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Antitrust Risk Allocation in Merger Agreements: Anticipating and Managing Risks of Deal Delay or Non-Completion

Negotiating Divestiture, Hell or High Water, and Reverse Breakup Fee Provisions; Navigating Interplay With Non-Antitrust Risk-Shifting Clauses

TUESDAY, JULY 29, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Stafford Live CLE Webinars
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Introduction

- Our Panel:
  - Mark J. Botti — Partner and Co-Lead of Global Antitrust and Competition Practice, Squire Patton Boggs (US) LLP
  - Keith A. Pagnani — Partner, Sullivan & Cromwell LLP
  - Melissa Sawyer — Partner, Sullivan & Cromwell LLP
- Today's Program:
  - Commonly negotiated antitrust risk-shifting provisions
  - Legal implications of including risk-shifting provisions in merger agreement when dealing with antitrust enforcement agencies
  - Coordinating antitrust risk-shifting provisions with other clauses in the merger agreement

Level Set: Understanding the Law

- Section 7 of the Clayton Act essentially prohibits transactions that:
  - May substantially lessen competition or create a monopoly
    - In any line of commerce (product market)
    - In any part of the country (geographic market)
  - Focus tends to be on:
    - Identifiable set of customers
    - Ability to increase prices, reduce product or service quality, reduce rate of technological innovation or product improvement, and possibly reduce product diversity
    - Horizontal effects v. vertical effects

Level Set: Understanding the HSR Process

- When do you file?
- Early termination
- Second requests
- Timing agreements
- DOJ litigation

Importance of Assessing Substantive Antitrust Risk Early

- Bid strategy implications
  - Competitive auctions
  - PE v. strategic bidders
- Pricing implications
  - Factoring in costs of remedies
- Closing certainty implications

Overview of Drafting/Negotiating Strategy

- Benefits of being explicit v. being intentionally vague
- Specifying:
  - What must be done
    - Proposing remedies
    - Agreeing to remedies
    - Litigation
  - What must NOT be done
    - Protecting certain assets
    - Protecting the financial parameters of the transaction
      - Material Adverse Effects

Contract Provisions: Efforts Commitments

- General standard of efforts
  - A range of commitment levels (listed below in descending order):
    - All actions required (often called a "hell or high water" provision)
    - Best efforts
    - Reasonable best efforts
    - Reasonable efforts
    - Commercially reasonable efforts
    - Good faith efforts
  - Do these terms of art have meaningful distinctions?
    - State common law

Contract Provisions: Efforts Commitments

Continued

- General standard of efforts (*cont'd*)
  - Practice pointer
    - Draft should properly qualify general standard of efforts (i.e., the default rule) by all relevant exceptions
    - Draft should be clear about whether general standard of efforts contained in the regulatory approvals section applies to other obligations under the agreement
      - Apollo Tyre/Cooper dispute regarding applicability of general standard of efforts contained in approvals covenant to obligation to obtain union consents

Illustrative Example: Efforts Commitments

Continued

- Universal Health Services/Psychiatric Solutions (2010)
  - Acute inpatient psychiatric services; deal value $3.1 billion
  - "[T]ake any and all steps necessary to avoid . . . each and every impediment under any antitrust . . . Law that may be asserted by any Governmental Authority or any other party so as to enable the parties hereto to consummate the Transactions, and in any event prior to the Termination Date, including . . . divestiture . . . . In addition, Parent shall defend through litigation on the merits any claim asserted in court by any party in order to avoid entry of, or to have vacated or terminated, any decree, order or judgment (whether preliminary or permanent) that would prevent the Closing prior to the Termination Date."

Illustrative Example: Efforts Commitments

Continued

- WellPoint/Amerigroup (2012)
  - Managed Medicaid Plans; deal value $4.5 billion
  - Use "reasonable best efforts," defined to include "all actions necessary to avoid each and every impediment under any . . . Antitrust Law. . . ."

