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Allocating Antitrust Risk in M&A Agreements

Wayne D. Collins & Lisl J. Dunlop
Shearman & Sterling LLP.

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I. INTRODUCTION

The allocation of antitrust risk has become an important feature of modern M&A agreements. In many strategic deals, where an antitrust challenge by one or more reviewing agencies is a meaningful possibility, the allocation of antitrust risk can be as important to each of the merging parties as the price. The failure to negotiate mutually acceptable antitrust-related provisions in a sale and acquisition agreement can mean the end of the deal even before the antitrust review begins.

In the typical negotiation where the sellers are selling for cash and will have no interest in the combined company, the buyer wants *optionality*, that is, the ability to terminate the acquisition agreement and walk away from the deal if the concessions necessary to obtain antitrust clearance are no longer consistent with its economic interest. Sellers, on the other hand, want *deal certainty*, that is, the assurance that the deal will close regardless of the concessions that might be required to obtain antitrust clearance.

The conditions precedent and the affirmative covenants in an acquisition agreement will determine the balance between the opposing interests of the buyer and seller. In addition, the "drop-dead date" in the termination provision (that is, the date before which the parties cannot escape their obligations under the contract) will determine how long the buyer has to defend the deal and satisfy its affirmative contractual obligations.

Finally, the willingness of a party to accept antitrust risk is a function of the consideration to be paid for the deal. Although it is obvious, it is worth noting that as a general rule buyers are willing to accept more risk the lower the price and sellers willing to accept more risk the higher the price. A little less obviously, consideration may be paid *ex post* in the purchase price, which is paid only if the deal closes, but also *ex ante* in a price that is paid regardless of whether the deal closes.

All of these provisions—conditions precedent, affirmative covenants, termination, and consideration—work together in allocating antitrust risk. Before turning to these provisions, however, it is helpful to step back and think about antitrust risk.

II. IDENTIFYING AND QUANTIFYING ANTITRUST RISK

Contract negotiations are an exercise in tradeoffs and compromise, and before a party can sensibly begin negotiating the allocation of antitrust risk in an acquisition agreement it must have some idea of what this risk is. A good way to approach antitrust risk is to think about it in terms of three nested categories:

[1] Respectively, Partner and Counsel in Shearman & Sterling's New York offices.

1. Inquiry risk—the probability that an antitrust authority, or perhaps a third party, will raise the question of whether the transaction, as originally structured, violates the antitrust laws.
2. Liability risk—the probability that, the question having been raised, the transaction will be found by the relevant decision-maker to violate the antitrust laws.
3. Remedy risk—the probability and cost to the party of the imposition of particular remedies in the event that the transaction is found to be unlawful.

These categories should not be rigidly defined, but rather should be considered in the context in which they arise. For simplicity, we will consider these risks in the common context of a possible review of the transaction by the Antitrust Division of the U.S. Department of Justice ("DOJ") or the Federal Trade Commission ("FTC"). It is straightforward to refine the categories in the context of a possible investigation by another antitrust authority or a threat of litigation by a private party.

The inquiry risk in connection with a possible DOJ or FTC premerger investigation will depend largely on whether the transaction is subject to the reporting and waiting period requirements of the Hart-Scott-Rodino ("HSR") Act. If the agencies have experience in the industry and are likely to spot the transaction as one to investigate, or if a simple internet search reveals a market structure in which antitrust problems could possibly occur, the inquiry risk will be high. Moreover, the risk can be significantly increased—if not made certain—if the documents submitted by either party in response to Item 4(c) and (d) of the HSR form suggest that the deal will harm customers or otherwise be anticompetitive.

Whether or not the transaction is reportable, the inquiry risk also may be heightened by complaints to the antitrust agencies by customers or competitors or by the publicity generated by the transaction (especially when press reports observe that the deal is a good one for the acquiring company since it is eliminating its most significant competitor).

