The M&A LAWYER

October 2013 ■ Volume 17 ■ Issue 9

A Practical Approach to Negotiating Confidentiality Agreements in the Corporate Acquisition Context

BY PHILIP RICHTER AND DAVID SHINE

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This article discusses the use of Confidentiality Agreements in connection with the exchange of confidential information as a first step in a possible corporate combination and addresses the negotiation of such an Agreement from the perspective of the target company's legal counsel.[1]

In negotiating a transaction for a change of control, or in which a significant minority investment will be made by a third party, the target company (the "Company") may face conflicting objectives. Once the Company has decided to entertain offers to acquire or invest in the Company, it will be requested to provide potential acquirors or investors ("Bidders") and their representatives with sufficient information regarding the Company to enable the Bidders to make their best offers. However, the release of confidential information to Bidders, many of whom may be direct competitors of the Company, poses obvious dangers to the Company. The Company will seek to minimize these business risks. The Company must also recognize the danger that, after having had the cooperation of the Company in receiving confidential information, the Bidder may be tempted to end-run the Board of Directors of the Company in the negotiating process by either making a public unsolicited proposal (in an attempt to cause stockholders to pressure the Board) or making an unsolicited tender offer directly to the stockholders. The Bidder might thereby attempt to consummate the transaction on terms that would be unobtainable through direct negotiations with the Company's Board.

The "Confidentiality Agreement" is a contractual device used to reconcile these

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One Year Subscription ■ 10 Issues ■ $644.73
(ISSN#: 1093-3255)

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From the EDITOR

No Shutdown for M&A Antitrust Cases

The Department of Justice's pending lawsuit seeking to prevent the merger of American Airlines and U.S. Airways (which was still underway at presstime despite the ongoing federal government shutdown) remains one of the most-watched events in the M&A world, but the federal antitrust agencies are also busy this fall with a few other cases that also merit observation.

For instance, take the ongoing DOJ challenge to the merger of Bazaarvoice and Power Reviews (the *M&A Lawyer* examined the case in February, in an article by Jones Day's Kathryn Fenton and Elizabeth O'Neill: "It's Not Over Until It's Over: U.S. DOJ Challenge to Consummated, Non-Reportable Transaction Highlights Danger of Bad Documents"). The trial began in federal district court in San Francisco in late September. As with the American/US Airways case, the DOJ's complaint quotes from documents obtained from the parties. As Fenton and O'Neill noted at the time, the government is using the quotes to bolster allegations that the purpose of the acquisition was to eliminate Bazaarvoice's sole competitor. The defendants argue that the documents are irrelevant because the level of competition has not diminished since the deal closed.

The government shutdown also, as of presstime, had not delayed the FTC's case against Ardagh Group and Saint-Gobain Containers was set to be heard in federal district court later in October. Here the FTC is challenging the proposed merger of two glass bottle manufacturers, alleging that the deal will greatly reduce competition in that sector, as the merged firm and its rival Owens-Illinois would now control more than 75% of the U.S. market for glass containers "for beer and spirits." Ireland's Ardagh said it would address the FTC's concerns by divesting itself of four of its U.S. glass manufacturing plants, but a judge in late September ruled that Ardagh cannot introduce at trial any evidence relating to this proposal, which she said had been offered too late.

There's also the FTC's challenge to the proposed merger of St. Luke's Health System and Saltzer Medical Group, which is being tried in the federal district court in Idaho. The FTC is looking to follow up on two recent victorious challenges to hospital mergers this year. Here, the FTC alleges that the merger will give St. Luke's an 80% share of primary care physicians in its location of Nampa, ID. As Davis Polk & Wardwell attorneys wrote, in an brief examination of the case, "the defendants argue that the relevant geographic market is larger than Nampa and that the merged firm intends to invest $200 million in a new electronic medical records system. The FTC's record in challenging hospital mergers has been decidedly mixed over the past decade or so, although it has prevailed in its two most recent challenges."

As lawyers noted, these are just the cases currently going to trial: the FTC and the DOJ could unveil further challenges of prospective mergers in the waning months of 2013.

CHRIS O'LEARY
MANAGING EDITOR

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objectives by permitting the Company to provide confidential information to a Bidder while protecting it from the risks of misuse of such information by the Bidder. The Confidentiality Agreement typically contains confidentiality provisions to protect the Company against the business risks of disclosure or misuse of information by competitors, as well as provisions that govern a Bidder's conduct to ensure a competitive sale process. The Confidentiality Agreement may also contain (in the public company context) standstill provisions to protect the Company against unsolicited takeover attempts by Bidders and provide for an orderly marketing process.

A Word of Caution

This article describes various approaches to the negotiation of a hypothetical Confidentiality Agreement by the Company. Although Confidentiality Agreements have become relatively standardized, there are still variations between forms. In addition, there are always a multitude of specific facts and circumstances that makes each negotiation unique. Therefore, any of the arguments described herein may be made either more or less relevant by the circumstances of the particular negotiation and the relative significance attached to individual bargaining points by the specific parties. There are also an infinite number of other points that may be appropriate to any particular negotiation.

General Practice Pointers

The process of negotiating the terms of a Confidentiality Agreement on behalf of the Company can be complex, particularly when, as is common, negotiations with a multiple interested Bidders are occurring simultaneously. In this regard, it is very helpful to establish ground rules at the outset, and to make sure that the Company and its financial advisors are aware of and in agreement with these ground rules.

A first rule of thumb is that the negotiations should be conducted by a small number of people (one individual, if possible) in order to ensure uniformity in the extent and types of concessions granted to Bidders. The initial form of agreement, which is disseminated by the financial advisors to potential Bidders, is typically prepared by the Company's outside counsel, who conducts the negotiations of the agreement with the Bidders. Generally, the Company must approve all substantive variations on the form of agreement.

A frequent question is the extent to which the Company is required to grant a particular concession to all Bidders once it has been granted to one Bidder. Generally, unless a Bidder has negotiated "most-favored nation" status (see "Most Favored Nation Status" below)—something that a Company will strongly resist—the Company has no obligation to go back to Bidders who have already signed agreements and offer to amend their terms.

On the other hand, the Company may have trouble justifying its refusal to grant a concession to future Bidders who demand it, once the Company has agreed to the concession for another Bidder. Generally, if the Company can justify such discrimination on the grounds of special facts or circumstances that made the concession more appropriate for one Bidder than the others, then the Company should be entitled to discriminate. Also, as a negotiating tactic, Company's counsel may resist making the concession until a Bidder indicates (credibly) that without it Bidder will not sign the agreement. However, if the negotiations do reach that point, the Board must be able to justify to shareholders a negotiating position that excluded a potential Bidder when the Board was willing to make the same concession to another Bidder. If the Company ultimately enters into an acquisition agreement, then the Board's actions may be scrutinized by a court to determine whether the Board acted in good faith to maximize shareholder value in the sale of the Company. This has been interpreted to include an obligation that the board maintain a "level playing field" when entertaining bids from more than one Bidder. Although some departures from the concept of "level playing field" may be supportable by the Board (*e.g.*, withholding pricing information from a competitor due to anti-trust concerns) such departures should be avoided whenever possible.[2]

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Limited Purpose

The Confidentiality Agreement should specify its limited purpose: that is, to assist the Bidder and its "Representatives" (as defined below) in connection with the evaluation of a "possible negotiated transaction" (or "acquisition," if the form of transaction is limited to that) with the Company. The transaction is often described as a "possible" transaction in order to avoid implying that there is an agreement in principle for such a transaction created by reason of the Confidentiality Agreement itself or that the Company is committed to engaging in any transaction. The transaction is also often described as a "negotiated" transaction in order to reinforce the concepts that (i) it would be a breach of the Confidentiality Agreement if, after receipt of confidential information, a Bidder made a hostile bid and (ii) the Company's purpose in entering into the Agreement, is to facilitate a process which it controls.

The Confidentiality Agreement often specifies that the confidential material furnished to the Bidder will not be used in any way that is detrimental to the Company. The Bidder may object that this language is overly broad, since the Bidder should be entitled to use negative confidential information it receives to reduce its bid, seek additional legal protections or withdraw from the process, all of which may be "detrimental" to the Company. One way for the Company to address this issue is to provide an express and limited exception that would allow the Bidder to use confidential information for these types of "detrimental" purposes, but not others.

The Delaware Court of Chancery's recent decision in *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*[3] demonstrates that a failure to clearly define the permitted use of confidential information could create an implied standstill, effectively prohibiting the Bidder from pursuing a hostile deal while the Confidentiality Agreement is in effect. The Court determined that Martin Marietta, the bidder, breached its confidentiality agreement with Vulcan, the target company when it initiated a hostile bid for Vulcan using confidential information. The agreement permitted Martin Marietta to use confidential information "solely for the purpose of evaluating the Transaction," which was defined as "a possible business combination transaction" between the parties. The Court ruled that the language of the confidentiality agreement was not clear, and that, based on extrinsic evidence, the parties intended the confidential information to be used solely for a *consensual* transaction. To remedy the breach, Martin Marietta was enjoined from taking any actions to advance its hostile takeover for a period of four months.

Representatives

In the process of negotiating a possible transaction with the Company, the Bidder and its financial and legal advisors need access to various types of information. The Confidentiality Agreement typically imposes confidentiality obligations on the Bidder and on its directors, officers, employees, agents and advisors (including attorneys, accountants, consultants, bankers and financial advisors, collectively referred to as "Representatives") who have a "need to know" and are provided with such information. In addition, certain Bidders may wish to share the confidential information with their potential sources of debt or equity financing (or potential acquirors of a portion of the Company's business from the Bidder in connection with or after the completion of an acquisition by a Bidder), and therefore include such financing sources (or potential acquirors of a portion of the Company's business from the Bidder) in the definition of "Representatives." The definition of "Representatives" may also be expanded to include the Representatives of a Bidder's affiliates and potential financial sources (and potential acquirors).

The Company will ask that the Bidder agree that it will be liable for any breach of the Confidentiality Agreement by any of its Representatives. However, Bidders may desire to avoid the applicability of certain provisions of the Confidentiality Agreement (such as non-solicit and standstill provisions) to Representatives that are its third party advisors (such as investment banks, attorneys and accountants) and financing sources.

If there is a possibility that any Representative (such as an investment banker) may also or al-

ternatively act as a principal in the transaction, or if the Bidder will not take responsibility for any breach of the Agreement by its Representatives, the Company may seek separate execution of Confidentiality Agreements by the Representatives (or make it an obligation of the Bidder that such Representatives agree in writing to be bound by the Confidentiality Agreement on the same terms as the Bidder (with the Company as an express third-party beneficiary) before the Bidder provides confidential information to such Representatives).

Protecting Confidential Information

Types of Information

The types of information in which a Bidder will be interested may include financial, technical, and "human resource" information. Each type of information has differing characteristics and the relative importance of each type of information to the Company and Bidder will shape the context of the negotiations. For example, financial information such as projections typically has a short "shelf life" of usefulness. On the other hand, technical information, such as manufacturing techniques, may have an indefinite shelf life and may be easily exploitable by competitors.

Financial Information

The Bidder and its Representatives generally need confidential financial information regarding the Company, including both historical financial information (particularly for non-public companies) and financial projections. In addition, the Bidder may want detailed business information, including pricing information and information on individual units (*e.g.* stores, factories or divisions) of the Company. The Company and its advisors must be sensitive to anti-trust concerns if it intends to provide pricing and market information to any competitors of the Company.

While U.S. and international antitrust laws recognize that companies contemplating a transaction have a legitimate need to exchange information, the exchange of "competitively sensitive" information among parties that are competitors raises antitrust sensitivities (and potentially concerns) under such laws. What constitutes competitively sensitive information will vary from case to case, but customer pricing and bidding information are often among the most sensitive materials. Accordingly, in transactions involving competitors, pre-merger information exchanges should be conducted subject to appropriate antitrust guidelines. The parties should consult with antitrust counsel before exchanging any confidential business information, and antitrust counsel should review potentially competitively sensitive materials before the parties exchange them. Upon advice of counsel, some materials may need to be withheld, redacted, and/or distributed to only a limited group of individuals (*e.g.*, "clean team"). Failure to comply with the antitrust obligations concerning due diligence activities could result in the imposition of significant penalties and potential delay in obtaining antitrust approvals of a transaction.

