Deal certainty is a critical negotiating point in most M&A transactions. A bidder’s ability to offer deal certainty to a seller in an auction can make or break a bid. Even if the seller has leverage over the buyer, it would be unusual to allocate all of the antitrust risk to the buyer by forcing the buyer to “close through” a failure to get a requisite regulatory approval. It is more common to allocate some of the risk to the buyer by forcing the buyer to take agreed steps to obtain antitrust approvals, and to allocate some of the risk to the seller by allowing the parties to walk away from the deal if the most extreme risks materialize. Fortunately, there are a number of recognized approaches that parties can use to understand, evaluate and parse antitrust risks in a manner that may allow the execution of definitive deal documents to go forward. Each of these techniques can be customized to take account of the relevant facts and circumstances of any given deal.

This article outlines the top ten techniques for allocating antitrust risks in M&A agreements. This article is designed for deal lawyers, not antitrust advisors, and it is not intended to present an analysis of substantive antitrust issues that can arise in M&A transactions.


1. Information Sharing and Joint Defense Agreements

Well before either party prepares a first draft of the transaction agreement, both parties should make a critical assessment of the antitrust risks of the proposed transaction. Each party should consult antitrust counsel, and economists if needed, to understand what the potential “overlaps” are, whether there are any reasonable remedies that would satisfy the regulators and allow the transaction to proceed and, if so, what impact
the antitrust approvals process is likely to have on the transaction timeline. In competitive auctions, bidders should also assess how high their antitrust risk is compared to other likely bidders, because this may inform how aggressive the antitrust risk-sharing proposals of their bid should be.

Each party can complete some of its preliminary analysis independently, based on publicly available information and its own internal financial data. The parties can also review internal marketing materials and potential “4(c)” documents (such as presentations to senior management about the market share impacts of the transaction) to assess whether they have any “smoking guns” that cast their antitrust-related issues in a problematic light.

Parties to transactions involving companies that have assets or sales in non-U.S. jurisdictions should pay close attention to non-U.S. competition law requirements. Some of the BRIC countries, among others, have adopted expansive transaction notification requirements in the past few years. In some cases, non-U.S. filing requirements have long notice periods that can meaningfully impact overall transaction timing. Delays in transactions due to competition law processes expose the transaction to the risk of not closing by making it more possible for intervening events, changes in market conditions, interlopers or other disruptive factors to arise.

At some point in the deal process, the parties may need to exchange more detailed turnover and other information with each other. In fact, they may need to discuss with specificity what assets, if any, they would be willing to divest to obtain regulatory approvals, and how those divestitures would be structured and timed. Prior to having those discussions, especially if the parties need to share strategic views about divestiture remedies, it is often advisable for the parties to have their respective outside antitrust counsel enter into a joint defense agreement to try to ensure their discussions remain privileged. Thereafter, they should confine those discussions to outside counsel and a limited number of in-house legal and business people who have a “need to know” the information discussed. If the parties take notes about the discussions, they should mark their notes “privileged and confidential”. Preserving the confidentiality of these types of discussions is critical because producing notes and other documents that reveal the parties’ views about likely issues and potential solutions could otherwise provide a roadmap to the regulators of what remedies to seek.

One caveat related to joint defense agreements is that, in a recent case, *Martin Marietta v. Vulcan*, the court found that the confidentiality provisions of a joint defense
agreement were evidence of the parties' intent to enter into a “back-door” standstill.\(^1\) Accordingly, in entering into a joint defense agreement, the parties should be cognizant not to include any language purporting to supersede any confidentiality or standstill understandings that they may otherwise have.

2. **Level of Efforts**

The primary antitrust-related contractual commitment in an M&A agreement usually resides in the covenant that addresses what level of efforts the parties must undertake to complete the transaction. The default rule is that the parties have to use “best efforts”, “reasonable best efforts” or “commercially reasonable efforts” to obtain the requisite antitrust approvals. The general standard tends to be intentionally vague, without specifying whether the level of efforts should be measured against the contracting parties’ own capabilities, against an industry standard or against the level of efforts exerted by similarly situated (from a regulatory perspective) parties to M&A transactions. Does the choice of formulation among these three otherwise vague “efforts” options have any meaning? Perhaps.