In assessing antitrust risk for the purpose of negotiating an acquisition agreement, the liability risk will arise only if an agency commences a premerger investigation (No doubt there can be liability risk postclosing for the buyer, but this is irrelevant to the negotiation of the acquisition agreement.) We think about liability risk in the context of a DOJ or FTC investigation as whether the agency will initiate a challenge that threatens to block the closing, not whether the agency can prove in court that the acquisition is unlawful. This is because, as we will see below, it is the prospect of an agency challenge that triggers the affirmative covenants in an acquisition agreement. Accordingly, the liability risk depends on the probability that the parties can convince the reviewing agency to close its investigation without taking any enforcement action.

The remedy risk arises only if the liability risk matures. The remedy risk depends on what divestitures or other remedies might be acceptable to the investigating agency in a consent settlement that would allow the restructured deal to close. More precisely, the remedy risk involves both the probability and the consequences of what is likely to be a menu of potential remedies, since it may be difficult to determine at the time of the negotiation of the acquisition agreement what exact remedy will be acceptable to the agency if it decides to challenge the deal.

Moreover, the remedy risk is different for buyers and sellers. For buyers, the remedy risk is the economic consequences to the benefits the buyer expects to gain from the deal if the remedy is implemented, while for a seller the remedy risk is the economic consequences to its going-concern value in the event the required remedy is not implemented and the deal terminates.

Three additional observations are in order before turning to the provisions in the contract that can be used to allocate these risks:

1. At the stage of the contract negotiations, very little information may be available to assess these risks. In many situations, the negotiation of the provisions that allocate antitrust risk takes place when the number of people in the company who know about the deal is very limited and those "in the loop" do not have access to the information necessary for a more complete antitrust risk analysis.
2. The parties' analysis of the antitrust risk at the time of the negotiations may not be the same. The two parties may have access to different information relevant to the analysis—for example, each may have access to some of its own documents, but is not likely to have much (or any) access to the other party's documents—or even if they have the same information they may interpret it differently.
3. Where the parties land in allocating antitrust risk in an acquisition agreement can depend significantly on the context of the negotiations. For example, strong sellers—for example, those who have multiple interested bidders, including financial bidders with no antitrust risk—will be in a better position to ask for strong protections. Conversely, strong buyers—such as those seeking to acquire distressed assets, or offering a very significant premium—may be in a better position to gain more flexibility in their ability to negotiate with antitrust regulators or get out of the deal altogether if the price becomes too high.

III. CONDITIONS TO CLOSING

A condition to closing is a condition precedent that must be satisfied before the obligation to close becomes operative. If a condition to closing for a party is not satisfied, that party does not have to close. There are two types of conditions primarily relevant to the allocation of antitrust risk: merger control conditions and no-litigation conditions.

A. Merger Control Conditions

These provisions condition the closing on the satisfaction of the merger control requirements of some or all of the jurisdictions with authority over the transaction. These include jurisdictions, such as the United States, that provide for suspensory waiting periods before a transaction can close, as well as jurisdictions, such as the European Union, that prohibit the closing of a transaction until it is affirmatively cleared.

As a general rule, merger control conditions are not especially significant to the allocation of antitrust risk. The parties usually reach agreement to include in the conditions at least the major, if not all, jurisdictions with authority over the transaction. In some cases, however, less significant jurisdictions will not be included in the conditions. This does not mean that the transaction has to close even if it is unlawful in some jurisdiction not included in a condition,

since as a matter of comity it is unlikely that any court would compel a closing in these circumstances. Rather, if the parties intended to exclude the jurisdiction from the conditions precedent, the party refusing to close when all of the conditions are satisfied (almost certainly the buyer in a cash purchase transaction) could be liable to the other party for damages in a breach of contract action for either failing to close or delaying the closing until the requisite clearance could be obtained.

B. No litigation Conditions

Most contracts contain a "no litigation" condition. The most buyer-favorable condition is that no government agency has threatened to commence, or has commenced, litigation under the antitrust laws to block the transaction. An intermediate condition is that no government agency has commenced litigation. The most seller-favorable condition is that there is no injunction or other order that would make the closing of the transaction unlawful. (This is sometimes called an "if you can close, you must close" condition.)