Technical Information

In the category of technical information, issues may arise with regard to the scope of detailed information to be provided to Bidders that are competitors of the Company. A competitor may request that confidential technical information be excluded from the information being provided, and may seek to have access only to information deemed "non-confidential" in order to avoid any possible future claim of misuse of the Company's proprietary information. While theoretically this solves the problem of giving a competitor access to sensitive information, in reality it is difficult to implement, particularly if the Bidder is permitted to conduct interviews with Company employees. It is therefore preferable from the Company's point of view to bind the competitor under a more restrictive Confidentiality Agreement (which could limit the competitor's ability to actually receive sensitive information, but instead require that such information be shares only with an outside third party). Similarly, the Bidder will sometimes request that the Company identify, by marking as "confidential," the written documents it seeks to protect. The Bidder may

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also request that oral discussions be reduced to writing in order to be protectable. This obviously shifts the burden to the Company. The Company may point out in response that these provisions would inhibit full and frank discussions between Bidder and the Company's employees. For example, the Company would need to have witnesses (and possibly recordings) for each interview with its employees in order to monitor and transcribe the information given to Bidder.

The Company may be prohibited from disclosing confidential technical information by restrictions under existing contractual relationships of the Company (such as classified government contracts or contracts governing joint research and development ventures or other collaborative efforts). The Company's investment advisors should be sensitive to the existence of any such restrictions in preparing "selling books" or other documents containing Company information.

Access to Employees

The Bidder may seek access to the Company's "human resources" through interviews with management and other key personnel. Although the Confidentiality Agreement may attempt to limit the information which may be given to the Bidder, employees of the Company may respond to the Bidder's questions and unintentionally disclose restricted information. It is therefore good practice to require that all contacts be made through one source (usually, the Company's investment banker) in order to ensure that only certain employees are interviewed and that those employees are properly briefed, if necessary. This approach also limits operational disruptions during the acquisition process.

Additionally, the Company may have concerns about "raiding" by the Bidder of its important employees, particularly at a time when the employees are likely to be concerned about corporate stability. To address this concern, the Confidentiality Agreement typically will contain a provision prohibiting the Bidder from soliciting or employing the Company's key employees.

Definition of Confidential Information and Exceptions

The materials furnished to the Bidder should be defined in a manner appropriate to the nature of the Company's business, as well as to the type of transaction being contemplated. The "Evaluation Material" or "Confidential Information" may be broadly defined as any information, written or oral, provided by the Company to the Bidder, or may be defined in greater detail. The definition should also be broad enough to cover summaries and abstracts of the information prepared by Bidder and its Representatives.

Note that the definition of confidential information is typically a subtractive process, *i.e.*, all information is defined as "Evaluation Material" and then specific exceptions are added to exclude information which is not, in fact, proprietary to the Company.

Required Disclosures of Confidential Information

The Confidentiality Agreement will not protect the Company from disclosures which are mandated by legal proceedings. Therefore, it is usual for the Confidentiality Agreement to provide that in the event the Bidder and/or its Representatives must disclose confidential information of the Company, prior notice must be given to the Company so that it can, if appropriate, attempt to protect itself from such disclosure. Further, the Bidder should be asked to agree that it will provide only the minimum amount of information necessary to satisfy the legal mandate (preferably, as determined by its legal counsel in a written opinion).

Record Keeping

The Confidentiality Agreement will typically include a provision requiring the Bidder and its Representatives to return all materials upon the Company's request, and to return the materials immediately if the Bidder decides not to proceed with a transaction with the Company. In lieu of returning the materials, the Bidder may be permitted to destroy such materials if the Bidder furnishes an officer's certificate or other written

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confirmation of such destruction. Bidders will also be required to destroy all electronic copies of confidential information. A Bidder may attempt to limit its obligation to return or destroy confidential information to circumstances where it received instruction from the Company to do so. In such a case, the Company (or its investment bank) should send written notices to each Bidder instructing them to return or destroy confidential information at the appropriate time in the sale process (and requesting that each Bidder confirm that it has done so).

A Bidder will frequently want to keep copies of the materials for its and its Representatives' record keeping and internal compliance purposes. In addition, a Bidder may seek an exception to the obligation to destroy electronic copies of confidential information for information that is contained in automated back-up tapes or other media. In such cases, the Company may seek to provide for proper controls to be established (*e.g.*, by requiring that such copies shall be maintained in the Bidder's legal department for compliance purposes only, or, in the case of electronic backups, not be readily accessible by the Bidder's employees) and that any retained information remains subject to the confidentiality obligations for as long as such information is retained.

Disclosure of Negotiations

The Confidentiality Agreement may prohibit, absent the prior written consent of the Company, disclosure by the Bidder of the fact that the confidential information has been provided or made available, or that discussions or negotiations are taking place concerning a possible transaction. This provision protects the Company's employees, customers, competitors or other potential Bidders from having knowledge of the transaction, which could cause a potential disruption to the business of the Company and the deal process. In addition, if the Company is public, such a disclosure by a Bidder could trigger a request by the exchange upon which the Company's securities trade to make disclosure regarding the process being conducted by the Company. The Bidder may seek a reciprocal provision prohibiting disclosure of negotiations by the Company.

Absent a Company or its insiders selling, or trading in, the Company's securities and absent a tender offer for the Company securities, the existence of active merger negotiations will generally not trigger a public disclosure obligation on the part of the Company.[4] That said, the securities exchange upon which the Company's securities are trading may require to the Company to issue a press release responding to marketplace rumors. In drafting an agreement that will provide the Company with the ability to control the flow of information to the market, the Company must be sensitive to its and the Bidder's disclosure obligations under securities laws and exchange rules.

The Confidentiality Agreement often refers to the fact that confidential information has been provided or made available, or that discussions or negotiations are taking place concerning a possible transaction as "Transaction Information" and subjects such information to disclosure restrictions.

Discussions Among Bidders

The Company will also seek to control the Bidder's ability to discuss the possible transaction with other potential Bidders. Absent this prohibition, a Bidder could reach a secret agreement with another potential Bidder to submit a joint bid. Alternatively, a Bidder may reach an agreement with a third party (who otherwise might itself have been a Bidder) to sell certain assets of the Company after its acquisition by Bidder. Such scenarios could result in the Company's achievement of less than the best possible price, since the Company has lost much of the benefits of competitive bidding.

The likelihood of consummation of a transaction may be affected by the identities of the parties, as particular parties may raise anti-trust issues, financing concerns, and other factors that the Company is entitled to (or even obligated to) consider in evaluating a proposal for a transaction. Likewise, the Company needs to know with whom it is dealing in order to decide what information is appropriate to deliver. The Company may also insist that the Bidder inform the Company if it is approached by another potential Bidder inquiring about the Company.

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Accuracy of Confidential Information

Both the Company and its Representatives are likely to insist upon a disclaimer as to any representation or warranty of the "accuracy or completeness" of the confidential information being provided, and limiting any representations and warranties to those made in a final definitive agreement regarding a transaction, when and if such an agreement is entered into. The Delaware Supreme Court's decision in *RAA Management, LLC v. Savage Sports Holdings, Inc.,*[5] highlights the importance of such language in the context of a broken deal where no definitive agreement is ever executed. Relying on the non-reliance disclaimer in the confidentiality agreement executed by the parties, the Court affirmed the dismissal of the plaintiff/bidder's complaint that the defendant/seller committed fraud by misrepresenting and concealing certain liabilities. The Court explained that the purpose of a confidentiality agreement is to facilitate precontractual negotiations and that non-reliance disclaimers are intended to limit or eliminate liability for misrepresentations during the due diligence process.

Standstill Provisions

Background

In the case of a public company (or, although unusual, potentially in the case of a private company that has a broad shareholder base), the Confidentiality Agreement typically contains "standstill" provisions setting forth the terms under which the Bidder may acquire, vote or dispose of stock of the Company. A standstill facilitates the Company's control of the deal process. Most importantly, the standstill can prevent the Bidder from making a hostile takeover attempt after the parties fail to complete a negotiated deal when the Bidder has had access to the Company's confidential information. The variety and combination of standstill provisions are infinite, depending upon the special circumstances of the parties and their relative bargaining strengths.

Stock Acquisitions and Dispositions

The starting point of negotiations from the point of view of the Company is usually to seek to prohibit all acquisitions of the Company's securities by the Bidder. Sometimes the Bidder may request a "basket" that would permit the Bidder to acquire up to a specified percentage of the Company's stock. The appropriateness of this request depends upon the facts of each case.

For example, a Bidder with separate trading and investment functions may request that other divisions of the Bidder be able to continue trading in Company stock without violating the standstill. For instance, a broker-dealer, mutual fund, pension fund, or other Bidder with ongoing market trading activities may have a separate investment division separated by a so-called "Ethical Wall" to prevent leaks of confidential information. Such "Ethical Wall" exceptions are not unusual, provided the Company can be assured that the Bidder has an effective means to police and enforce the "Ethical Wall."

In any event, the Company will not want the Bidder to acquire more than 5% of the Company's stock, since that would normally trigger the filing of a Schedule 13D with the Securities and Exchange Commission, which in turn would require disclosure of the Bidder's plans and purposes with respect to the Company and the Bidder's contracts with respect to the Company's shares (including the Confidentiality Agreement). This disclosure may put the Company "in play," *i.e.*, create public anticipation of a pending transaction and cause a run-up in the Company's stock.

Note that the Bidder will, in any event, need to be sensitive to the requirements of federal securities laws restricting trading while in the possession of material inside information. Broker-dealers use "restricted lists" in order to avoid having trading personnel soliciting orders while investment banking personnel are in possession of inside information. If the Bidder already owns a substantial block of the Company's securities, the Company may wish to restrict the disposition of that block since dispositions to a party not covered by a standstill agreement with the Company could destabilize the process through which the Company is soliciting bids.

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Proxy Solicitations

The Company will typically also seek to prevent Bidders from attempting to acquire control of the Company through a proxy contest. Since the law concerning proxy solicitation is extremely fact specific, the Confidentiality Agreement may attempt to approach the subject in several ways: (i) by prohibiting "solicitations" of "proxies"; (ii) by prohibiting participation in a "group" or ; (iii) by prohibiting other action seeking to control or influence the management of the Company.

Timing of Proposals

The Company will typically seek to restrict the ability of the Bidder to make proposals concerning the types of transactions discussed above, as well as concerning transactions that by their nature could only be effected with the cooperation of the Company, such as mergers, recapitalizations and asset sales. Although the Bidder may question what interests of the Company are advanced by prohibiting the making of proposals without the Company's consent, this is, in fact, one of the most critical aspects of a standstill in the context of an auction process for a public company. A variety of factors could force the Company to make a public disclosure of any proposal it receives concerning a change-in-control transaction (*e.g.*, (i) previous disclosures of the Company may become misleading without such disclosure if the Company has not followed a strict "no comment" policy in the past or (ii) the Company may feel obligated to make an announcement if there is a sudden increase in market activity based on rumors).

