of the buyer
  - Covenants
  - Conditions precedent
  - Termination
  - General provisions

M&A agreements

- Typical organization of M&A agreements
  - Definitions
    - Among other things, may define—
      - Antitrust laws
      - HSR Act
      - Government authority
      - Material adverse effect
      - Termination fee
    - Can be substantive: For example—
      - Antitrust laws may specify certain laws and exclude all others
      - Government authority may specify some authorities and exclude all others
      - Termination fee may specify the actual amount of the termination fee
  - The transaction
    - Identifies the transaction and obligates the contracting parties to consummate the transaction in accordance with the terms of the agreement
      - In a sale and purchase agreement, identifies the business or assets the seller is selling and the consideration the buyer will pay for them
      - In a merger agreement, identifies the companies to be merged, the form of the merger, the conversion of shares, and the initial organization of the merged company

M&A agreements

- Typical organization of M&A agreements (con't)
  - Representations and warranties
    - Separate sections for the acquired side and acquiring side
    - Reps and warranties of the acquired side are often very detailed
      - Usually will include facts on which the acquiring side is relying to obtain the benefits of the bargain it is anticipating
      - Common topics include authority to engage in the transaction, required consents or clearances, capitalization, intellectual property, tax, financial statements, compliance with law, employment, ERISA, and material contracts.
    - Reps and warranties of acquiring side usually limited
      - Generally go to the legal and financial ability of the buyer to complete the transaction
      - UNLESS part of the consideration is the buyer's stock (in which case the seller with probably want reps and warranties on the buyer's business)
    - Due diligence
      - *Due diligence* typically involves an investigation by the buyer of the target's business to establish its assets, liabilities, and commercial potential for the purpose of valuation
      - Buyers usually demand significant cooperation from the seller/target in investigations the conditions of the business (including reviewing business and legal records), inspecting facilities, interviewing management, and understanding the target's systems and processes
        - NB: Especially when the companies are competitors, the antitrust laws can regulate the timing and extent of due diligence activities
      - Some due diligence results may be reflected in the reps and warranties
        - Especially when the facts may change between the time of the investigation and the closing

M&A agreements

- Typical organization of M&A agreements (con't)
  - Covenants
    - Impose contractual obligations on the parties during the pendency of the agreement
    - While some covenants are reciprocal, other covenants will be specific to the buyer or the seller
    - Examples of common covenant provisions:
      - *Conduct of business*: Imposes limits on how the target will conduct its business between the signing and the closing
        - Typical requirement is that the target operate only in the ordinary course of business
          - Excludes extraordinary actions such as the sale of a plant
        - Covenant subject to the requirements of the antitrust laws
      - *"Efforts" clause*: Specifies the efforts that the parties must undertake to close the transaction
      - *No solicitation*: Obligates the seller not to solicit other bids for the business

M&A agreements

- Typical organization of M&A agreements (con't)
  - Conditions precedent
    - Specify the conditions that must be satisfied before the parties are required to execute their respective sale and purchase obligations
    - While some conditions precedent are reciprocal, other conditions will be specific to the buyer or the seller
    - Examples of common conditions precedent:
      - No law or order making consummation of transaction unlawful
      - HSR Act waiting period has expired or been terminated
      - The reps and warranties are true in all material respects
      - No material adverse change in the business since the signing of the agreement
  - Termination provisions
    - Provide for the *termination* of the agreement (and therefore the obligations imposed by the agreement on the parties) under identified conditions
    - Specifies any payments or other actions that must be taken as a consequence of termination

Specific provisions: Merger control filings

- "Consents and approvals" reps and warranties
  - Merging parties typically represent that the execution of the agreement and consummation of the transaction will not require any consents and approvals except for compliance with the HSR Act or ECMR (if applicable)
  - For other jurisdictions:
    - Parties can identify in advance all other specific jurisdictions, but this requires significant due diligence and agreement up-front
    - Parties typically refer to all "applicable", "all required foreign approvals" or all "necessary foreign approvals" (generally understood as those with mandatory suspensory effect)
    - May have a carve out for those foreign filings that would not have a material adverse effect if not obtained

Specific provisions: Merger control filings

- Where do merger control filings need to be made?
  - Over 85 jurisdictions have merger control filing requirements
    - Most are mandatory and suspensory—cannot close without filing and obtaining clearance
    - A few are voluntary (e.g., U.K., Australia, Singapore)
    - A few are not suspensory (e.g., Argentina)
- When do the merger filings have to be made?
  - Two considerations
    - Starting the clock as quickly as possible
    - Allowing sufficient time for preparation of defense and customer contacts
- Which clearances will be incorporated in the closing conditions?
  - Major jurisdictions almost always specifically identified
  - *Query*: What if the closing conditions do not include clearance in a suspensory jurisdiction in which a filing is required?