Contract Provisions: Divestiture Commitments

- Obligation to divest and take other actions
  - Who is required to take the actions?
    - Typically the buyer is required to agree to take the actions, and the target is required to agree to the actions approved by the buyer as long as they would not take effect pre-closing
  - When must the actions be accepted?
    - To avoid litigation by the DOJ v. at any time prior to the outside date (i.e., after DOJ litigation has commenced)
  - When must the actions be completed?
    - Fix-it-first v. consent decree
  - Types of actions that must be taken
    - Divestitures, hold separate, other

Contract Provisions: Divestiture Commitments

Continued

- Obligation to divest and take other actions (continued)
  - Challenges of divestitures
    - Finding a buyer
      - Needs to be a viable competitor
      - How much transitional support will the buyer need to operate the assets? Will the divesting seller need to kick in additional capital investments to set the buyer up as a stand-alone competitor? Which assets/employees must be included in the divestiture?
    - Getting a good price in a "fire sale" atmosphere

Contract Provisions: Divestiture Commitments

Continued

- Divestiture thresholds ("Burdensome Condition" concept)
  - "Material Adverse Effect" test
    - Example: Divestiture not required it if would have "material adverse effect" when measured against the size of the target
    - In this formulation, the numerator is "material adverse effect" and the denominator is "the size of the target"
    - Not unusual for denominator to be the size of the combined company, or the size of the buyer
  - Other tests
    - Specified reduction in combined company's EBITDA
    - Divestiture of specified assets/business lines
    - Impairment to benefits the buyer expected to derive from the transaction (i.e., synergies)
    - Regulatory settlements consistent with past industry practice (specifying transaction sizes and/or range of dates during which transactions may have occurred)
    - Other

Illustrative Example: Divestiture Commitments

- Boston Scientific/Guidant:

  "[R]equired to agree to Divestitures . . . of . . . assets, including. . . : (a) the vascular intervention and endovascular businesses of the Company; [and] (b) all assets of Parent that relate to cardiac ablation and beating heart surgery products, including, but not limited to, Parent's equity and equity option interests in Endoscopic Technologies Inc., as well as the Company's cardiac ablation and beating heart surgery assets collaterally impacted by the Divestitures. . . ."

Illustrative Example: Divestiture Commitments

- Stericycle/SAMW Acquisitions/Healthcare Waste Solutions:

  "[I]n no event . . . obligated to . . . make any divestiture . . . that, in the reasonable judgment of Buyer, could be expected to limit the right of Buyer . . . to own . . . all or any portion of its or Target's assets other than assets consisting of not more than two facilities of Target, any one of which may be a treatment facility and any of which may be transfer facilities."

Illustrative Example: Divestiture Commitments

Continued

- Universal Health/Psychiatric Solutions:

  "[N]o provision . . . shall require . . . any action that, individually or in the aggregate, would result in a Burdensome Condition. For purposes of this Agreement, a "Burdensome Condition" shall mean . . . (i) . . . sale . . . of any assets . . . or (ii) . . . any limitation on the ability . . . to conduct their respective businesses . . . that, in the case of clause (i) and (ii), would, individually or in the aggregate, reasonably be expected to result in a Behavioral Health Business Material Adverse Effect."

Illustrative Example: Divestiture Commitments

- Express Scripts/Medco:

  "[S]hall agree . . . to (1) the divestiture or disposition of one mail order dispensing facility of Aristotle, . . . (2) the divestiture or disposition of property, plant and equipment associated with specialty pharmacy dispensing or infusion facilities . . . (3) the divestiture . . . [of] Contracts . . . ."

Contract Provisions: Control of Process

- Which party leads communications with DOJ/FTC?
- Which party's counsel leads strategy
  - For example, who decides whether to give the DOJ an extension under a timing agreement?
- Obligation to consult with each other
- Right to attend meetings/participate in substantive calls

Contract Provisions: Obligation to Litigate

Continued

- Express obligation to defend litigation
  - Whether or not litigation has a reasonably prospect of success?
- Cap on obligation to expend funds in response to (1) information requests and/or (2) litigation

Contract Provisions: Restriction on Making Other Acquisitions

Continued

- If acquisition "would be reasonably expected to materially delay" approvals
- If acquisition "would be reasonably expected to materially increase the risk of not obtaining" approvals
- Dollar thresholds
- Business lines/segments

Contract Provisions: Closing Conditions and Termination Rights

Continued

- Outside date
  - Ability to extend to permit regulatory approvals
  - Relationship to obligation to litigate
    - Typical timing of district court and appellate processes
    - Ticking fees
- Closing condition
  - Government litigation is pending or threatened?
    - According to ABA's Deal Points study, only 22% of recent public deals including "threatened"
  - Non-governmental litigation – at issue in relation to antitrust?