Moreover, control over proposals gives the Company control over the auction process itself. The Company, through its financial advisors, will often circulate bidding guidelines governing the substance, timing and manner of submission of proposals. These guidelines enable the Company to maximize the competition among Bidders and thereby, hopefully, maximize the value of the bids. For example, setting a fixed deadline for bids may help neutralize any timing advantage enjoyed by one Bidder over another. These guidelines also can help ensure that the Company receives sufficient information with the bids to allow for their evaluation. The bidding guidelines can then provide that only bids which are submitted in accordance with the guidelines are deemed to be approved for purposes of compliance with the Confidentiality Agreement.[6]

Restrictions on Requests for Waivers

The restrictions on proposals are most effective when coupled with a provision in which the Bidder agrees not to request any waivers or amendments of the standstill. These "don't ask, don't waive" provisions are intended to prevent a Bidder from getting around the purpose of the standstill by requesting the ability to "make a compelling offer." A waiver request framed in those terms may put a board in a position where it feels compelled to grant the waiver in order to satisfy its fiduciary duties regarding maximization of shareholder value. Two recent bench rulings from the Delaware Court of Chancery confirm that care should be taken when employing "don't ask, don't waive" provisions and the importance that the board of directors be fully informed regarding the power of a "don't ask, don't waive" provision and the potential consequences of its use. In a November 2012 ruling on a motion to enjoin the acquisition of Complete Genomics, Inc. by BGI-Shenzhen, the Court ruled that the standstill agreement executed between the bidder and the target impermissibly limited the target board's statutory and fiduciary obligations.[7] Two weeks later, the Court clarified that "don't ask, don't waive" provisions are not per se illegal in Delaware and, accordingly, may continue to be used under the right circumstances and with the right process checks.[8] If these provisions are included in the Confidentiality Agreement, the target board should revisit the appropriateness of maintaining them (and the desirability of waiving them) during the various stages of the sale process.

Including an exception to the standstill that allows a Bidder to make a confidential proposal to the Company's Board once a change of control transaction has been publicly announced by the Company should address the concerns of the court with respect to "don't ask, don't waive" provisions.

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Most-Favored Nation Clauses

A Bidder may sometimes request "most favored nation" status, that is, the right to get any preferential concessions granted to any other Bidder, with respect to, in particular, standstill provisions. The Company, on the other hand, can assert its need to respond flexibly to Bidders depending upon their individual circumstances. For example, if a Bidder already has commenced a tender offer for the Company, or the Bidder already has a significant block of the Company's securities, the Bidder may argue that it is entitled to special considerations in the negotiation of the standstill provisions. Additionally, if the Company agrees with one Bidder to a Confidentiality Agreement that contains an exception to the standstill for that Bidder's existing tender offer, the Company arguably should not have to agree to waive its standstill with another Bidder merely because that other Bidder had obtained a most favored nation clause. For this reason, the Company will typically strongly resist all requests for most-favored nation status.

Miscellaneous Other Provisions

Acknowledgment of Prohibition Against Insider Trading

The Company may ask the Bidder to acknowledge its responsibilities in connection with federal and state securities laws prohibiting insider trading.

Note that the federal securities laws are not a substitute for a standstill provision in the Confidentiality Agreement. Under the federal securities laws, a Bidder could purchase or sell securities of the Company so long as the Bidder disclosed the material non-public information in its possession as part of the transaction. Also, not all confidential information that is obtained by Bidder will be material to the public. For example, Company projections may well be considered material to the public and, indeed, it is increasingly common for Bidder, if its bid is accepted, to include a summary of the projections in its disclosure to the Company's shareholders. On the other hand, technical information, or financial information about individual units of the Company, may or may not be considered material (see "Disclosure of Negotiations" above).

No Definitive Agreement/Freedom to Change Process

Bidders are often requested to acknowledge that no obligations are incurred in connection with the possible transaction with the Company unless and until the parties sign a final definitive agreement and to waive, in advance, any claims in connection with such transaction until a definitive agreement is executed. In addition, the Company may seek from the outset to put Bidders on notice that any procedures established by the Company for submission of proposals for consideration by the Company may be terminated or changed without notice.

Data Site Provision

The Confidentiality Agreement may also provide that the terms of the Agreement supersede any of the boilerplate language that is customarily included in offering memoranda and when logging on to an electronic data room. This provision may also specify how the Bidder and its Representatives may access the data room, *i.e.*, only during the normal course of business and only while complying with the terms of such data site. Additionally, the Company may insist that the Bidder maintain a list of those persons with access to the data site in order to monitor who may have access to the Company's confidential information.

Enforcement of the Confidentiality Agreement

Equitable Relief/Specific Performance

The amount of monetary damages resulting from the public disclosure or use by a competitor of confidential information may be extremely difficult to ascertain. Further, monetary damages to the Company resulting from the violation of standstill provisions would be expected to be inadequate since these provisions are intended to pre-

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vent transactions that may be difficult to reverse once consummated. Accordingly, Confidentiality Agreements typically contain a paragraph stating that the parties agree that equitable relief (including specific performance) is an appropriate remedy for breach of the Agreement by the Bidder. On the other hand, specific performance is always at the discretion of the court. The principal effect of this clause, if any, is therefore to attempt to estop Bidder from arguing to the court that specific performance is inappropriate. Note that Bidders sometimes object on the ground that the matter should be left to the equitable discretion of the courts.

Jurisdiction

The Company may wish to designate a particular jurisdiction for convenience in the event of any actions or other proceedings arising out of the Agreement. This may be particularly important when dealing with foreign Bidders. The Company may also seek to provide for indemnification in the event of any litigation regarding or arising from the Agreement. In addition, the Company may seek to clarify that a broad variety of persons (*e.g.*, directors, officers, stockholders and, especially, the Company's financial advisors) may have interests in the enforcement of the Confidentiality Agreement (particularly the exculpation clauses), and therefore the Company may seek to make such persons explicit third party beneficiaries.

Survival of the Confidentiality Agreement

There are a variety of approaches to the issue of whether the Confidentiality Agreement should set forth a specific term of its duration, should be silent as to its term, or should specify that some provisions survive negotiations while others do not. As discussed above, the standstill and non-solicitation provisions will typically specify a term for which the Bidder will be subject to restrictions. Other provisions, such as the obligation to keep records of confidential information, may be perpetual or may expire after a stated number of years or upon a stated event.

The Company may be able to make a persuasive argument that certain proprietary information, *e.g.*, "know-how" or "trade secrets," has an indefinite life and remains proprietary until it is disclosed. So long as the information is proprietary, the Company may argue that Bidder should be prevented from disclosing or misusing it. Alternatively stated, it does not make sense to pick an arbitrary period of time after which the Bidder is permitted to disclose the Company's proprietary information if, in fact, the information is still proprietary and valuable to the Company at that time. However, the Bidder may counter that such proprietary information is subject to rapid supercessions particularly in a "high-tech" industry. In such a case, Bidders may request that the Company notify them before providing such proprietary information, and that such proprietary information be labeled as such.

In attempting to limit the duration of the entire Agreement, the Bidder may argue that the Agreement should expire if the Company enters into an Agreement for a transaction with another Bidder or with itself. The Company can point out in response that if a transaction is consummated with another Bidder, that Bidder (*i.e.*, the Company's new owner) will want other Bidders to be prohibited from misuse of the Company's confidential information. If the transaction is with the Bidder who is seeking a limited duration of the Confidentiality Agreement, the Company can point out that the definitive agreement between the Company and that Bidder can supersede restrictions in the Confidentiality Agreement, to the extent appropriate.

Negotiations in the Context of Hostile Offers

The process of negotiating Confidentiality Agreements in the context of an auction for a public company is complicated when there is an existing hostile tender offer by a Bidder who is not participating in the auction. The Bidder will typically litigate against the Company's rejection of its offer. In addition, the Company's stockholders often bring derivative suits against the Company's board of directors challenging its actions. Both the hostile Bidder and the shareholders may argue in court that the board has a duty to make

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available to the Bidder the same information that is made available to the other auction participants, in order to enable the hostile Bidder to present its best price.[9] Both the hostile Bidder and the shareholders may also argue that it is inappropriate for the Company to impose restrictions on the hostile Bidder that are more onerous than those imposed upon other auction participants. In this context, the Company must remember that any concession it makes when negotiating a Confidentiality Agreement with a friendly Bidder may ultimately be required to be made in the Confidentiality Agreement with the hostile Bidder. The hostile Bidder therefore effectively may have most favored nations status.

Moreover, both the hostile Bidder and shareholders may argue that the Company should impose extremely limited, if any, standstill restrictions on the Bidder as a condition of receiving the information. The hostile Bidder can differentiate itself from the others in that it has already expended considerable time and money in putting an offer on the table for the shareholders to accept. The Company may have difficulty arguing that the Bidder should be forced to withdraw that offer in order to see if it can better it.

NOTES

1. For a discussion of other possible uses of Confidentiality Agreements, *see* Fleischer and Sussman, *Takeover Defense: Mergers and Acquisitions*, Ch. VIII.D. (Wolters Kluwer) (2012) (hereinafter cited as *Takeover Defense*).
2. *Takeover Defense*, Ch. 14.
3. C.A. No. 7102-CS (Del. Ch. 2012).
4. See *Levie v. Sears Roebuck & Co.*, 676 F. Supp. 2d 680 (2009).
5. Del., No. 577, 2011 (2012).
6. For sample bidding guidelines, see *Takeover Defense*, Exhibits 82, 82A, 82 B, 82C and 82D.
7. *In re Complete Genomics, Inc. Shareholder Litigation*, C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012).
8. *In re: Ancestry.com Inc. Shareholder Litigation*, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012).
9. See generally *Takeover Defense*, Ch. 14 for a discussion of the "level playing field doctrine" when selling a company.

Risky Business: Recent Trends in Contractual Provisions Allocating Antitrust Risk

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How should parties to a transaction address potential antitrust risk? The growing scrutiny by U.S. antitrust regulators and by competition authorities around the globe has, in recent years, heightened parties' concerns relating to antitrust risk in M&A deals. As a result, parties have increasingly had to focus on contractual means of either mitigating antitrust risk or allocating it between the parties. M&A lawyers employ several tools to accomplish these goals, such as divestiture limits, which cap the total value of assets potentially to be divested in order to pass antitrust muster, drop dead dates, material adverse change clauses, which authorize the parties (usually the buyer) to terminate the agreement if something occurs that materially affects the value of the deal, or by offering to pay the antitrust and regulatory fees and expenses of the other party. This Article focuses on two risk allocation mechanisms antitrust-related efforts clauses and reverse termination fees ("RTF"). Antitrust efforts clauses are currently more common than antitrust RTF provisions, but both are used as a way to address the uncertainty and risk associated with antitrust review. Here, we examine some recent transactions to analyze how these tools have been employed. In the case of the best efforts clauses, we look to recent court decisions interpreting "best efforts"

provisions and examine whether these clauses actually provide the buyer with the protection it seeks. Although there is some uniformity in how the courts tend to interpret this language, the variation should be enough to provide some pause to an M&A lawyer who believes that a particular efforts clause unequivocally captures the will of his or her client. We also provide examples of recent antitrust RTFs to provide a snapshot of current market trends.

Efforts clauses can come in many forms: "best efforts," "reasonable best efforts," "commercially reasonable efforts," etc. These clauses require one or both of the parties to undertake certain levels of effort to accomplish some task the parties deem important to the overall successful execution of the agreement. These clauses can implicate antitrust laws generally—by requiring that the parties take efforts to bring about the closing of the deal—or directly—by making reference to specific antitrust hurdles that either or both of the parties agree to try to overcome, or both.[1] Unfortunately, there is little case law evaluating efforts clauses relating specifically to antitrust, and no recent court of which we are aware has made specific reference to antitrust or interpretations specific to antitrust when reviewing efforts clause languages. That said, certain trends emerge in courts' interpretations of the various efforts clause language available to parties, which can be helpful in allowing efforts clause to memorialize the true intent of the parties.

Although the numbers involved in antitrust RTFs differ from deal to deal, the language used is less varied than that used in an effort clause. In general terms, it is a payment made by the buyer to the seller (thus, it is in "reverse"; a termination fee would normally go from the seller to the buyer) if the transaction is not consummated because of the failure to obtain antitrust approval, as defined by the parties.