In our hypothetical of a U.S. government investigation, the practical differences in the conditions are probably small. If the DOJ or FTC threatens to challenge the transaction, and the parties indicate that they will proceed anyway, the agency almost certainly will commence litigation. If the agency has commenced litigation and the parties indicate that they will close in the absence of an injunction, the court most likely will issue a temporary restraining order ("TRO") to block an immediate closing and make clear to the parties that closing after the expiration of the TRO, but before a motion for a preliminary injunction can be decided, would not be in the interests of the merging parties. (Courts can, and have, ordered rescission as preliminary injunctive relief in government challenges.) Accordingly, as long as the agency has a colorable case, it is likely that the no-litigation condition, whatever its form, will not be satisfied if the agency threatens a challenge.

Regardless of their precise form, no-litigation conditions almost always are limited to government plaintiffs. Private plaintiffs rarely challenge transactions premerger (there are no damages), and even when they do, courts are very reluctant to grant injunctive relief to block the closing. Consequently, absent special circumstances indicating that there is material risk that a transaction would not be able to close because of private antitrust litigation, the parties rarely apply no-litigation conditions to private plaintiffs.

IV. AFFIRMATIVE COVENANTS

Affirmative covenants impose a contractual obligation on a party to perform some act. There are five types of affirmative covenants relevant to the allocation of antitrust risk: efforts obligations, merger control compliance obligations, cooperation obligations, settlement obligations, and litigation obligations.

A. Efforts Obligations

Efforts clauses prescribe the level of effort that the buyer must exert to obtain the necessary antitrust clearances to satisfy the closing conditions in the absence of more particular obligations. The most buyer-favorable obligation is "commercially reasonable efforts," which is

generally understood to require no effort beyond what is commercially in the interest of the buyer.

On the other extreme, the most seller-favorable clause is "best efforts." (Perhaps an even more extreme efforts obligation would be "any and all efforts," which appears, albeit rarely, in acquisition agreements.) Although some interpret a best efforts obligation as requiring the buyer to do whatever is in its power—including any divestitures the reviewing agencies might require regardless of commercial consequence—to satisfy the antitrust closing conditions, it is unlikely that a court would go so far in the absence of compelling evidence that this is what the parties intended in entering the contract.

In between these two obligations are "reasonable efforts" and "reasonable best efforts," neither of which has an accepted judicial interpretation, although the former is considered to impose a weaker obligation on the buyer than the latter. Empirically, the most common efforts obligation in acquisition agreements where antitrust issues may be present is "reasonable best efforts." Perhaps not surprisingly, the oxymoronic structure of the clause is the source of its appeal. "Reasonable" qualifies the obligation in favor of the buyer; "best efforts" qualifies it in favor of the seller; and both parties can implicitly agree that they will leave undefined the precise nature of the obligation until a breach of contract litigation if a failure to perform ever becomes an issue. Most likely the parties anticipate that there never will be a dispute or, if there is, that the precise nature of the obligation will be compromised in a settlement without the need for litigation.

B. Merger Control Compliance Obligations

These provisions impose an obligation on a party to make their required premerger filings, often within a specified time period. For example, it is common for transactions subject to the reporting requirements of the HSR Act to require that the HSR forms be filed within ten business days of the signing of the acquisition agreement. In jurisdictions where there is practice of a prefiling negotiation, such as the European Union, these provisions can be somewhat more difficult to craft, although a seller could still negotiate for milestones that the buyer must meet in the prefiling negotiations with the agency. In the United States, some acquisition agreements also specify the time that the parties have to respond to a second request.

Merger control compliance obligations can be important to both the buyer and seller, since the timing of the end of waiting periods, merger clearances, and, in the United States, the time to negotiate consent settlements or litigate can depend on when the parties comply with their various filing obligations.

C. Cooperation Obligations

These provisions impose reciprocal obligations on the parties to cooperate with one another in the antitrust defense of the transaction. Buyers want these provisions to ensure that sellers are providing information and access to knowledgeable personnel helpful in the defense of the transaction, while sellers want these provisions to ensure that the buyer is doing everything appropriate to defend the transaction and not sink the deal.

Usually these provisions give the right to the other party to review in advance submissions to the investigating agency and to attend substantive meetings and conference calls with the agency subject to the agency's agreement (which is usually granted to outside counsel operating under a joint defense agreement). In some contracts, the buyer will reserve explicitly the right to control the defense of the transaction before the investigating agency and, if it arises, in litigation.

