

-MERGER ANTITRUST LAW

LAWJ/G-1469-05
Georgetown University Law Center
Fall 2024

Tuesdays and Thursdays, 3:30 pm – 5:30 pm
Dale Collins

wdc30@georgetown.edu
www.appliedantitrust.com

CLASS 7 WRITTEN ASSIGNMENT—INSTRUCTOR’S ANSWER

Instructions

Submit by email by 3:30 pm on Tuesday, September 17
Send to wdc30@georgetown.edu
Subject line: Merger Antitrust Law: Assignment for Class 7

Assignment

A. *Financial questions*: Calls for short answers in short paragraphs that the average person can understand. Math is neither required nor desired.

Company A wants to acquire 100% of Company B through a negotiated merger. The proposed plan of merger calls for Company A to pay cash to Company B’s shareholders as consideration for their interests in Company B. Company B is a widely held Delaware corporation that only issues common stock. Company B’s stock is traded on the New York Stock Exchange.

1. Explain what is meant by Company B’s “market capitalization.”
2. Explain why Company A will have to pay a premium above Company B’s market capitalization in order to acquire Company B. (There are two reasons.)
3. Explain how Company A will determine the maximum price per share it would be willing to pay for Company B’s stock.
4. Explain how Company B might try to bargain with Company A for a high purchase price.
5. Once the two companies have reached an agreement on price and signed a definitive merger agreement, explain how another company can make a bid for Company B that Company B’s board of directors must consider.

B. *Aon/WTW*:¹ Calls for a prediction supported by a financial analysis. *The date is July 15, 2021.*

I encourage you to work in groups on this problem

On March 9, 2020, Aon and Willis Towers Watson (WTW), the second and third largest of the “Big Three” insurance brokers, announced their intention to combine in an all-stock transaction, creating a company with a pro forma combined equity value of approximately \$80 billion. Under the merger agreement, WTW shareholders will receive 1.08 Aon shares for each Willis Towers Watson share for a total deal consideration of \$30 billion. The purchase price represents a 16.2%

¹ This is a real matter and I have taken the facts in this problem from company reports and court documents. If you are interested in more on this case, see [Aon/Willis Tower Watson](http://www.appliedantitrust.com) in Unit 14 on AppliedAntitrust.com for additional materials. Although this is a merger, think of Aon as the buyer and WTW as the seller (since WTW shareholders get premium).

premium to Willis Towers Watson's closing share price on March 6, 2020, and will result in the WTW shareholders holding 37% of the stock in the combined company.

The companies expect that the transaction will yield annual synergies of \$267 million in the first year, \$600 million in the second year, and \$800 million thereafter. They also anticipate that the transitional cost to achieve these expected synergies will be \$1.4 billion split equally in the first two years. The companies also expect transaction costs of approximately \$200 million and retention costs of up to \$400 million, both payable in the first year. In its investor presentation at the time of the deal's announcement, Aon stated that it anticipates "over \$10 billion of expected shareholder value, from the capitalized value of expected pre-tax synergies and net of expected one time transaction, retention and integration costs."²

The drop-dead date for the deal is September 9, 2021. If the deal does not close for antitrust reasons, Aon must pay WTW an antitrust reverse termination fee of \$1 billion.

The transaction is subject to review by the United States and the European Commission.³ The European Commission approved the deal with conditions (divestitures) on July 9, 2021. Given that the EC review is suspensory, the deal could not have closed before receiving EU approval. In setting their strategy, the parties assumed that the EC-required divestitures, perhaps with some additional divestitures that would be acceptable to the parties, would be sufficient to satisfy the Department of Justice and enable the parties to close under a consent decree.

The parties were wrong. The DOJ refused to accept the additional divestitures offered by the parties to settle the investigation. On June 16, 2021, the Department of Justice filed a Section 7 complaint in the United States District Court for the District of Columbia. The parties say that the divestitures required by the European Commission plus additional divestiture they offered negates all Section 7 concerns about the deal and that they intend to litigate the fix.

The case was assigned to Judge Reggie Walton. Citing the drop-dead date of September 9, the merging parties asked Judge Walton to begin the trial on August 23 or as soon thereafter as possible (suggesting implicitly that the parties would extend the drop-dead date for at least a short period of time beyond September 9). The DOJ responded with a proposed trial date of February 28, 2022, five and a half months later than the date proposed by the merging parties and a little more than eight months after the filing of the complaint. On July 9, Judge Walton set the trial dates for November 18, 2021, to November 23, 2021, and from December 20, 2021, to December 22, 2021, for a total of seven trial days. Judge Walton, presumably recognizing that a trial starting eight months after the filing of the complaint was unusually long in these types of cases, explained that these were the earliest times he had available given the criminal trials already scheduled involving prosecutions in connection with the January 6 insurrection.

The date is July 15, 2021. You are advising an arbitrator. The arb wants to know whether you think WTW will exercise its unilateral right to terminate the merger agreement on the September 9 drop-dead date and take the \$1 billion reverse breakup fee or instead agree to

² Aon plc & Willis Towers Watson, [Investor Presentation: Combination of Aon and Willis Towers Watson: Creating a Next Generation Global Professional Services Firm](#) 6 (Mar. 9, 2020).