Efforts Clauses

Since early 2011, there have been numerous federal and Delaware court decisions interpreting efforts clauses in contracts, but only a few of the federal decisions examined these clauses in M&A agreements. However, courts often apply case law interpreting efforts clauses in one type of agreement to cases involving contracts of a different nature—distinguishing efforts clauses based on the language of the clause rather than the context of the contract. Thus, recent cases interpreting efforts clauses outside of the M&A context can provide additional insight into how—and whether—courts distinguish between "best efforts," "reasonable best efforts," "reasonable efforts," and "commercially reasonable efforts" clauses in M&A agreements. On the whole, recent decisions appear to treat "best efforts" and "reasonable efforts" clauses equivalently. The case law on "commercially reasonable efforts" in the past few years is much more limited, but courts seem to view that term as either equivalent to or perhaps slightly less stringent than "best efforts" and "reasonable efforts." Finally, a review of cases since the start of 2011 has not revealed any relevant decisions interpreting "reasonable best efforts" clauses.

A Struggle to Define Efforts

Courts seem to struggle to affirmatively define what characterizes a party's "best efforts," or even their "reasonable efforts." As a result, many of the decisions regarding these clauses turn on a court defining the efforts clauses in negative terms: in other words, the court asks whether the defendant failed to live up to the "best effort" standard set forth in the agreement. While this is undoubtedly helpful for resolving disputes, the information it provides to drafters of such agreements is somewhat limited. In the antitrust context, parties concerned with how a court might enforcing certain interpretations on efforts clauses might want to consider stating how far the parties need to go in defending the merger to satisfy the language of the agreement (*e.g.*, up until a second request is made, up to the point where the competition agency requires a divestiture, etc.). While a drafting party may derive some utility by avoiding specifics, this benefit from ambiguity is often outweighed by the cost of the uncertainty it adds with relation to antitrust consequences—

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consequences which are more likely than most to break up a deal entirely.

That seemed to have been the lesson of the Fifth Circuit's application of Texas contract law in a recent case interpreting a clause requiring that one party use its "best efforts" to "promote, market, and sell" the products of the other.[2] The plaintiff felt that the defendant failed to live up to its obligations and sued for breach of contract.[3] The court determined that "'best efforts' provisions may be enforceable under Texas law if they provide some kind of objective goal or guideline against which performance is to be measured," and held the "best efforts" clause at issue to be unenforceable since it did not provide a goal or guideline.[4] The court largely avoided the language itself, although it did quote a Texas case which stated, somewhat obliquely, "Under some circumstances, a party could use best efforts to achieve a contractual goal and fall well short. Under different circumstances, an effort well short of one's best may suffice to hit a target."[5]

In a Seventh Circuit case revolving largely around an issue of Wisconsin contract law, the court observed that "best efforts" clauses "usually require[] one party to make appropriate investments for another's benefit."[6] While it sounds ostensibly like a considerable effort (here almost to the point of some fiduciary duty), the court's application was far less. The parties were obligated to "use their best efforts to conclude the buy-sell contract."[7] But the court found that only good-faith bargaining toward such a buy-sell contract was required under Wisconsin law.[8] Even though no buy-sell contract was ever signed, and even though the contract required "best efforts," the court determined that the duty owed under the clause had been met.

Weighing Clauses Against Each Other

Perhaps more helpful, then, for purposes of understanding the duties owed under these effort clauses are decisions weighing one clause construct against another. The courts recently engaging in this exercise have, with considerable uniformity, found that "best efforts" and "reasonable efforts" require the same effort of the bound party.

A recent decision applying New York law to a "reasonable efforts" provision noted that New York courts use the terms "reasonable efforts" and "best efforts" interchangeably.[9] Observing that "reasonable efforts to supply a product are not necessarily the same as actual success in supplying a product,"[10] the court found that the allegations were insufficient to support the plaintiff's claim that the defendant failed to use "reasonable efforts" to supply fuel cells as required by the distribution contract.[11] This opinion echoed another court's interpretation of "best efforts" under New York law[12] (finding that "best efforts" is equivalent to "reasonable efforts" and that both impose a higher obligation than "good faith"; stating that a party bound to give best efforts may reasonably consider its own interests but that its considerations become unreasonable when they result in harm to the party owed the obligation). In addition to these cases, other cases construing Georgia and Illinois law also find "best efforts" equivalent to "reasonable efforts."[13]

In another case in Texas involving a contract for art, the court in *Hoffman v. L & M Arts*[14] construed a contract requiring the buyer to "make maximum effort to keep all aspects of [the] transaction confidential indefinitely."[15] The court first cited Texas law to observe that "maximum effort" and other idiosyncratic language akin to "doing all that one can" is interpreted as requiring "best efforts."[16] Rejecting the two extremes the parties proposed to construe the clause, the court determined that " "best efforts" . . . can be determined by assessing whether the defendant made every reasonable effort to reach the identified end, measured according to what an average, prudent, and comparable person would or would not have done, under the same or similar circumstances, to make every reasonable effort when exercising due diligence and in the absence of neglect."[17] The court further found that the efforts clause here held "defendants to an objective standard based on norms of reasonableness in the industry."[18] Thus, the *Hoffman* court essentially viewed the "best efforts" requirement as equivalent to a "reasonable effort" requirement.

While there appears to be uniformity in the courts' interpretation of "best efforts" and "reasonable efforts," at least relative to one another, there is considerably less agreement on how courts should apply "commercially reasonable efforts" clauses. No recent court decision has found that "commercially reasonable efforts" obligate a party to do more than it would under a "best efforts" or "reasonable efforts" clause, though one has determined that they are all roughly equivalent, each having "diligence as its essence," but "fall[ing] short of the standard required of a fiduciary."[19] The court in *Kansas Penn Gaming* did not find it necessary to analyze the term in greater depth, though, as it found that the defendant had pursued "the only viable way of profitably operating" and had therefore complied with the "commercially reasonable efforts" provision.[20]

Other courts have determined that "commercially reasonable efforts" need not rise to the level of "best efforts" or "reasonable efforts." In *MBIA Ins. Corp. v. Patriarch Partners VIII, LLC*,[21] the court explained, finding that the defendant's efforts "were well within the bounds of any rational characterization of the 'commercially reasonable standard,'" that "[a] contractual requirement to act in a commercially reasonable manner does not require a party to act against its own business interests."[22] This same standard was proposed by the court in *Citri-Lite Co. v. Cott Beverages, Inc.*[23], "[C]ommercial practices by themselves provide too narrow a definition [of "commercially reasonable efforts"] and that the performing party may consider its own economic business interests in rendering performance"). It further noted that "[w]ithin the beverage industry, it is understood that a 'best efforts' clause imposes a higher standard . . . than a 'commercially reasonable efforts' clause."[24]

Overall, while relevant case law on "commercially reasonable efforts" clauses in recent years is somewhat limited, the *Kansas Penn*, *MBIA*, and *Citri-Lite* decisions suggests that courts could view "commercially reasonable efforts" clauses as requiring either equal or slightly less effort than "reasonable efforts" and "best efforts" clauses. However, as mentioned above, a party might consider making its intent evident in the agreement if it wants a court to interpret the clause in a specific way. This can be done by expressly defining what the parties mean by "best efforts" or any other formulation, and/or by including other antitrust risk allocation provisions, like divestiture commitments. Further, counsel should make sure that the choice of law provision specifies governing law suitable to the intent of the parties.

Reverse Termination Fee Provisions

In a typical deal with antitrust concerns, the target company faces a number of costs associated with a lengthy antitrust investigation and business uncertainty if the deal cannot pass antitrust muster. Increasingly, to mitigate these costs, the seller will insist on an RTF. The RTF, if large enough, can act to pressure the buyer to fight for the deal until the end—indeed, the cost of the RTF may prove more effective in inspiring buyer efforts than some "best efforts" clauses could. At very least, the RTF acts as compensation to the seller for the damages endured during a failed merger. Buyers often can use RTFs to coax an otherwise-unwilling seller to the table in a risky transaction. More interestingly, the buyer can treat the RTF as an option, allowing the buyer to walk away at a known price if any issues deemed unacceptable to the buyer arise during the course of the transaction.

There have been a number of M&A deals announced since the start of 2012 that feature a reverse termination fee addressing antitrust risk. The list included here is meant to be representative rather than exhaustive. These deals were large, publicly reported, and located primarily through a search of Form 8-K reports. The antitrust-related RTFs in these recent deals range from approximately 2.4% to 10.4% of a deal's equity value, with an average of around 6.2%. The outlier RTFs that occurred within the last five years, where, as a percentage of the deal's value, the RTF was up to 31%, have been less prevalent of late. Notably, in some of these recent agreements, antitrust approval issues are the sole way to trigger the RTF, while in other agreements, the RTF can also be triggered by different regulatory approval issues or even by a party's breach of an

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antitrust efforts clause. These varying triggering conditions obviously will greatly impact the risk that the buyer will ultimately have to pay the fee.

FX Alliance and Thomcorp (Thomson Reuters): 2.4% RTF

On July 8, 2012, Thomcorp Holdings Inc. (with Thomson Reuters Corporation as "Parent Guarantor") agreed to purchase 100% of the shares of FX Alliance Inc. The agreement required Thomcorp to pay an RTF of $14.5 million "under certain circumstances, including failure to obtain the Regulatory Approvals." The RTF provision in the agreement itself set out a number of triggers for the RTF, including: (1) specified issues relating to antitrust laws, investment laws, the Food Safety Modernization Act, and other laws, and (2) a breach by FX Alliance of its promise to use "reasonable best efforts" with respect to various undertakings, including obtaining antitrust approval. While the RTF could be triggered by non-antitrust related regulatory issues, the agreement's RTF provision appears to have been primarily addressed at managing antitrust risk. The agreement also provided that the RTF would be Thomcorp's "sole and exclusive remedy" against FX Alliance with respect to the agreement and associated transactions. The deal was initially valued at approximately $616 million, making the RTF close to 2.4% of the deal value.

DigitalGlobe and GeoEye: 4.4% RTF

On July 22, 2012, DigitalGlobe, Inc. and GeoEye, Inc. entered into a merger agreement that provided for an RTF of $20 million. The RTF provision obligated DigitalGlobe to pay the $20 million if either party terminated the deal based on a non-appealable restraint cause by the antitrust laws or by the Communications Act, or if FCC- or HSR-related approval did not come by a specified end date. Interestingly, the agreement also provided for a "recoupment payment" of $10 million if DigitalGlobe paid the RTF and, prior to a specified date, GeoEye signed or consummated "a GeoEye Takeover Proposal." The equity value for the deal was anticipated to be approximately $453 million. Therefore, the $20 million RTF represented approximately 4.4% of the deal's value.

Coventry and Aetna: 7.9% RTF

On August 19, 2012, Coventry Health Care, Inc. entered into a merger agreement with Aetna

Parties	Deal Value	RTF Amount	RTF Percentage of Deal	Antitrust-only Trigger?
FX Alliance / Thomcorp	$616m	$14.5m	2.4%	No
DigitalGlobe / GeoEye	$453m	$20m	4.4%	No
Coventry / Aetna	$5.7b	$450m	7.9%	Yes
McKesson / PSS World Medical	$1.46b	$100m	6.8%	Yes
Honeywell / Intermec	$600m	$24m	4%	Yes
Nielsen / Arbitron	$1.26b	$131m	10.4%	Yes
NYSE Euronext / IntercontinentalExchange	$8.2b	$750m	9.1%	Yes
Smithfield / Shuanghui	$4.7b	$275m	5.9%	No
Western Digital / sTec, Inc.	$340m	$17m	5%	No

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Inc. The deal contained an RTF provision of $450 million to address both antitrust risk and other regulatory risks. As with other deals, the RTF was conditioned on failure to achieve antitrust approval (non-appealable or injunction) by a specific time, or on Aetna's failure to fight an order or injunction granted because of antitrust or regulatory issues. Here, the RTF would be Coventry's "sole and exclusive remedy" against Aetna, except in the case of fraud. At the time of the deal's announcement, its equity value was anticipated to be around $5.7 billion. The RTF of $450 million thus represented approximately 7.9% of the deal's value.