Specific provisions: Litigation closing condition

- Common formulation: No threatened or pending litigation
  - Typically provides that no government action is pending or threatened that seeks to delay or prevent consummation of the transaction
  - *Question*: What constitutes a "threat" of litigation?
  - *Question*: What about private party actions?
- Alternative: No order
  - Typically provides that no restraint, preliminary or permanent injunction or other order or prohibition preventing the consummation of the transaction shall be in effect
  - "If you can close, you must close"
- Carve-out
  - From a seller's perspective, may wish to have a carve-out that prior to asserting the failure of the condition, the asserting party must be in compliance with its best efforts obligations (e.g., to settle or litigate)

Specific provisions: Litigation covenant

- Are the parties committed to litigate in the event of an antitrust challenge?
  - May be imposed on buyer alone or on both parties
  - Obligation may be to litigate through to a final, non-appealable judgment, or something less
- Interactions with—
  - Any obligation to accept remedies in order to obtain clearance
  - The drop-dead date
    - Should the drop-dead date automatically be extended to keep the deal pending through the conclusion of litigation?
    - Should the unilateral right to terminate be symmetrical?

Specific provisions: Restructuring obligations

- Can arise in two provisions
  - “Efforts” covenant
  - Specific covenant to offer and accept remedies

Specific provisions: Efforts covenant

- Sets standard for obligations to obtain antitrust "clearances"
- These covenants usually only provide vague parameters, but they do provide a general guide of what is expected from both parties

Decreasing level of required efforts

  - Best efforts;
  - Reasonable best efforts/commercially reasonable best efforts, or
  - Reasonable efforts

Specific provisions: Efforts covenant

- Unqualified "best efforts" provision
  - Usually taken to imply an obligation to offer or accept restructuring relief if necessary to obtain antitrust clearance
  - Often coupled with express risk-shifting provision
- "Reasonable best efforts"/"commercially reasonable best efforts"
  - Something less than best efforts/something more than reasonable efforts
  - Most common formulation in antitrust covenants
  - Obligation not well defined by courts
    - Usually chosen precisely for this reason
  - *Conventional wisdom*: Does not imply an obligation to offer or accept material restructuring relief to obtain antitrust clearance
    - Can add express proviso to make explicit or limit obligation
- "Reasonable efforts"
  - Generally regarded as imposing no obligations that would change the transaction or reduce the benefit of the deal to the buyer in any meaningful way

Specific provisions: Remedies

- Range of alternatives
  - Unqualified "hell or high water" provision
  - Qualified hell or high water provision (capped divestiture obligation)
  - Remain silent and rely on general efforts covenant
  - Explicit no divestiture obligation

Decreasingly onerous on Buyer

- Unqualified "hell or high water" provision
  - Requires seller to offer whatever remedy is necessary to obtain antitrust clearance
    - Includes divestitures, licenses, behavioral undertakings, and hold separates
    - Theoretically could require divestiture of entire target business
      - But investigating agency has no incentive to accept such a fix
  - HOHW provisions are not self-executing: Agency still must agree to accept remedy
    - In some deals, agency will not accept any consent decree (e.g., Staples/Office Depot, AT&T/T-Mobile, NASDAQ/NYSE Euronext)

Specific provisions: Remedies

- Qualified hell or high water provision (capped divestiture obligation)
  - Limited to certain business, product lines, or assets
  - Limited by revenue, EBITDA or materiality cap
- Remain silent and rely on general efforts covenant
- Explicit no divestiture obligation

The "Road Map" Problem

Item 3(b) of the HSR form requires the reporting party to submit a copy of the most recent version of the acquisition agreement. When the divestiture obligations are explicit in the agreement, the investigating agency will see them (the agency always looks) and learn what remedies the buyer is required to accept if the agency demands it. Buyers often resist including unqualified or qualified hell or high water provisions for this reason, arguing that it completely deprives them of bargaining leverage in settlement negotiations with the agency.

Queries:

Can the joint defense privilege or work product doctrine shield a risk-shifting provision from disclosure in an HSR filing or second request?

Even if there are, are there disclosure obligations under applicable securities laws that will require the divestiture obligations to be disclosed anyway?

Specific provisions: Litigation

- Are the parties committed to litigate in the event of an antitrust challenge?
  - May be imposed on buyer alone or on both parties
  - Obligation may be to litigate through to a final, non-appealable judgment, or something less
- Interaction of litigation provision with—
  - Any obligation to accept remedies to obtain clearance
    - The more onerous the obligation, the more the buyer will want a credible threat to litigate
  - The drop-dead date
    - A litigation obligation (or right) is meaningless in the absence of time to litigate
    - Should the drop-dead date automatically be extended?
    - Should the unilateral right to terminate be symmetrical?