D. Settlement Obligations

The usual practice of the DOJ or FTC when the agency concludes that there is an antitrust problem with a transaction is to permit the transaction to close subject to a consent settlement that will negate the anticompetitive effects the agency believes otherwise would result from the transaction. These settlements usually require the buyer to divest businesses or assets, although depending on the circumstances they could require the buyer to do a variety of other things.

In order to maximize certainty of closing, sellers in transactions that have antitrust risk often seek to impose obligations on the buyers to offer and accept consent settlements where necessary to avoid time-consuming and burdensome litigation, if not the nonsatisfaction of a condition to closing.

- The most seller-favorable provision is a so-called "hell or high water" clause, which obligates the buyer to do whatever the agency requires for a consent settlement, regardless of the economic consequences for the buyer.
- The most buyer-favorable provision is a proviso to the effect that the efforts clause does not impose any obligation on the buyer to propose or accept a consent settlement.
- In between, the obligation on the buyer may be capped by a revenue or materiality threshold or limited to sales to specific businesses or assets. Conversely, the obligation may exclude some business or assets that the buyer deems essential but puts everything else at risk to be included in a consent settlement.

Given their economic consequences to the buyer and the deal certainty implications to the seller, these obligations can be among the most intensely negotiated provisions in the acquisition agreement and often exhibit considerable drafting creativity.

Beyond their general desire to preserve optionality and not be required to do anything that is not in their economic interest, buyers will often vigorously resist including a settlement obligation in the contract because the obligation will (1) reveal to the investigating agency a competitive problem the agency might otherwise have missed, and (2) deprive the buyer of any leverage with the agency in discussions to settle for something less than the buyer is contractually obligated to the seller to give up. This is often called the "roadmap problem." Although the DOJ and FTC routinely disavow that they are influenced by settlement obligations in a contract—and there are many examples where the agencies have not sought relief even when the buyer was obligated to accept a consent order—the almost universal view in the bar is that a settlement obligation in the acquisition agreement will seriously harm the economic interest of the buyer.

The roadmap problem has led some parties to look for ways to shield a settlement obligation from disclosure to the investigating agencies, usually through a joint defense agreement specifying how the parties will defend litigation—U.S. consent relief exists only on the context of litigation—and a concomitant appeal to work-product protection for litigation strategy. The agencies, on the other hand, have steadfastly declared their position that any contractual obligation to settle is part of the acquisition agreement and hence must be disclosed in the HSR filings by the parties. The issue has yet to be litigated.

E. Litigation Obligations

In the United States, unlike in the European Union and most other jurisdictions, the antitrust agencies cannot block the closing of a transaction on their own but rather must challenge the transaction in federal district court. The court will grant an injunction only if the agency makes a threshold showing, including a likelihood of success in prevailing on the merits at trial, and the parties can offer their own evidence to contest whether the agency has satisfied its burden. Any successful defense, however, will require both parties to work together, even though one or the other party may want to cut its losses and walk away from the transaction if litigation is threatened.

To deal with this asymmetry, some acquisition agreements include covenants that require the parties to defend the transaction through litigation if necessary. Buyers may like this covenant as a means of succeeding on a transaction in the face of an agency challenge, or at least as a means of gaining some additional bargaining power with the agency in the settlement negotiations. Sellers may like this covenant as a means to increasing deal certainty. Both parties may want a litigation covenant for the signal it sends the reviewing agency that it will be put to its proof in court in the event the agency decides to challenge the transaction. Of course, litigation is costly and often time-consuming, and a litigation obligation can impose a significant burden on a company when it would rather abandon the transaction.

V. TERMINATION

The termination provisions of an acquisition agreement determine the time period during which the parties are bound to their obligations in the contract. Absent special provisions to terminate early, the time period will last at least to the "drop dead" date, that is, the date at which either party may unilaterally terminate the agreement without cause. Accordingly, each party can only count on the time between the signing and the drop-dead date to make their required premerger notification filings, submit any additional materials the investigating agencies may require, make their substantive arguments in defense of the transaction, possibly litigate, and ultimately close the transaction.