McKesson and PSS World Medical: 6.8% RTF

On October 24, 2012, McKesson Corporation entered into an agreement to acquire PSS World Medical, Inc. The agreement called for McKesson to pay an RTF of $100 million if the agreement was terminated "due to the failure of any Antitrust Condition to be satisfied, or . . . due to a final and nonappealable . . . action enjoining or prohibiting . . . the Merger . . .under any Antitrust Law." The agreement further provided that "except in the case of fraud or a willful and material breach," the RTF (plus any fees and expenses incurred in the course of enforcing the RTF provision) would be the "sole and exclusive remedy" of PSS against McKesson with respect to the agreement and associated transactions. The equity value of the deal was announced at $1.46 billion, which means the RTF amounted to approximately 6.8% of the deal value.

Honeywell and Intermec: 4% RTF

On December 9, 2012, Honeywell International Inc. entered into a merger agreement with Intermec, Inc. The agreement required Honeywell to pay an RTF of $24 million if the agreement were to be terminated "due to a failure to obtain required anti-trust approvals under specified circumstances." The agreement provided that the RTF would be triggered by a termination due to: 1) an injunction related to the Hart–Scott–Rodino Antitrust Improvements Act or to foreign "competition, antitrust or investment laws," or 2) the failure to consummate the merger by a specified date. The RTF provision thus addressed both foreign and domestic antitrust issues, and also matters beyond the antitrust context. Since the deal was valued at approximately $600 million, the $24 million RTF represented approximately 4% of the deal value.

Nielsen and Arbitron: 10.4% RTF

On December 17, 2012, Nielsen Holdings N.V. and Arbitron Inc. entered into a merger agreement. The agreement provided for an antitrust-related RTF of $131 million that could be triggered in two ways: (1) either company terminates the agreement at a specified date because of an antitrust injunction or threatened or pending antitrust litigation, or any judgment or law blocking the merger for antitrust reason; or (2) failure of Nielsen to use "reasonable best efforts" to obtain antitrust approval. Notably, the agreement did not define what constitutes reasonable best efforts. Here again, the RTF was Arbitron's exclusive remedy with respect to any losses arising from the failure to consummate the merger, the termination of the agreement, or related claims. The purchase price for the deal was estimated at $1.26 billion, which means the $131 million RTF equaled approximately 10.4% of the deal value.

NYSE Euronext and IntercontinentalExchange: 9.1% RTF

On December 20, 2012, NYSE Euronext and IntercontinentalExchange entered into a merger agreement. The agreement provided for a number of different termination fees and RTFs that applied in various *circumstances*, the largest of which was an antitrust-related RTF. The agreement required IntercontinentalExchange to pay an RTF of $750 million if the agreement was terminated because either the merger could not be completed by the specified date, a regulatory or competition law authority issued any final non-appealable order, or a law was passed, prohibiting the merger from going through, or because of a breach by IntercontinentalExchange that directly led to the merger not being consummated on competition

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grounds. Interestingly, the terminating party must have exercised "reasonable best efforts" to prevent the competition law challenge on which termination was based, meaning it could be applied to either the buyer or the seller. Again, activities constituting such reasonable best efforts were not defined in the agreement. The merger agreement also contained an extensive section about limitations on remedies that addressed the interaction of the $750 million RTF with other potential remedies. Given the deal's reported value of $8.2 billion, the antitrust-related RTF represented approximately 9.1% of its value.

Smithfield and Shuanghui: 5.9% RTF

On May 28, 2013, Smithfield Foods, Inc. and Shuanghui International Holdings Limited entered into a merger agreement that provided for an RTF of $275 million. The agreement required Shuanghui to pay Smithfield an RTF of $275 million if Shuanghui terminated by willful breach, failed to receive proceeds of its committed debt financing for the transactions described by the agreement, or if the parties were unable to obtain U.S. or foreign "antitrust or other regulatory approvals." With respect to antitrust concerns, the RTF is triggered if the "primary cause" of termination is the failure of a regulatory condition to be satisfied. The deal's reported value is $4.7 billion, so the RTF is approximately 5.9% of the deal's value.

Western Digital and sTec, Inc.: 5% RTF

On June 23, 2013, Western Digital Corporation entered into a merger agreement with sTec, Inc. The merger provided for a $17 million RTF upon termination if "certain conditions to consummating the Merger are not satisfied due to a Regulatory Injunction." The agreement defined "Regulatory Injunction" to include the enactment or enforcement of any antitrust law that prohibits consummation of the transactions contemplated by the agreement. The agreement also stated that if the RTF were paid, Western Digital would have "no further liability or obligation" to sTec with respect to the agreement and associated transactions. The deal's value is estimated to be around $340 million. Therefore, the RTF is approximately 5% of the deal value.

Conclusion

There is a slowly growing body of case law on efforts clauses in M&A agreements, and M&A agreements continue to use antitrust RTF provisions. These cases and agreements contain valuable information for parties negotiating antitrust risk allocation provisions in M&A deals. Regarding efforts clauses, courts are likely to treat "best efforts" and "reasonable efforts" clauses equivalently, and may view "commercially reasonable efforts" provisions as either equivalent to or slightly less stringent than "best efforts" and "reasonable efforts" provisions. As for antitrust RTFs, the trend in recent years has been for RTFs to average around 6.1% of a deal's equity value, with a range from 2.4% to 10.4%. Recent agreements contain both antitrust efforts clauses and antitrust RTF provisions, and this trend appears likely to continue as companies try to deal with what can be significant antitrust risk in a time of heightened antitrust scrutiny.

NOTES

1. For example, the Google/Motorola merger agreement contained the following efforts clause: "SECTION 5.04. Reasonable Best Efforts. (a) . . . each of the parties hereto shall cooperate with the other parties and use (and shall cause their respective Subsidiaries to use) their reasonable best efforts to promptly . . . take, or cause to be taken, all actions . . . proper or advisable to cause the conditions to Closing to be satisfied as promptly as reasonable practicable and to consummate and make effective, in the most expeditious manner reasonably practicable, the transactions described herein . . . .(b) Each of the Company and Parent shall (i) make, as promptly as reasonably practicable, all necessary filings and notifications and other submissions with respect to this Agreement and the transactions contemplated hereby under the Antitrust Laws, and in any event, file the Notification and Report Form under the HSR Act no more than ten (10) Business Days after the date hereof and (ii) . . . use its reasonable best efforts to obtain termination or expiration of any waiting periods under the HSR Act and such other approvals, consents and clearances as may be necessary, proper or advisable to effectuate the Merger under the Antitrust Laws and to remove any court or regulatory orders under the Antitrust Laws impeding

the ability to consummate the Merger by the Outside Date (as defined below).

2. *Kevin M. Ehringer Enters., Inc. v. McData Servs. Corp.*, 646 F.3d 321, 323-24 (5th Cir. 2011).
3. *Id.*
4. *Id.* at 327.
5. *Id.* at 326 (citation omitted).
6. *Denil v. DeBoer, Inc.*, 650 F.3d 635, 638 (7th Cir. 2011).
7. *Id.* at 637-38.
8. *Id.*
9. *Soroof Trading Development Co., Ltd. v. GE Fuel Cell Systems, LLC*, 842 F. Supp. 2d 502, 511 (S.D.N.Y. 2012).
10. *id.* at 511.
11. *Id.* at 508, 512.
12. *White v. National Football League*, 766 F. Supp. 2d 941, 950-52 (D. Minn. 2011).
13. *See, e.g., Progressive Emu, Inc. v. Nutrition & Fitness, Inc.*, 2:12-CV-01079-WMA, 2013 WL 2635248, at *2 n.2, *3 (N.D. Ala. June 7, 2013) (applying Georgia law and finding that a "best efforts" clause in a sales agreement required the seller "to use all reasonable efforts in good faith to fulfill . . . orders"); *TAS Distributing Co., Inc. v. Cummins, Inc.*, 07-CV-1141, 2011 WL 5180285, at *1, *6-7 (C.D. Ill. Oct. 28, 2011) (applying Illinois law and using the terms "reasonable/best efforts clause" and "best/reasonable efforts clause" in the course of interpreting a "reasonable efforts" clause in a License Agreement).
14. 774 F. Supp. 2d 826 (N.D. Tex. 2011).
15. *Id.* at 830.
16. *Id.* at 833.
17. *Id.*
18. *Id.*
19. *Kansas Penn Gaming, LLC v. HV Props. of Kan., LLC*, 662 F.3d 1275, 1290 (10th Cir. 2011) (quoting *T.S.I. Holdings, Inc. v. Jenkins*, 260 Kan. 703, 720 (1996)).
20. *Id.* at 1291-92.
21. 09 CIV. 3255, 2013 WL 2480244 (S.D.N.Y. June 10, 2013).
22. *Id.* at *51.
23. 1:07-CV-01075 OWW, 2011 WL 4751110, at *19 (E.D. Cal. Sept. 30, 2011),
24. *Id.* at *4.

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Notable UK Merger Decision Sees Ryanair Made to Sell Most of Its Minority Shareholding in Rival Aer Lingus

BY MATT EVANS AND MARGUERITE LAVEDAN

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August 2013 saw the UK Competition Commission (CC) require airline Ryanair to reduce its 29.8% shareholding in rival Aer Lingus to 5%. The CC ruled that Ryanair's gradual acquisition of its existing minority shareholding (i) amounted to a reviewable merger under UK merger law and (ii) had led or may be expected to lead to a substantial lessening of competition between the airlines. The decision follows the prohibition by the European Commission (EC) of Ryanair's third attempt to acquire Aer Lingus. It highlights the difference in treatment of minority shareholding acquisitions under EU and UK merger laws and reminds companies to tread carefully when acquiring even small stakes in a competitor.

The European Saga: Three Unsuccessful Bids but Minority Shareholding Intact

Ryanair built up a stake of 19.2% in Aer Lingus before launching its first public offer for the airline in October 2006. It continued to build its stake, to just over 29%, only for the EC to block the deal to acquire full control, under EU merger law. Ryanair appealed this decision to the EU General Court. During the EC's merger review, Aer Lingus asked the EC to force Ryanair to sell its minority shareholding should the merger be prohibited. However, the EC ruled that the acquisition of the minority shareholding—including the shares acquired following the bid announcement—did not trigger the application of the EU Merger Regulation (EUMR) and that it therefore did not have the power to require a sale of the shares. It held simply that it could block the outright takeover of Aer Lingus, but left the minority shareholding intact. Aer Lingus, anxious to rid itself of a rival it believed interfered with its business, appealed that decision. After a long delay, the General Court rejected both Ryanair's and Aer Lingus' appeals in 2010.

Meanwhile, Ryanair increased its stake in Aer Lingus to 29.8% and launched a second bid for the remaining shares in December 2008, only to drop it the following month after the Irish government, Aer Lingus' second-largest shareholder, indicated its opposition. In July 2012 Ryanair notified the EC of a third bid for Aer Lingus. The EC again blocked the deal, in February 2013. Ryanair has appealed that decision to the General Court.

EUMR vs. UK Merger Control

Following the 2010 General Court ruling upholding the EC's decision that Ryanair's acquisition of a minority stake had not triggered the EUMR, the UK Office of Fair Trading (OFT), which takes an initial look at mergers triggering UK merger control, asserted jurisdiction on the grounds that the stake created a "relevant merger situation" for the purposes of UK merger control. The EUMR provides a one-stop shop for qualifying mergers, giving the EC, with limited exceptions, exclusive jurisdiction over merger control within the EU. However, where the EUMR is not triggered, national merger control rules come into play.

This case highlights the difference between the EU and UK merger control regimes as to what type of deals qualify for merger control review. Under the EUMR, assuming certain annual sales tests are met by the merging parties, the acquisition of a minority shareholding will only be

notifiable if it confers "decisive influence," for example where special rights are attached to the minority stake, such as veto rights over strategic commercial decisions. The EC is currently powerless to review simple minority shareholdings under the EUMR.

Unlike the EUMR, national merger control in some member states—notably Austria, Germany and the UK—gives the local competition authority greater scope to review minority shareholdings. Under UK law, the OFT has jurisdiction over a transaction where (i) two enterprises cease to be distinct and (ii) either the turnover or share of supply tests are met. The turnover test is met where the target business generated UK sales in the previous year of more than £70 million. The share of supply test is met where both the acquiring corporate group and the target business supply or purchase the same category of goods and services in the UK, or part of the UK, and between them account for a 25% share of that supply or purchase.