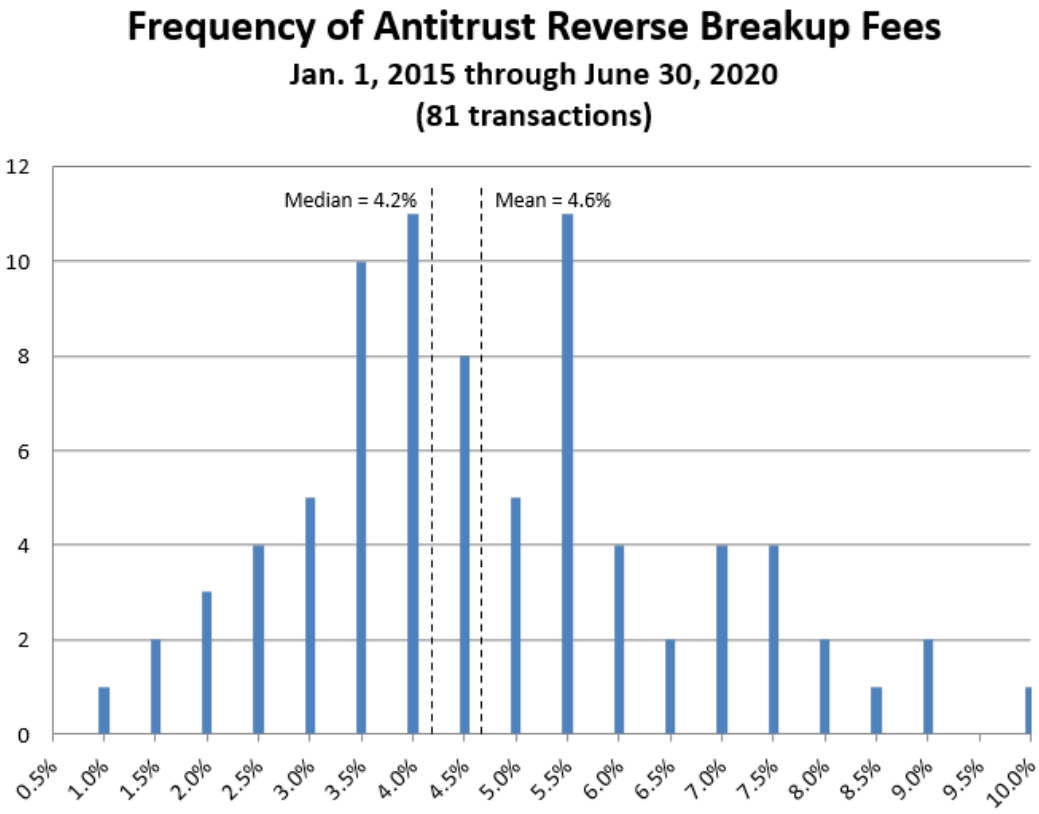
Specific provisions: Antitrust-related payments

- Antitrust reverse termination fees
- Nonrefundable partial payments or “deposits”
- Ticking fees
- “Take or pay” obligation

Antitrust reverse termination fees

- Reverse breakup fee with an antitrust trigger
  - Payable by the buyer to the seller where:
    - the transaction does not close before the purchase agreement is terminated, and
    - the only conditions not satisfied are the antitrust clearance conditions
  - Historically relatively rare, but seeing more often in modern agreements
    - Sellers usually negotiate some form of remedy obligation and/or higher purchase price to avoid reverse breakup fee
  - Size of fee—Varies widely
    - Complete sample (January 1, 2005 through June 30, 2020)
      - 1356 transactions total; 169 with antitrust reverse termination fees)
      - Mean: 5.2%
      - Median: 4.3%
      - Largest: 39.8% (Monsanto acquisition of Delta and Pine Land)
      - Smallest: 0.1% (CapitalSource's proposed acquisition of TierOne)
      - Highest absolute dollar value: $4.2 billion (AT&T's proposed acquisition of T-Mobile) (15.4%)
    - 5-year plus subsample (January 1, 2015, through June 30, 2020)
      - 81 transactions with antitrust reverse termination fees
      - Mean: 4.6%
      - Median: 4.2%
      - Largest: 12.5% (Novartis' acquisition of Endocyte)
      - Smallest: 0.6% (AT&T's acquisition of Time Warner)
      - Highest absolute dollar value: $2.5 billion (Walt Disney's acquisition of 21st Century Fox) (4.6%)

Antitrust reverse termination fees



NB: The difference between the intervals is not uniform.

For the complete set of the most recent data, see Dale Collins, Antitrust Reverse Termination Fees, AntitrustUnpacked.com.