First, it depends on which state law is the governing law of the agreement. Under New York law, for example, there are only a few cases that interpret “efforts” standards and it remains unclear whether there is a meaningful difference between the “best efforts”, “reasonable best efforts” or “commercially reasonable efforts” standard in terms of financial exposure or otherwise.\(^2\)

Second, it depends on whether the contract uses other formulations of the standards in other contexts. This can be entirely unintentional. For example, the use of different standards can arise when different drafts-people comment on different sections of the contract. Unfortunately, the inconsistencies can result in a court concluding that the parties intended the different formulations to imply different levels of efforts. Accordingly, the parties should scrub their use of these terms in a near-final version of the contract to ensure they are using different formulations only if they intend a different meaning.

Third, given the absence of bright line rules concerning which standard to use, parties should insert more detail about key aspects of their antitrust-related commitments. For

---

example, if the parties have agreed at a commercial level that the buyer will not be required to make divestitures in order to secure transaction approvals, the buyer should not rely on the “commercially reasonable efforts” standard alone to insulate it from a later claim by the seller that the buyer should nevertheless divest those assets. Instead, the contract should include a specific statement that no such divestitures are required. As a further example, in smaller transactions, parties may agree to expense caps associated with the costs of responding to second requests and similar regulatory action. If the cap would be exceeded, the parties would have the option to renegotiate the price or terminate the transaction.

3. Divestiture Obligations

The question of whether the buyer will have to divest any assets and, if so, which assets is a hot button in many transactions. Failure to reach a resolution on this question can often lead to a termination of negotiations. Although every transaction is different, there are a few formulations regularly used in M&A agreements to compromise on this issue so that both parties bear some risk. These are summarized below, roughly in order from most buyer-favorable to most seller-favorable.

a. No divestitures required. Obviously, this is a very buyer-favorable formulation. It is rarely acceptable to targets, but it might be appropriate in a transaction where the buyer is a private equity fund with no discernible overlapping businesses among its or its sister funds’ portfolio companies. Even in such a case, however, many targets would prefer to remain entirely silent as to divestitures rather than expressly provide that none are required.

b. De minimis divestitures of target and/or buyer assets. This formulation is rare, but could be used in a transaction in an industry in which the relevant markets are disaggregated and tested by the regulators in such small geographic areas that the value of any identified “problem areas” are truly tiny compared to the overall value of the transaction. In such cases, the lost revenues and synergies resulting from the divestitures would be outweighed by the benefits of the transaction.3

3 This formulation was used in the AT&T Inc./Centennial Communications Corp. deal (buyer’s divestitures capped at divestitures that are “de minimis in the aggregate” with respect to the target).
c. Specified, limited divestitures of identifiable or objectively measurable target and/or buyer assets. If the parties are able to identify narrow “problem areas” in advance, they might agree to a specific fix. In some cases, the buyer might even agree to implement a “fix-it-first” remedy promptly after signing the transaction agreements. The downside of this strategy is that it provides a clear road map to the regulators about what the problem areas are and, as a practical matter, eliminates the parties’ ability to argue that no divestitures are required. On the plus side, this strategy facilitates a faster closing by eliminating the risk of long negotiations with the regulators over whether divestitures are required and allowing the buyer to commence an auction for the divested assets promptly and with the seller’s cooperation (which may be necessary for assembling a data room about the target’s assets, for example).

d. Limited divestitures of target and/or buyer assets capped by reference to a “material adverse effect” relative to the size of the target (assuming the target is smaller than the buyer). In M&A lingo, this is the classic “target in the denominator” formulation. If the target is smaller than the buyer, then the quantum of assets that the buyer agrees to divest under this formulation is smaller. The use of “material adverse effect” as the standard is not the only option but it is widely used. Delaware courts have repeatedly found that “material adverse effect” is a very high standard that is rarely satisfied. Among other things, it requires the effect to be “durationally significant”. Accordingly, the use of “material adverse effect” can be target-favorable and reinforces the need for the buyer to consider both the customary and any deal-specific carve-outs to the “material adverse effect” definition carefully. On the other hand, many buyers prefer this approach to more objectively-verifiable tests because it does not provide a road-map to the regulators and it gives the buyer enough wiggle room to make an argument later on.

e. Limited divestitures of target and/or buyer assets capped by reference to a “material adverse effect” relative to the size of the buyer (assuming...
the buyer is larger than the target). This is the “buyer in the denominator” formulation and is a slightly less buyer-favorable version of the standard described in subsection (d) above.6

f. Limited divestitures measured by reference to the size of the buyer and the target combined. This is the “combined company in the denominator” formulation and is an even less buyer-favorable version of the standard described in subsections (d) and (e) above.7

   “Hell or Highwater”. This is the least buyer-favorable option because it means that the buyer is required to close “come hell or highwater”, with no limits on how much the buyer is required to divest. Rarely appearing in definitive agreements in practice, this standard often appears as the target’s “going out” position in the bid draft in a sell-side auction.