Ryanair and Aer Lingus between them account for more than 25% of passengers flown between the UK and Ireland. This met the share of supply test. Two enterprises will cease to be distinct if they are brought under common ownership or control. Three levels of control are recognized:

(a) a controlling interest (*de jure* control);

(b) the ability to control policy (*de facto* control); and

(c) the ability to materially influence policy (material influence).

The OFT will presume that a shareholding of more than 25% confers material influence, because under UK law it generally enables the holder to block special resolutions.

The OFT raised concerns about Ryanair's 29.8% stake and, in accordance with UK merger control procedure, it therefore referred its investigation to the CC for an in-depth review. The CC confirmed that Ryanair had the ability materially to influence Aer Lingus, in particular by blocking special resolutions and the sale of slots at Heathrow airport.

Substantial Lessening of Competition on Routes Between Great Britain and Ireland

The CC confirmed that Ryanair's minority shareholding had led or may be expected to lead to a substantial lessening of competition between the airlines on routes between Great Britain and Ireland. It found that Ryanair would have the incentive to use its influence to weaken Aer Lingus' effectiveness as a competitor, in particular by impeding or preventing Aer Lingus from merging with another airline. In addition, the CC found that Ryanair's minority shareholding could affect the commercial policies and strategies available to Aer Lingus by limiting its ability to manage its portfolio of Heathrow slots, and restricting it from optimizing its route network and timetable across London airports.

The CC considered that these concerns could be addressed by a partial divestiture of Ryanair's shareholding in Aer Lingus to a level which, taking into account historic voter turnout and voting patterns at shareholder meetings, would remove the risk that Ryanair could block a special resolution or otherwise restrict Aer Lingus' commercial policy. It set that level at 5%, together with a ban on Board representation.

Conclusion

This is not the first time UK merger control has applied to the acquisition of small minority shareholdings. The previous most notable case occurred in 2007 when the CC held that BSkyB's acquisition of a 17.9% share in rival broadcaster ITV gave it material influence and might be expected to result in a substantial lessening of competition. BSkyB was required to divest its shares to a level below 7.5%.

The BSkyB and Ryanair cases are exceptional insofar as the low shareholdings they were permitted to retain reflect particular concerns arising from the fact that they were investing in competitors. Such concerns are less likely to arise in a typical private equity minority investment. Nevertheless, companies seeking to buy a minority stake should always make sure that they do not trigger merger control laws and if they are invest-

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ing in a competitor extra care should be taken to assess the likely impact of that investment on the target company.

The CC's decision does not mark the end of the Ryanair/Aer Lingus saga. Ryanair has appealed the CC's decision in the UK courts and already has an appeal pending in the EU courts against the EC's prohibition of its full takeover of Aer Lingus. In the meantime, the EC has been consulting on extending the scope of the EUMR, to enable it to extend its jurisdiction over the acquisition of non-controlling minority shareholdings. If its jurisdiction is extended in this way, merger control in Europe may become even more of a tangled web than it is today.

The UK Competition Commission's August 28, 2013 final report, and other documents from this matter, can be found at http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ryanair-aer-lingus.

Antitrust-Approval Risks: Issues and Pitfalls in International M&A Agreements

BY JAY MODRALL

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For many M&A transactions,[1] obtaining antitrust approvals is a key part of the overall transaction process. There are now well over 100 national and regional antitrust regimes, with new regimes being introduced and existing regimes extended on a regular basis. In just the past few years, major changes have occurred in Brazil, China, the Common Market for Eastern and Southern Africa ("COMESA"), India and Turkey. A significant expansion is also proposed in the European Union ("EU").[2] Recognizing the growing complexity of the antitrust approval process, merging parties and their counsel increasingly seek to identify required filings and potential substantive antitrust risks early and to build the results into the transaction timetable.

Requirements to make antitrust filings and obtain antitrust approvals must also be appropriately documented in the Purchase Agreement. However, antitrust-related provisions involve traps for both M&A and antitrust lawyers, because merger review regimes differ in ways that can have significant implications for the wording of related provisions, and the provisions that bear on antitrust approvals may interact in unexpected ways. Standard forms are often based on the provisions of particular legal systems, such as Hart-Scott-Rodino ("HSR") in the United States or the EU Merger Regulation. M&A lawyers may be insufficiently familiar with the differences among antitrust regimes to recognize when a provision does not work as intended in other jurisdictions. Conversely, antitrust lawyers commenting on proposed contractual language may not fully appreciate how merger agreement provisions work together to allocate antitrust approval risks.

This article reviews the main Purchase Agreement provisions relating to antitrust-approval risks and discusses pitfalls these can raise.[3] The relevant provisions include warranties relating to antitrust approvals; covenants to obtain antitrust approvals; conditions to the parties' obligations to close the transaction; termination provisions; and indemnification and termination fee provisions. Concrete examples of how these issues are addressed in practice are drawn from two recent transactions that raised serious antitrust issues, American Airlines/US Airways[4] and UPS/TNT Express.[5]

Background

Types of Merger Review Regimes

International merger review regimes vary widely, complicating the task of defining the parties' obligations in terms that apply to all relevant jurisdictions. The parameters that are most relevant

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for Purchase Agreements are briefly outlined below, and then discussed in more detail in relation to the provisions to which they are most relevant. This outline of the characteristics of different merger regimes is not exhaustive, but is intended to highlight aspects of different merger review regimes that can give rise to pitfalls in the negotiation of Purchase Agreements.

Notifying party or parties. If a transaction is notifiable, the buyer is typically required to notify, but other entities may also be obliged to notify. These can include the target, as in the United States; non-selling shareholders that continue to exercise control over the target, as in the EU; and selling shareholders. As a result, contract language making merger filings the sole responsibility of the buyer may not reflect the parties' actual legal obligations.

Notification thresholds. Most merger review regimes define the transactions that must or can be notified based on some measure of the transactions' significance. Criteria commonly used in notifiability thresholds include: the revenues of the buyer, the target and (sometimes) the seller; the value of the parties' assets; the transaction value; and the parties' market shares. Market share tests can be particularly difficult to apply, since the definition of relevant antitrust markets is a difficult exercise. Even antitrust authorities often leave the issue of market definition open in their decisions. Parties who determine based on one market definition that no filing is required in a jurisdiction may change their assessment if authorities in jurisdictions where the transaction is notified define the markets differently and the notification thresholds would be met based on the new market definition.

Mandatory vs. voluntary regimes. In most jurisdictions, including the United States and the EU, notification is mandatory for transactions meeting the relevant thresholds. In some jurisdictions, including Australia, New Zealand and the UK, however, notifications are voluntary. Merging parties may choose not to notify, bearing the risk that the authorities may later open an investigation on their own initiative. After a transaction becomes public, authorities in such voluntary filing jurisdictions may proactively request that a notification be filed. The distinction between mandatory and voluntary regimes can create ambiguities in contracts that refer to "required" or "necessary" notifications, since a voluntary notification may not qualify.

Suspensory vs. non-suspensory regimes. Most merger control regimes are suspensory, which as noted means that a notified transaction cannot legally be closed until approval is received. Some are non-suspensory, however, meaning that notifying parties may close their transaction at their own risk before receiving approval. The new COMESA regime is an example of a mandatory but non-suspensory merger review system. The difference between suspensory and non-suspensory regimes can give rise to ambiguities in antitrust-related conditions precedent, because approvals in non-suspensory regimes may not qualify as "required" or "necessary."

Exclusive regimes vs. residual review authority. In some jurisdictions, antitrust authorities' power to investigate mergers is limited by the statutory notification thresholds. In the EU, for example, the Commission has no jurisdiction to review a concentration that does not have a "Community dimension" on its own initiative (although such a transaction may be referred to it by a Member State authority). In others, such as the United States and China, authorities may investigate transactions not meeting the mandatory filing thresholds on their own initiative. Where an authority exercises this power, covenants regarding merger notifications and approvals, conditions precedent and termination provisions referring to statutory notification regimes may not apply.

Internal procedures. Antitrust authorities follow a wide variety of internal procedures, some of which have implications for Purchase Agreement provisions. For example, some jurisdictions, including the United States, start the clock on their merger investigation timetables based on relatively simple filings with no prior consultation, but have wide discretion to extend the timetable if they choose. Others, such as the EU, are subject to strict deadlines once a filing is made but impose lengthy pre-notification consultations and long, complex notification forms to collect

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extensive information before their review timetables start. Other authorities with well-defined merger review timetables, including China and the Ukraine, accept formal filings without prenotification review but do not immediately start their review clocks. As a result, Purchase Agreement provisions requiring that filings be made by a particular deadline mean different things in different jurisdictions.

Another important difference concerns the structure of authorities' investigations after a filing is made. Many jurisdictions, including the United States and the EU, divide their investigations into two steps, a preliminary or "Phase I" investigation and an in-depth or "Phase II" investigation. For some authorities, however, including China's MOFCOM, opening a Phase II investigation does not necessarily reflect any substantive concerns. For still other authorities, there is no formal distinction between a brief, preliminary level of review and the more intensive review of transactions that raise antitrust issues. Thus, contractual distinctions between preliminary and in-depth reviews may not work as intended.

There are also significant differences in relation to the procedures applicable to antitrust remedies, such as divestitures. In many jurisdictions, including the EU and China, the parties are normally allowed to close a transaction and complete any required remedies within a limited post-closing period, when the buyer and the target are under common control. In some cases, however, remedies must be finalized before closing. Such "fix-it-first" remedies are particularly common in the United States.

Direct decision-making vs. further proceedings. In many jurisdictions, including the EU and China, the reviewing authority has the power to block a notified transaction directly by means of a decision. In others, including the United States and the UK, reviewing authorities must go to court or refer the case to another authority to take a decision. This distinction can lead to ambiguity in Purchase Agreements. For example, in jurisdictions such as the United States, covenants and closing conditions dealing with general litigation may apply to antitrust approvals.

Buyer and Seller Interests

In addition to the applicable legal frameworks, the negotiation of Purchase Agreement provisions dealing with antitrust approvals is affected by the different perspectives of buyers and sellers. Buyers and sellers share a common interest in obtaining antitrust approvals to get their deal through. However, buyers and sellers commonly take different positions on specific provisions. In general, buyers prefer to have the maximum control over the process while also maintaining flexibility, for example on timing. Sellers, by contrast, generally prefer to document the buyer's obligations as specifically as possible in the Purchase Agreement to limit the risk of delay.

As regards the seller's obligations, buyers tend to focus on provisions requiring the seller to cooperate with the buyer and provide information for antitrust filings. Sellers tend to focus on provisions ensuring their right to participate in the process and to comment on filings and other substantive submissions made by the buyer.

As a result of these different perspectives, the buyer's and the seller's Purchase Agreement rights and obligations in relation to antitrust approvals tend to be asymmetrical, even though the parties may be subject to the same obligations under applicable laws. In the merger or joint venture context, antitrust-related provisions are more likely to be symmetrical, reflecting the different contractual positions of the parties as much or more than any difference in the applicable legal frameworks.

Warranties

Warranties commonly address antitrust approval requirements, but Purchase Agreements vary considerably in their approach. Some Purchase Agreements address the issue in general terms. For example, a Purchase Agreement may include a warranty that the performance of a Purchase Agreement does not require third-party approvals (including antitrust approvals) except as specified. Others may contain specific warranties listing jurisdictions where merger review filings will be made and stating that no other antitrust approvals are required.

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Both of these approaches can cause problems. As noted, a general warranty regarding "required" filings may not cover voluntary jurisdictions where filings are not required by law. A warranty listing specific jurisdictions may include voluntary jurisdictions, but such lists may be incomplete if the parties decide to make a filing after signing, for instance where an authority proactively requests that a filing be made, or where a filing becomes necessary based on the parties' market shares in a market that was not initially identified as relevant.