³ It is also subject to review in a variety of other jurisdictions, including Australia, Canada, New Zealand, Singapore, and South Africa. The merging parties claim, and you should assume here, that these other jurisdictions will clear the deal by September 9 either finding no competitive concerns with the deal or accepting a fix offered by the companies.

extend the termination date until the trial court issues a decision (most likely in February 2022). Assume that it will cost WTW \$10 million in out-of-pocket expenses for its part in the litigation beyond the drop-dead date. The companies have not announced how the divestitures required by the EC or offered to the United States will affect the synergies expected from the transaction. GuruFocus.com reported that on July 15, 2021, WTW's weighted average cost of capital (WACC) was 5.16% and its return on invested capital (ROIC) was 3.19%.

Bonus question: Should Aon agree to extend the drop-dead date in order to litigate, or should it terminate the deal on September 9 and pay WTW the \$1 billion breakup fee? Assume that Aon will pay \$15 million in out-of-pocket expenses for its part in the litigation. GuruFocus.com reported that on July 15, 2021, Aon's weighted average cost of capital (WACC) was 5.8% and its return on invested capital (ROIC) was 8.47%.

Send me an email if you have any questions. See you in class.

INSTRUCTOR'S ANSWER

A. Financial questions

1. Explain what is meant by Company B's "market capitalization."

Market capitalization is the aggregate value of the company's outstanding capital stock measured by the number of shares times the trading price for each share.⁴ For example, if Company B only has one class of capital stock (common stock), has 100,000 shares outstanding (issued) of this stock, and the trading price is \$76 per share, then Company B's market capitalization is 100,000 times \$76 or \$7,600,000. If Company B has multiple classes of capital stock, its market capitalization is the aggregate value of all classes of the outstanding stock. A company's market capitalization changes with changes in the number of shares of capital stock outstanding or in the stock price.

2. Explain why Company A will have to pay a premium above Company B's market capitalization in order to acquire Company B. (There are two reasons.)

First, the trading price of a company's shares is the price at which demand for the stock equals the supply so that (in principle) there is no trading. In other words, no stockholder is willing to sell one or more of its shares at a price that a buyer is willing to pay. This means that every shareholder values the shares it owns at least at the trading price, and some shareholders are likely to value their shares at a much higher price (that is, they expect the company to do better than the trading price would predict). This generates an upward-sloping supply curve for the stock. If Company A wants to purchase a certain quantity of Company B's shares and Company A cannot discriminate in the prices it pays

⁴ Capital stock is the number of common and preferred shares that a company is authorized to issue under its corporate charter. The outstanding capital stock are the shares that the company has actually issued.

to Company B selling shareholders, Company A will have to offer a price sufficiently above the current trading price to induce Company B's existing shareholders to sell the number of shares that Company A wants to buy.

Second, Company A will have to pay Company A will want to buy Company B only if Company A believes that Company B will be more valuable in Company A's hands than the price Company A will have to pay (including the amount necessary to induce the required stock sales on the supply curve) to acquire Company B. Call this the "gains from trade" of Company A acquiring Company B. If Company B can block the sale,⁵ then Company B can bargain for a portion of these gains from trade in terms of higher consideration to be paid to Company B's shareholders. This additional force will require Company A to pay more than the market price for Company B's shares.

The difference between the price Company A pays to acquire a share of Company B and the unaffected trading price is called the *premium per share*.⁶ The aggregate amount of this premium Company A will have to pay is the *premium over market capitalization*.

3. Explain how Company A will determine the maximum price per share it would be willing to pay for Company B's stock.

As explained above, Company A will be willing to acquire Company B only if Company A believes that Company B will be more valuable in Company A's hands. Thus, the maximum price per share Company A would be willing to pay for Company B's stock is the amount that would make Company A indifferent to acquiring or not acquiring Company B. For example, if Company B has a current market capitalization of \$7,600,000 and Company A believes that the acquisition of Company B would yield \$400,000 of discounted present value in synergies, then Company A would be willing at most to pay \$8,000,000 for Company B.

4. Explain how Company B might try to bargain with Company A for a high purchase price.

As explained above, if Company B can block Company A's acquisition of Company B's shares, then Company B refuses to deal with Company A unless Company A pays a higher price.

Moreover, if there are other potential buyers for Company B, then Company B can "play off" Company A and the other potential buyers against each other and thereby obtain a higher price. Assuming Company A has the highest willingness to pay for Company B, then Company B should be able to bargain for a purchase price equal to the second highest maximum willingness to pay of the remaining bidders.

5. Once the two companies have reached an agreement on price and signed a definitive merger agreement, explain how another company can make a bid for Company B that Company B's board of directors must consider.

⁵ In the case where Company B is the wholly owned subsidiary of Company C, Company C can simply refuse to sell unless Company A gives some of the gains from trade with Company C. In the case of a widely held public company, Company B's board of directors may be able to influence the willingness of Company B's shareholders to sell their stock through its recommendations to Company B's shareholders.

⁶ "Unaffected" here means the price at which the stock would be trading if there was no information in the market that Company A wanted to buy Company B.

Company B is a Delaware corporation and the transaction is a state law merger, which will require approval by a shareholder vote. Under Delaware corporate law, Company B's directors would violate their fiduciary duties to Company B's shareholders if the directors did not retain the right to terminate the purchase agreement with Company A and accept a superior offer by another bidder up until the time Company B's shareholders vote to approve the merger with Company A.

B. Aon/Willis

See the Unit 7 class slides for the answer.