Some transactions use combinations of the foregoing standards in the same agreement, or have even more customized formulations. For example, an agreement might require a buyer to make divestitures so long as they are customary for transactions in that industry or result from a change in the target’s business plans that the buyer intends to impose post-closing.

4. Obligation to Litigate

Whether the buyer is required to litigate against a governmental authority in order to secure regulatory approvals for the transaction is a negotiating point that is often overlooked. In practice, however, it can be as important as reaching an agreement on the scope of a buyer’s divestiture obligations.

The first question is, if a regulator commences litigation to block the transaction, does the buyer have to defend the deal in the litigation? Some buyers take the view that if a regulator has actually initiated litigation, the prospects of getting approval are already not that good, and the litigation process can be costly (both in terms of out-of-pocket expenses and in terms of the buyer’s ongoing relationship with the regulator, which can impact the buyer’s ability to do future transactions). On the other hand, the government does not win every case it initiates so there can be some value for targets to force the buyer to commit to defend the deal in litigation. From an optics perspective, it sends a

---

6 This formulation was used in the Sirius Satellite Radio, Inc./XM Satellite Radio Holdings deal.
7 This formulation was used in the Live Nation, Inc./Ticketmaster Entertainment, Inc. deal.
clear message to the regulators that the parties will not “go gently into that good night” at the first sign of opposition from the regulators, which might help to bring the regulators to the table for a more constructive discussion about divestiture remedies (depending on the regulator and how collaborative or adversarial the regulatory process is).

The second question is, even if a buyer agrees to defend the deal in litigation initiated by a regulator, is the buyer also required to agree to initiate litigation against the regulator? Buyers usually resist this very strongly, especially if they are serial acquirers who need to deal with the regulator at issue on a regular basis in connection with unrelated transactions. In addition, the timing of when to initiate such litigation is fraught with strategy questions on which the parties’ views may not be aligned.

Both of these questions are linked to the issue discussed in Section 7, below, relating to the “drop dead” date of the transaction. Litigation can take a long time. Accordingly, forcing a buyer to initiate litigation against the government is only a valuable right if the buyer cannot terminate the transaction agreement before the issues are fully litigated.

5. Ability to Enter into Other Transactions

Another issue that is often overlooked is whether the buyer should be restricted explicitly from entering into other transactions that could impact that antitrust review of the first transaction. This is particularly an issue if the buyer is a serial acquirer that is already pushing the limits of the market shares that the regulators will accept. In a cash deal, the buyer usually is not required to agree to interim operating covenants that restrict its activities, and it is not clear whether a “reasonable best efforts” standard alone (for example) would preclude a buyer from engaging in other M&A activity during the pendency of the first deal. Even setting aside the potential for worsening perceived overlaps through additional acquisitions, a target might prefer that the buyer commit to limit its other acquisition activities anyway so as to lessen any confusion or distraction that may result from the buyer’s being “in front of” the same regulator with two different transactions at the same time. On the other hand, when the regulatory timeline on a deal is expected to take a long time and the closing remains uncertain, a buyer is likely to resist having to forego other M&A opportunities.

6. Closing Condition
Even after exchanging non-public information, the parties may not fully agree which regulatory approvals should be conditions precedent for the transaction. This issue particularly arises in cross-border transactions involving jurisdictions with new, untested regulatory processes and in jurisdictions in which it is unclear whether the regulatory notification process results in a “clearance” that can be relied on by the parties as a safe harbor from future liability. Even jurisdictions that do not have an obvious material nexus to the transaction (or the parties’ businesses) could impose severe sanctions if the transaction proceeds in violation of the jurisdiction’s laws. Short of providing for staggered closings by which the “unapproved” portion of the transaction is delayed until approval is received (which is usually not an option in public company acquisitions), the parties must decide up front which party will take the risk associated with that jurisdiction.