In some cases, moreover, merging parties make a conscious decision not to file in "exotic" jurisdictions where filing thresholds are overbroad and the local authorities do not normally apply their regimes to foreign transactions with little or no local nexus. Even in such jurisdictions, however, the parties may later determine that a filing is necessary or appropriate, for instance where an authority requests that a notification be filed or local practices evolve (for instance in the case of a new review regime such as COMESA's).

Further complexity derives from the parties' differing interests. As noted, buyers typically prefer general warranties that leave them flexibility to decide where to make filings, even after signing. Sellers typically prefer specific warranties to minimize the risk of delay from unexpected filings. From the buyer's perspective, such specific warranties may be inappropriate, for several reasons. In some jurisdictions, sellers have a filing obligation as well as buyers. In many, whether a filing is required depends at least in part on information provided by the seller. In others, as in voluntary filing or "exotic" jurisdictions, decisions on where to file may be made jointly in agreement with both parties' counsel.

Purchase Agreements can address these issues in a number of ways. Specific representations regarding antitrust filing requirements could be reciprocal, rather than being made solely by the buyer. Indeed, in merger transactions, warranties regarding applicable merger filings tend to be reciprocal. To the extent either party makes warranties based on information provided by the other, its warranties should be conditioned on the accuracy of that information. Warranties to the effect that filings are expected only in specified jurisdictions should not preclude filings in other jurisdictions in response to changed circumstances or new facts. As discussed in more detail below, related Purchase Agreement provisions, such as termination provisions, should be drafted carefully to avoid unintended consequences if additional filings turn out to be necessary or appropriate.

By way of example, the AA/US Airways Agreement contains reciprocal warranties regarding antitrust approvals required in the United States and the EU but otherwise refers generally to "other applicable foreign antitrust, competition or similar" filings (Sections 3.1(d)(i)(B) and 3.2(d)(i)(B)). The use of the term "applicable" instead of "required" seems to leave more flexibility regarding where filings may be made. In the UPS/TNT Agreement, neither party gave warranties regarding required antitrust approvals, but specific jurisdictions were listed in connection with antitrust-related covenants and other provisions.

Antitrust-Approval Covenants

Purchase Agreements typically contain extensive provisions regarding the parties' obligations to make antitrust filings and to obtain antitrust approvals. Purchase Agreements commonly assign the leading role in making antitrust filings to the buyer, reflecting the fact that all regimes require filings to be made by the buyer and substantive antitrust issues, if any, typically arise from head-to-head competitive (horizontal) relationships between the buyer and the target or customer-supplier (vertical) relationships between the buyer and the target. On the other hand, assigning responsibility solely to the buyer is simplistic, because in some jurisdictions the seller is required to make its own filings, and in any case the seller controls the target information required to complete merger filings and to respond to questions from authorities. The seller may also have a legitimate interest beyond getting the deal through, since its retained businesses may be affected by positions the buyer takes on issues such as market definition.

Thus, a buyer might seek to negotiate general covenants giving it the maximum flexibility to

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manage the filing and approval process while imposing specific obligations on the seller to make its own filings where required and to assist in the buyer's notification process. Conversely, the seller may prefer covenants that impose specific obligations on the buyer while protecting the seller's right to participate in the notification process.

Covenants in relation to antitrust approvals may be divided into three categories: those relating to the preparation and filing of antitrust notifications; those relating to the approval process; and those relating to the granting of remedies to obtain antitrust approvals, if necessary.

Merger Filings

Covenants to complete and file merger notifications range from specific obligations to complete filings within a specified period after signing to general obligations to make filings as soon as practicable. Requiring filings to be made within a fixed, short timetable makes sense where filings are relatively short and simple and contain information controlled by the notifying party. This is the case, for example, with HSR notifications in the United States. Such an obligation would not be appropriate in the EU, where formal filings are made by the acquirer but must contain extensive information on the target and where the first "filing" is normally a draft that does not trigger any formal timeline.

To address the range of notification regimes, covenants to file merger notifications should apply to both parties, not only the acquirer. A single notification deadline may be unrealistic, but timing requirements can be more specific than filing as soon as reasonably practicable. For example, the parties can agree that all parties subject to an obligation to file will do so as soon as reasonably practicable but no later than an agreed deadline, such as one month, subject to timely receipt of all required information from the other party. More specific Purchase Agreements could further provide that the parties should pay any applicable filing fees on a timely basis and use their best (or reasonable best) efforts to cause the review timetable to commence as soon as possible (since not all "filings" trigger binding timetables for authorities).

Since additional merger notifications may be identified as necessary or appropriate after signing, however, specific timing obligations should be limited to those identified at signing, for instance those listed in related warranties. On the other hand, the parties' obligations to make filings in a complete and timely way and to cooperate with one another should apply to any additional filings and to investigations launched by authorities on their own initiative as well as to those filings identified in the Purchase Agreement.

By way of example, the AA/US Airways Agreement contains reciprocal, and rather general, obligations for the parties to use reasonable best efforts to make antitrust filings "as soon as reasonably practicable" (with more specific requirements in relation to U.S. filings) (Section 4.7(b)). The UPS/TNT Agreement provided that UPS would have "the primary responsibility" to make antitrust filings "as soon as permitted and practicably feasible," with very detailed requirements regarding the conduct of the EU notification (Clause 4.6).

Approval Process

Purchase Agreements commonly contain provisions regarding the parties' obligations to take further actions to obtain antitrust approvals after the original filing. These provisions commonly impose a general obligation to cooperate with antitrust authorities and to provide requested information, but the roles of the buyer and the seller differ from agreement to agreement.

The detailed allocation of responsibilities in relation to questions from and meetings with antitrust authorities can give rise to tricky drafting issues. Typically, the buyer will want maximum control over the process, but the buyer depends on the seller for information on the target's business and thus needs the seller to cooperate in the investigation process. The seller also typically wants the buyer to be contractually responsible for obtaining antitrust approvals, but also to ensure that the seller is kept informed of and has the right to participate in substantive meetings and conversations.

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The seller may also negotiate a right to comment on submissions by the buyer and to have its views taken into account. Often, the buyer is not required to accept the seller's comments but only to consider them, though in the merger context both parties may be required to approve substantive submissions. Taking account of the extensive information required in the initial merger filing in many jurisdictions, the right to comment on submissions should include the original filing and not only subsequent submissions and responses to authorities' questions.

Even if the parties agree to allocate the primary responsibility for merger filings to the buyer, the Purchase Agreement must also take account of jurisdictions where the seller or other shareholders are subject to filing obligations. In these situations, other parties may be required to make complete and timely filings and to inform the buyer thereof, rather than the other way around. Similarly, where the buyer has overall control of the process, the buyer may have a right to approve the seller's submissions (not just a right to be consulted).

As noted, the parties' obligations to cooperate in merger filings should not be limited to filings identified at the time of signing and covered by warranties, if applicable, since additional filing requirements may be identified after signing. For example, UPS was specifically required to make filings in the EU and jurisdictions identified as "Other Key Competition Clearances" but UPS's obligations to consult with TNT covered filings with all "Regulatory Authorities" (Clause 4.6).

Less commonly, a buyer may agree not to take actions that could make it more difficult to obtain antitrust approvals for the original transaction, such as acquiring another business that competes with the target. For example, in the UPS/TNT Agreement, UPS agreed not to enter into any agreement "likely to affect, delay, impede or in any respect prejudice the obtaining of the EU Competition Clearance or the Other Key Competition Clearances" (Section 4.6(c)). Such broad language could be a potential source of disputes.

Antitrust Remedies

In transactions raising serious substantive antitrust issues, the buyer's obligations to agree to divestitures or other remedies to obtain required antitrust approvals may be among the most difficult issues in the negotiation. The requirement for the buyer to agree to remedies provides deal certainty for the seller, but imposes economic risks on the buyer, especially since Purchase Agreements typically don't provide for purchase price adjustments as a result of divestitures or other remedies.

Alternative formulations for the buyer's obligations include the following:

- ***General efforts obligation.*** The buyer may be subject only to a general obligation to attempt to obtain required antitrust approvals. The level of the buyer's obligation, even in such a general provision, may range in strength from an obligation to use "commercially reasonable efforts"; "reasonable efforts"; "reasonable best efforts"; or "best efforts". The implications of any of these general formulations for the buyer's obligation to agree to a specific proposed remedy will be highly fact-specific, and may vary depending on the governing law. In particular, it is questionable whether such a general obligation would require a buyer to agree to divestitures or other remedies in order to obtain required antitrust approvals. To be safe, buyers may include an express exclusion of any such obligation.

- ***Material adverse effect.*** In a somewhat more detailed formulation, the buyer may be required to agree to divestitures or other remedies to obtain required antitrust approvals, provided such remedies would not have a "material adverse effect." A "material adverse effect" may be defined by reference to "business or financial condition" only or also with respect to future "prospects." The materiality of the effect can be measured based only on the business to be acquired or merged, or the larger combined business, or by reference to the synergies or benefits expected to arise from the merger. In general, a remedy is more likely to have a material

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adverse effect if the definition includes future "prospects" and if the effect is measured by reference to the smaller base of the target alone, rather than the combined entity. On the other hand, a definition based only on the effect on the target may not excuse a buyer from having to agree to remedies affecting principally the buyer, such as a divestiture of part of the buyer's business. Defining materiality by reference to expected synergies or benefits may give rise to disputes, unless the parties agree in advance on the nature and amounts of those synergies or benefits.

- *Quantitative criteria.* To reduce the uncertainty inherent in an obligation to agree to remedies that will not have a "material adverse effect," the buyer can agree to accept divestitures or other remedies that will not exceed agreed quantitative targets, such as divestitures of assets generating sales or profits, or having a book or market value, not exceeding specific levels. The agreed levels may be negotiated having in mind specific remedies, such as specific divestitures that may be required to address anticipated antitrust concerns, but quantitative criteria may not easily apply to behavioral remedies, such as access remedies, supply agreements or intellectual property licenses. Thus, quantitative criteria should not be the exclusive measure of materiality.

- *Specific remedies.* To further reduce ambiguities, the buyer may agree to accept certain specific remedies, such as divestitures of identified subsidiaries or plants or product lines (already owned by the buyer or part of the business to be acquired) or supply agreements, intellectual property licenses or other behavioral remedies it is prepared to accept. One party to the deal, for example, might agree to divest businesses in a certain product line. Often, however, the buyer will prefer to avoid identifying possible divestitures too specifically for fear of harming their negotiating position with regulators.

- *"Hell or High Water."* At the far end of the spectrum, the buyer can agree that it will accept any remedy necessary to obtain required antitrust approvals. In other words, the buyer is obliged to obtain required antitrust approvals "come hell or high water." Even where the buyer has accepted such an obligation, however, situations may arise in which no available remedy will result in the obtaining of required approvals.

A seller will typically seek to obtain the strongest possible commitment from the buyer assuming that antitrust remedies have no implications for the purchase price. The buyer will typically seek to minimize its obligations, although in some cases a buyer without antitrust issues may seek to differentiate itself from other prospective buyers by offering a "hell or high water" level of commitment.

Apart from the allocation of antitrust risk between the buyer and the seller, imposing the obligation to obtain antitrust approvals on the buyer can raise technical issues where remedies require action by the seller before closing. Although Purchase Agreements typically require a seller to refrain from making significant changes without the buyer's approval, the buyer would not necessarily have the ability to direct the seller to take specific actions. The buyer may need such powers in connection with remedies that require action before closing, for instance a fix-it-first remedy. In such cases, of course, the seller would want to clarify that obligations to complete divestitures or take other irreversible steps are conditioned on closing of the notified transaction.

To illustrate how transaction parties can address these issues, in the UPS/TNT Agreement, UPS was under very limited obligations to agree to remedies to obtain antitrust approvals. While UPS and TNT were both required to use their "best efforts" to obtain approvals (Clause 4.7), any commitments required to obtain antitrust approvals had to be "reasonably satisfactory" to UPS (Clause 4.6). On the other hand, if TNT terminated the agreement for antitrust reasons, UPS was required to pay TNT €200 million (Clause 16.2(a)). In the AA/US Airways Agreement, by contrast, American Airlines and US Airways are subject to more detailed, but reciprocal, cooperation obligations (Section 4.7(b)-(e)).