Payments

- Ticking fees
  - Require buyer to pay interest on purchase price if transaction not closed by particular date
  - Aim to motivate buyer to obtain regulatory clearances quickly
  - Relatively rare in public transactions
    - Dow Chemical/Rohm and Hass: 5% of equity value
    - Boston Scientific/Guidant: 3% of equity value
- Nonrefundable partial payments
  - Like a ticking fee but requires more than the payment of interest
  - Payable on a specified schedule
- "Take or pay" clauses
  - Requires the buyer to pay the seller the purchase price even if the deal does not close
  - But offset later by a "refund" in the amount of the sales price minus expenses when the seller ultimately sells the business
  - Extremely rare (but there are examples)

Cooperation covenants

- Specifies level of cooperation by parties in obtaining antitrust clearances
- Typical requirements
  - Advance notice and review of communications and submissions with agency
  - Right to attend meetings/conferences with agency
    - Subject to agreement by agency
  - Right to review 4(c) and second request documents
- Party interests
  - Buyer usually want to control process and not have seller operating independently with governmental authorities
  - Seller wants to know what is going on to ensure buyer is fulfilling efforts obligations
  - Both want to maximize knowledge of the evidence submitted to the agency

Timing provisions

- Timing for filings
  - Often “as promptly as possible”
  - But some delay (5-10 business days) may be desirable to permit:
    - Indepth substantive analysis
    - Customer rollout
    - Coordination in submitting required merger filings
- Other timing-related provisions
  - Provisions agreeing not to withdraw filings, extend waiting periods or enter into timing agreement without consent of other party
  - Seller may want to impose a specific deadline on second request compliance

Timing and termination

- Drop-dead date
  - Does it provide long enough for expected approvals?
  - Firm termination date or extension (typically +120 days) in the event of a second request or Phase II investigation?
  - MAC clause: If business likely to deteriorate significantly during a prolonged antitrust review, may need provisions to ensure MAC is not used to avoid any divestiture commitments or avoid payment of reverse breakup fees

Risk-shifting summary

	Buyer-friendly		Seller-friendly
Level of efforts	Commercially reasonable efforts	Reasonable best efforts	Best efforts
Obligation to make divestitures	Silent/expressly excluded	Divestitures up to cap – measured in asset or revenue terms or MAC applying to part or all of acquired or merged business	Obligation to make any and all divestitures necessary to gain clearance no matter how much or what impact is (HOHW)
Timing for other aspects of regulatory review	Silent/may be deadline for submission of HSR filing	Silent/may be deadline for submission of HSR filing	Express timing for submission of filing, Second Request compliance and other milestones
Timing for offering divestitures	Silent	Silent	Express timing for offering remedies to obtain clearance
Control of regulatory process	Buyer controls; require cooperation from Seller and may give access and information	Buyer leads; Seller entitled to be present at meetings, calls; obligation on Buyer to communicate certain matters to Seller	Full involvement of Buyer in negotiations with regulators; Seller prohibited from communicating without Buyer (except as required by law)
Obligation to litigate	Silent/expressly exclude/litigate at buyer's option	Silent/expressly exclude	Obligation to litigate if regulators block exercisable at seller's option; does not relieve buyer of obligations to make divestitures
Termination provisions	Open-ended, extendable at buyer's option	Tolling at either party's option	Tolling at seller's option
Reverse break-up fee	None	Possible	Substantial fee; provision for interim payments and interest
Time to termination date	As long as buyer anticipates needing to fully defend transaction on merits, plus ability to extend at buyer's option	Tolling at either party's option	Tolling at seller's option at specified inflection points (e.g., second rquest compliance, commencement of litigation)
"Take or pay" provision	None	None	Requires payment of full purchase price by termination date even if transaction cannot close

SUMMARY

Summary: Will the deal close?

- The framework for assessing a horizontal transaction

What "markets" should be analyzed?	"Market" here means any identifiable subset of customers that purchase from one or both of the merging parties (not a Merger Guidelines relevant market)
What "markets" will be challenged?	*Ultimate question*: Will customers likely be harmed in prices, quality, or innovation? Are the parties head-to-head competitors? How many other realistic alternative sources of supply? Are the parties uniquely close competitors? Is one of the merging parties a "maverick"? Is one of the merging parties a potential entrant? Will there be significant customer complaints? Are there "bad" documents?
Can the problematic "markets" be fixed?	*Ultimate question*: Can the threat to customers be eliminated through a divestiture? What businesses or assets need to be divested to solve the antitrust problem? Are additional assets necessary to make the divestiture assets separable from the business? Are additional assets necessary to make the divestiture assets saleable? Are there buyers acceptable to the reviewing agency? Will the agency require a single buyer for all divestiture assets?
Is the deal still worthwhile?	What is the loss of value (including lost synergies) due to the divestiture(s)? What contractual protection can be obtained to ensure against a bad deal? *Important but not critical*: How long will all of this take?