7. Termination and Drop Dead Dates

Usually parties will have termination rights if it becomes clear that a closing condition is not capable of being satisfied. This determination is not always clear-cut when it comes to assessing the likelihood of receiving regulatory approvals. Accordingly, parties usually agree on a drop dead date. It has become relatively customary for parties to agree that either party can automatically extend the drop dead date if the only condition outstanding (other than those conditions that, by their nature, can only be tested on the closing date) is a regulatory approval condition. A typical extension is two or three months, but the length is a negotiated point that varies from deal to deal.

Related to the question of whether and when the parties can terminate the transaction if the regulatory approvals process has stalled is the question of whether they will continue to bear any liability post-termination for how they pursued those approvals. This too is a negotiated point that varies from deal to deal. Some transaction agreements preserve all liability for pre-closing breaches; other transactions only preserve liability for willful and intentional misconduct. In a complex transaction where the regulatory approval process will require numerous strategic decisions without precedent, a buyer should strongly resist having any residual liability for those decisions if the transaction cannot proceed.

8. Reverse Break Fees and Ticking Fees

Allowing a buyer to “buy its way out” of a contract if it prefers not to undertake remedies imposed in connection with getting the antitrust approvals is one way to bridge the gap
in negotiations over the antitrust risk allocation. It can be an excellent solution in auctions in which the buyer and seller disagree about the quantum of antitrust risk or the seller might take a lower bid that has less perceived antitrust risk. If the buyer believes the seller is overestimating the risk, the buyer can offer to “put its money where its mouth is” by including a reverse break fee that will become payable to the seller immediately if the transaction terminates due to a failure to obtain antitrust approvals when all other closing conditions would otherwise have been satisfied. The size of the fee is a negotiated point. From a target’s perspective, it needs to be high enough to convince the seller that it will be made whole for losing the deal over any antitrust issue. It should also be high enough that, if the buyer has a choice between a divestiture remedy that will allow the deal to proceed or paying the reverse break fee, it will not simply view the reverse break fee as a “free option” to walk away and avoid the unpleasantness of a divestiture. From a buyer’s perspective, it needs to be a reasonable amount that can be funded in the absence of completing the transaction.

Reverse break fees are less useful in transactions where the parties agree about the quantum of antitrust risk but simply disagree as to who should bear that risk. This is more likely to be the case in a negotiated transaction (not an auction) in which the parties have substantially agreed to all of the other key deal terms and accordingly have little leverage over each other with respect to the antitrust risk allocation issues. For this reason, in negotiated transactions, it is wise to raise the issues early on in the transaction and fold them into the larger horse-trading discussion over price and other deal certainty issues.

Ticking fees are often discussed but not often used in practice. Like a reverse break fee, a ticking fee is a fee paid by the buyer. However, unlike a reverse break fee, the target does not have to wait until the transaction is terminated to start collecting its fee. The buyer is required to start paying if the antitrust approvals process takes longer than expected. The theory behind ticking fees is that they help to align a buyer’s incentives with the target’s desire to get through the antitrust approvals process quickly by penalizing the buyer for antitrust-related slippage in the transaction schedule. The buyer can then weigh the costs of proffering a fix-it-first remedy to the regulators at the outset against the costs of the ticking fee. Ticking fees make sense in transactions in which regulatory delays have an unusually adverse impact on the target – whether because they cause the target to forego income generating activities or because the target is being sold as a “locked box” whereby the buyer gets the benefit of any income generated in the period between signing and closing without a further price adjustment. Ticking fees, however, make less sense in transactions in which there is no way for a
buyer to “cure” a regulatory issue by proffering a remedy. In such cases, the ticking fee would merely penalize the buyer for the time it takes a regulator to review the transaction without any ability on the buyer’s part to expedite that process.


The customary provisions that require the parties to cooperate with each other and keep each other updated regarding their respective discussions with regulators rarely get a lot of attention pre-signing, but they can be quite important in practice. For example, if the parties dispute the extent to which a buyer is required to make divestitures in order to obtain transaction approvals, each party will want to ensure that it has a seat at the table for any discussions the other party is having with the regulators regarding divestiture requirements. On the other hand, even in contentious situations, the process-related provisions should not be so restrictive as to cause a foot-fault if a party receives an unscheduled call from a regulator or to prevent a party from responding to requests from a regulator whom the party needs to deal with on a regular basis outside the context of the transaction.