Conditions Precedent

A Purchase Agreement's "conditions precedent" set out the conditions that must be satisfied before either party can require the other party to complete the transaction. Purchase Agreements may contain a general condition precedent to the effect that the parties' obligation to complete a transaction is subject to the obtaining of all "required" antitrust approvals, but such general language may not cover important jurisdictions in which filings are voluntary and/or non-suspensory.

Purchase Agreements may specifically list jurisdictions where antitrust approval is a condition to closing, commonly the same jurisdictions listed in the warranties. In suspensory jurisdictions, such a condition merely restates the law, as it would be illegal to close a notifiable transaction before the applicable waiting period expires or approval is obtained. This general formula, however, conceals a number of potentially difficult issues. For instance, approvals in voluntary filing jurisdictions may not be "required" approvals for this purpose.

Purchase Agreements sometimes provide that closing can be required without antitrust approvals, even in suspensory jurisdictions, if failing to obtain approval would not have a material adverse effect. The identification of jurisdictions where failure to obtain approval would not reasonably be expected to have a "material adverse effect" raises difficult issues of its own, since a jurisdiction that is not material from a business viewpoint may provide for severe sanctions in the event that a transaction is closed in violation of local law, including in some cases criminal sanctions.

Even after relevant approvals are obtained, a transaction may still be subject to antitrust challenge, for example by complainants. In one recent example, Cisco appealed to the European Courts the Commission's approval of Microsoft's acquisition of Skype. A buyer wishing to address the risk of a third-party challenge might insist that antitrust conditions precedent is satisfied only when the relevant approvals have become final and non-appealable. For the seller, however, such an approach may seem too open-ended.

Transaction parties should also consider the relevance of other conditions precedent to the antitrust review process. For example, a condition precedent to the effect that the closing will not violate applicable law might not be met if clearances have not been received in a suspensory jurisdiction—even if the parties have separately agreed for purposes of the specific antitrust condition that such jurisdiction would not be deemed "material." Similarly, a provision conditioning closing on the absence of litigation challenging the transaction might cover appeals by complainants against antitrust approvals. A condition precedent to the effect that warranties made at signing continue to be true at closing may be breached if the warranties purport to list all antitrust filings to be made but the parties later decide to or are required to file in additional jurisdictions.

To illustrate how these considerations can apply in practice, the AA/US Airways Agreement provides that obtaining U.S. and EU antitrust approvals is a condition precedent to the parties' obligations to close the transaction, but other approvals are not unless closing without those approvals could result in a material adverse effect (as defined) or impose criminal liability on the parties or their directors or officers (Section 5.1(b)). On the other hand, the "No Orders or Restraints; Illegality" condition precedent (Section 5.1(c)) might not be met if an antitrust authority whose approval would not otherwise be required if a "Law" in that country prohibited closing.

In the UPS/TNT Agreement, by contrast, UPS' obligations were conditioned on receipt of EU approval and "Other Key Competition Clearances", but not on approval by other relevant Regulatory Authorities (Clause 4.3(b)). Thus, the antitrust condition could be met even if closing without other Regulatory Authorities' approval could result in criminal liability or other material sanctions. Again, however, a more general condition relating to legal impediments to completion "in any material respect" might nonetheless apply (Clause 4.3(i)).

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Termination Provisions

The termination provisions of a typical Purchase Agreement help allocate antitrust-approval risks by determining the date and possibly other conditions on which the seller (or possibly both parties) may terminate the Purchase Agreement if required antitrust approvals have not been obtained.

While antitrust-approval covenants define the scope of the buyer's obligations to obtain antitrust approvals required for closing, the termination provisions define how long the parties can be held to their agreement while such approvals are being obtained. The length of this period may be especially sensitive for the seller, in view of the business risks borne by the seller during the uncertain period between signing and closing.

In general, the "drop-dead date," after which one or both of the parties may terminate the Purchase Agreement if the conditions precedent to closing have not been met must be established taking into account the period of time the parties expect will be needed to obtain antitrust approvals. In many cases, the seller will attempt to negotiate a relatively tight drop-dead date to limit the time period during which it bears the economic risk of ownership of the affected business but does not yet have certainty that it will receive the purchase price (but not so short that the buyer may have an opportunity to walk away if the terms later appear unfavorable to it). The buyer, conversely, may attempt to negotiate a longer drop-dead date to give it time to obtain required antitrust approvals, especially if the buyer is subject to stringent obligations to agree to remedies or to pay a significant breakup fee if the transaction is terminated because antitrust approvals are not obtained.

In cases where antitrust issues are expected to arise, it may be appropriate for the parties to agree on a compromise formula. For instance, the Purchase Agreement might provide for a tight drop-dead date if the buyer's conditions precedent are not satisfied, with the possibility of extension only if an authority opens an in-depth or Phase II investigation involving a finding that the transaction raises antitrust issues. Such a condition would not apply in China, where a Phase II investigation can be opened without a finding that a transaction raises antitrust issues. The termination provisions may provide for payment of a break-up fee to the seller in the event that the deal is not closed because required antitrust approvals were not obtained.

Although failure to obtain antitrust approvals by the drop-dead date is typically ground for termination, Purchase Agreements may contain provisions requiring the buyer to litigate to defend a transaction against legal challenges. In the antitrust context, such clauses can have very different implications depending on the characteristics of the applicable merger review regime. For example, U.S. authorities who want to block a transaction must commence litigation, while the EU Commission can prohibit a transaction without litigation. A provision requiring the buyer to litigate to defend a transaction may be triggered by a U.S. lawsuit, but not by a Commission prohibition decision. However, Purchase Agreement provisions requiring the buyer to litigate to defend a transaction may not distinguish between different ways in which antitrust challenges can arise.

To illustrate the resolution of these issues in practice, the AA/US Airways Agreement provides that either American Airlines or US Airways has the right to terminate the agreement if the transaction was not completed by October 14, 2013, but either party could extend the agreement for certain antitrust-related reasons (Section 6.2(a)). In the UPS/TNT Agreement, either party could terminate the agreement if the conditions precedent were not met by the "Long Stop Date" (assuming the failure was not due to a breach by the terminating party) (Clause 15.1), with no competition-related right to extend. If termination was caused by the failure to obtain competition clearances, however, UPS would be subject to a nine-month standstill obligation (Clause 15.1(e)).

Indemnification and Termination Fees

Purchase Agreements typically contain provisions entitling each party to indemnification for losses caused by breaches of representations or covenants by the other party, which may include (especially in the case of the seller) losses caused by

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breach of the buyer's obligation to seek to obtain antitrust approvals. In practice, it may be difficult for the seller to enforce such a general indemnification obligation, especially if the buyer's antitrust-approval covenants are also generally worded. Purchase Agreements could contain more specific provisions providing for indemnification for losses resulting from any challenge or delay of the transaction on antitrust grounds. Given the potential amount of such a claim and the difficult issues of proof, it is perhaps not surprising that such indemnification provisions are rare.

More commonly, the acquirer—which typically has primary responsibility for obtaining antitrust approvals—may agree to pay a lump sum to the seller if required approvals are not received. Where a termination fee is provided for, the seller may not need specific provisions on remedies. As noted, for example, in the UPS/TNT Agreement UPS agreed to pay TNT €200 million if TNT terminated the agreement for antitrust reasons, but UPS was not subject to detailed obligations to offer remedies to obtain antitrust approvals. In mergers of equals, as opposed to acquisitions, termination fees are not typical, and indeed the AA/US Airways Agreement does not contain such provisions.

Conclusion

Parties to an M&A transaction should consider the impact of antitrust-approval requirements early in the deal process. Corporate and antitrust counsel must ensure that the relevant provisions of the Purchase Agreement work together to reflect the parties' intentions regarding antitrust approvals and the allocation of related risks. If the deal involves no material antitrust risk, generally worded conditions precedent and covenants to make required filings and to cooperate to obtain approvals might be sufficient. If the deal raises substantive antitrust issues, more specific provisions may be needed, including clear conditions precedent specifying which antitrust approvals will be required before closing as well as express provisions governing the extent of the buyer's obligation to agree to remedies if necessary to obtain those approvals.

The differences between merger control regimes and authorities' procedures and the interaction between antitrust-related provisions in the Purchase Agreement can create pitfalls for transaction parties. For example, warranties may list jurisdictions where filings are expected to be made at the time of signing, but these jurisdictions should not be limited to "required" filings if voluntary filing jurisdictions may be relevant. Covenants to make antitrust filings in a complete and timely manner should not be limited to filings identified at the time of signing, but should cover all filings that may be necessary or appropriate in connection with the transaction.

Although the buyer may be assigned primary strategic responsibility for obtaining antitrust approvals, the relevant covenants should take account of the fact that the seller may also be obliged to make filings in its own name. Where the seller is the filing party, for instance, the seller should be required to inform the buyer of material communications with antitrust authorities, to consult on the contents of filings and other submissions and to allow the buyer's representatives to participate in meetings—not only the other way around.

The buyer's antitrust-related obligations commonly include an obligation to agree to remedies to obtain antitrust approvals. Although the scope of these obligations is a business matter for the parties to resolve, as a technical matter if the buyer may be required to take action before closing, it should have the ability to direct the seller to take actions needed for the buyer to comply with its obligations, for instance in a fix-it-first remedy (even if the completion of such remedies is conditioned on closing the notified transaction).

The buyer's obligations to agree to antitrust remedies must be viewed in light of other Purchase Agreement provisions, such as termination rights and termination fees. Where a buyer must pay a termination fee if antitrust approvals are not obtained, for example, the seller may need less protection regarding the specific remedies the buyer must offer to obtain approval. Similarly, where the buyer is subject to stringent remedy-related obligations or to pay a termination fee, the buyer may reasonably negotiate the right to extend drop-dead or long-stop dates in order to obtain those approvals.

Transaction parties should also bear in mind that provisions not specifically related to antitrust ap-

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provals may apply depending on the characteristics of the applicable merger review regimes. This is particularly true of provisions relating to litigation and illegality. For example, if an authority commences litigation to oppose the transaction under the relevant merger review procedure, or a complainant appeals an antitrust approval, such litigation may lead to non-satisfaction of a condition precedent that no litigation be pending or threatened that challenges the legality of the transaction, even if the jurisdiction is not one of the key jurisdictions where antitrust approval is a closing condition.

Although the parties may not be able to protect themselves completely from unexpected or bad regulatory decisions, they can ensure—through careful drafting of the Purchase Agreement—that antitrust-approval risks are identified in advance and allocated between the parties in an acceptable way. Transaction parties and their counsel need to understand the characteristics of international merger review regimes and how the various antitrust-related provisions of their agreement interact to avoid unintended consequences.

NOTES

1. Many different types of M&A transactions may trigger notification requirements. For convenience, I adopt terminology from acquisitions of sole control in which one party (the "buyer") is acquiring a business (the "target") from another party (the "seller"), and the buyer and seller enter into a definitive purchase and sale agreement (the "Purchase Agreement"). This terminology may not be appropriate in cases involving an acquisition of a public company, where the buyer's counterparty is the board of the target, a merger or a joint venture, but many of the same issues arise.
2. J. Modrall, "EU Plans Major Merger Review Expansion," *The M&A Lawyer*, July-August 2013.
3. This article focuses only on antitrust-approval risks, not other antitrust risks, such as potential antitrust liabilities of the target, or other regulatory approvals.
4. Agreement and Plan of Merger among AMR Corporation, AMR Merger Sub, Inc. and US Airways Group, Inc., dated as of February 13, 2013 (the "AA/US Airways Agreement").
5. Merger Protocol between United Parcel Service, Inc. and TNT Express N.V. dated 19 March 2012 (the "UPS/TNT Agreement").

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