Contract Provisions: Reverse Break Fees

Continued

- Size
  - NOT limited to 2-4% common for stockholder vote-related termination fees
  - Antitrust break-up fees are typically in 5-8% of target's equity value range
    - Many studies available on size and frequency of these fees
- Currency (cash v. other form of consideration)
- Practice pointers
  - Whose option?
  - Reconcile relationship to "efforts" covenant and specific performance covenants
  - Sole remedy

Agency Reaction

- Are the contract terms part of the review?
  - Which ones?
- Substantive implications
  - Defining "antitrust risk" – substance and procedure
  - Inferences or admissions?
- Other relevance
  - Negotiating leverage
  - Timing

Agency Reaction

- Putting divestiture commitments in side agreements or schedules v. the merger agreement
  - No public agency challenges to withholding of a side agreement
  - Arguments against production:
    - Privilege issues
    - Unilateral representations

Agency Reaction

- Are side agreements disclose-able?
  - HSR Form, Item 3(d) requires copies of documents which constitute the agreement among the parties to the transaction
  - "Let me be really clear, antitrust side agreements are part of the . . . filings. And you execute them and you don't give it to us, do it at your own peril because we will likely find out about it."
    Antitrust Division, AAG, at an ABA event February 2011
  - "We have learned that some counsel are advising their clients to take 'hell or high water' clauses out of the merger agreement and place them in their joint defense agreement. The parties then presumably withhold the agreement on the basis of attorney-client privilege. This is an unfortunate development. We consider these clauses, which detail the parties' bottom line on divestiture, to be an integral part of the merger agreement, and a necessary part of our antitrust analysis. Dropping them into a joint defense agreement does not change this fact. We are, therefore, adding a specification to our second requests to help us find and get this information."
    Director, Bureau of Enforcement, presentation April 2000

Agency Reaction

- Public disclosure obligations
  - Putting critical obligations in a schedule instead of the body of the merger agreement does not necessarily shield them from disclosure obligations

The Road-Map Question: Illustrations Of Some Outcomes

- Boston Scientific/Guidant
  - Risk shifting provisions described all vascular assets
  - FTC required divestiture of all vascular assets
- Stericycle/SAMW Acquisitions/Healthcare Waste Solutions
  - Divestiture of one transfer facility
  - Risk shifting contemplated up to one transfer and one treatment facility
  - Relief less than Agreement contemplated
- Express Scripts/Medco
  - No divestitures
  - Risk shifting provisions contemplated divestitures

Communications: Before the Deal

- Internal to a party
  - Protecting privileged communications
  - Cognizance of HSR, 4(c) and 4(d) documents
    - Inclusiveness and redactions

Communications: Before the Deal

Continued

- Between the parties
  - Negotiations and due diligence
  - Techniques for exchanging competitively sensitive information
    - Clean rooms
    - Third parties and aggregation
    - Walled off personnel
  - Outside counsel communications
    - Antitrust issue spotting
    - Sharing work product
    - Martin Marietta Materials, Inc. v. Vulcan Materials Co., C.A. no. 7102-CS (Del. Ch. May 4, 2012)

Communications: After the Deal

- Integration planning
  - Gun Jumping 101
  - HSR v. non-HSR context
  - Competition in the interim
- Privilege and work product
- Ordinary course covenants or prior approval clauses for out-of-the-regular course matters

Communications: After the Deal

- Ordinary course covenants
  - Smithfield Foods, Inc./Premium Standard Farms LLC
    - January 21, 2010, $900,000 civil fine
    - 2006-07: 7 month merger review; cleared without challenge
    - During review,
      - Premium required to "carry on its business in the ordinary course consistent with past practice"
      - Smithfield's written consent before entering into certain "material" contracts (defined broadly in the agreement and including certain contracts involving assets or payments in excess of $1 million)
      - For three, multiyear hog contracts for more than 400,000 hogs with a combined price between $57 million and $67 million – Premium Standard provided Smithfield with the proposed contract terms, including purchase price, quantity, and length

Communications: After the Deal

Continued

- Smithfield Foods, Inc./Premium Standard Farms LLC (*cont'd*)
  - The Antitrust Division charged "gun jumping"
    - Premium Standard ceased exercising independent business judgment in "ordinary course of business" hog purchases that were key elements of Premium Standard's ongoing business
    - Division recognized these were "*customary* interim 'conduct of business' provisions."
  - Contracts were "material contracts" but not, the Division alleged, extraordinary business events
    - Hog purchasing was the important competitive overlap under review
      - A "purpose of this waiting period is to preserve the acquired firm as an independent company in case the proposed acquisition is blocked or otherwise not consummated so that the competition that the antitrust laws protect does not suffer."

Communications: After the Deal

Continued

- Smithfield Foods, Inc./Premium Standard Farms LLC (*cont'd*)
  - Lessons
    - Agencies apply their own analysis of what is material and in the ordinary course regardless of what the merger agreement says
    - Eventual approval of the underlying transaction will not immunize unlawful conduct

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