Key process-related provisions include the following: deadlines for making initial filings; requirements that initial filings and subsequent submissions be in substantial compliance with applicable legal requirements; requirements to satisfy any follow-up requests from a regulator promptly; requirements to keep the other party informed about communications with the regulators; and rights to review filings and other information prior to submission.

10. Unsolicited Transaction Issues

Unsolicited bids initially do not give parties the ability to negotiate refined allocations of antitrust risk. However, in their public filings, buyers still have to address the extent to which their bid is conditioned on obtaining regulatory approvals. This disclosure typically appears as a tender offer condition or a disclosure in a proxy filing. Targets often try to use antitrust issues to stymie the buyer’s bid, by telling their shareholders that they have no certainty of closing if they tender their shares to the buyer or give the buyer control of the target’s board. A buyer can stop a target’s negative public relations campaign in its tracks if the buyer is prepared to offer up a fix-it-first remedy for any serious antitrust issue. If the buyer is not willing to offer up a remedy immediately, a buyer still has a few advantages. First, a buyer has a “first mover” advantage in that it can frame the antitrust issues in its favor in its early discussions with the regulators.
before the target has even had an opportunity to file its notification form. Second, a buyer has the advantage of driving the timing of the bid, and can delay or accelerate its strategy in response to regulatory developments without the need for the target's approval.

Hostile bids often become friendly transactions once the parties agree on a price, so the target has to be careful not to be too negative about the buyer’s prospects. A target also needs to consider whether to enter into a joint defense agreement with the bidder notwithstanding that it is otherwise opposing the transaction. Meanwhile, a buyer needs to be careful not to be too quick to offer up publicly a remedy that it might otherwise be able to keep in its back pocket if the transaction becomes a friendly deal.

*    *    *

Complex M&A transactions can raise complex antitrust issues for the parties and regulators alike, particularly in sectors that have already experienced significant consolidation. Fortunately, not all antitrust risk allocation issues are binary decisions. There are many recognized approaches that parties can use to share these risks.

For more on antitrust issues in M&A deals, see Corporate Acquisitions and Mergers, Part IV, Chapters 6 thru 22 (Matthew Bender & Co., Inc. 2012)
Special Committee in going private transactions, 2012 Emerging Issues 6205
Corrupt Practices Act in M&A Transactions, 2012 Emerging Issues 6206

Click here for more Emerging Issues Analyses related to this Area of Law.

About the Authors. Frank Aquila is the co-head of Sullivan & Cromwell LLP’s global corporate practice. Mr. Aquila has a broad multidisciplinary practice that includes extensive experience in negotiated and unsolicited mergers and acquisitions; complex cross-border transactions; global joint ventures; private equity transactions; and corporate governance matters. Mr. Aquila was named a “Dealmaker of the Year” by The American Lawyer in 2009, received the 2010 Atlas Award as the Global M&A Lawyer of the Year and was named by the National Association of Corporate Directors (NACD) to their “Directorship 100” – one of the 100 most influential people in corporate governance and inside the boardroom. He is also a two-time winner of the Burton Award for Legal Achievement (2005 and 2010). In 2009 Mr. Aquila was selected by the American Bar Association as a “Legal Rebel” – one of the profession’s 50 leading innovators.
Frank Aquila and Melissa Sawyer on
Speed Reading: Top 10 Ways to Address Antitrust Risk in M&A Transactions

Melissa Sawyer is a partner in the Sullivan & Cromwell LLP Mergers & Acquisitions Group. Ms. Sawyer is also a member of the Adjunct Faculty of Columbia Law School. Her practice has focused on a variety of corporate, M&A and private equity matters in the U.S. and abroad. Ms. Sawyer was featured in "The Facebook of Wall Street's Future" (New York Times, October 3, 2007) as one of Wall Street's "next generation of deal makers." She received her B.A. degree from Washington & Lee University and her J.D. degree from the University of Virginia Law School.

Emerging Issues Analysis is the title of this LexisNexis® publication. All information provided in this publication is provided for educational purposes. For legal advice applicable to the facts of your particular situation, you should obtain the services of a qualified attorney licensed to practice law in your state.