Parties that want to be able to exit a deal if the defense burden is likely to be large typically seek short drop-dead dates, while parties that are willing to take on substantial costs and burdens in order to increase deal certainty—or increase leverage in a settlement negotiation through a credible litigation threat—seek drop-dead dates of a year or more after signing. The most common drop-dead date in deals with meaningful antitrust risk appears to be one year, although some contracts including extensions of three to six months if litigation has commenced to permit the parties to defend the transaction.

VI. THE PURCHASE PRICE, REVERSE BREAKUP FEES, AND OTHER PAYMENTS

A party's willingness to accept risk is usually a function of its expected return. As a result, a seller may be willing to accept more risk the higher the purchase price the buyer is willing to offer, while a buyer may be willing to accept more risk (say, of divestitures) the lower the purchase price the seller is willing to accept. It is not unusual for the purchase price to change as the parties adjust the antitrust risk allocation.

But the purchase price is paid only if the transaction closes. Some sellers want a payment, known as an "antitrust reverse breakup fee," in the event that the transaction does not close because of a failure to satisfy the antitrust conditions precedent. The usual explanation for an antitrust reverse breakup fee is that the seller wants to be compensated for the burden it has sustained and any lost profits or going concern value in the event of a busted deal.

But in our experience the better reason is that it provides a financial incentive to the buyer to propose curative divestitures or other solutions to satisfy the competitive concerns of the antitrust agencies and so permit the deal to close even in the absence of affirmative settlement covenants. In principle, a buyer should be willing to settle as long as the value it expects to receive from a restructured deal above the purchase price is greater than the amount of the reverse breakup fee. As a result, an antitrust reverse breakup fee may substitute for an affirmative settlement obligation. Moreover, since buyers do not like the idea of having to pay and get nothing in return, most acquisition agreements with antitrust reverse breakup fees also contain a litigation covenant and a termination provision that allows enough time to litigate at least through a decision on a preliminary injunction, if not through an appeal.

Over the last eight years, about 10 percent of large public negotiated strategic deals had antitrust reverse breakup fees. The average amount has been 5.8 percent of transaction value. A few very large percentage breakup fees skew the distribution to the right, so that a more meaningful number is the median, which is 4.0 percent of the transaction value. There has been no discernible trend in either the frequency or the amount (as a percentage of transaction value) of antitrust reverse breakup fees since the beginning of 2005.

Interestingly, very few antitrust reverse breakup fees have been triggered. Since 2005, about 78 percent of the deals with antitrust reverse breakup fees were cleared without enforcement action; all but one—AT&T/T-Mobile—of the remaining deals settled with a consent decree and closed their transaction. The AT&T/T-Mobile agreement provided for a reverse breakup fee of $3 billion in cash and below-market pricing on various contracts and assets (which AT&T valued at $1.2 billion), representing 10.8 percent of the transaction value of $39 billion. AT&T paid the fee to Deutsche Telekom (the parent of T-Mobile) when the acquisition agreement was terminated in 2012 while in litigation with the DOJ.[2]

Finally, some purchase agreements provide for "ticking fees." These are fees payable by the buyer to the seller for delays in the closing beyond a specified date. Ticking fees are designed to both incentivize the buyer to make concessions in order to settle the investigation and close the deal sooner rather than later in the contract period, as well as to compensate the seller for the

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[2] For more detail on the occurrence of antitrust reverse breakup fees, see Dale Collins, *Antitrust Reverse Breakup Fees* (July 20, 2012), and subsequent updates of the database on Antitrust Unpacked.com.

time value of money. A typical ticking fee would be a monthly payment—often an interest rate or other percentage of the purchase price—for every month that the deal has not closed. Ticking fees may escalate in amount over time to further incentivize the buyer to settle the investigation and close the deal.[3]

[3] For an extensive collection of risk-shifting and other antitrust provisions in M&A agreements, see Dale Collins, *Sample Antitrust-Related Provisions in M&A Agreements* (April 27, 2013), on Antitrust Unpacked.com.