

CHEAT SHEET

- *Big risk, big payoff.* Large international mergers face renewed regulatory risk given merger control regulations and national security issues.
- *Proactively manage risk.* Some tools include hell-or-high-water provisions, reverse termination fees and termination dates.
- *Beware trust busters.* In some jurisdictions, like the United States, investigating mergers for antitrust can be lengthy; hence termination dates gain significance.
- *Order in the chaos.* Balancing risk with such provisions provides certainty in mergers fraught with regulatory doubt.



SHARING REGULATORY RISK IN GLOBAL M & A

By Mark Van De Voorde, Barry A. Pupkin and Stephen E. Chelberg

Global merger and acquisition transactions are increasingly subject to regulatory review by governments around the world. Scores of countries now have merger control regulations that assess the competitive effects of pending and sometimes even completed transactions. With a larger number of merger control jurisdictions comes a greater degree of regulatory risk when closing deals. Also, with new merger control laws being enacted and amended around the world, it is increasingly likely that some of these laws will be implemented or revised during the period between a deal's announcement and its scheduled close. Sometimes those revisions can affect the filing obligations of the merging parties and, on occasion, might even affect the government's substantive competitive analysis. Increasingly, larger deals are subject to renegotiation, revaluation and restructuring due to imposed divestitures. Because of the increasing uncertainties in closing large global transactions, brought on in part by increasing governmental regulations around the world, sellers, in particular, have made greater use of strategies to mitigate and rebalance regulatory — and in particular antitrust — risk.

Risk sharing strategies

Reverse breakup fees are being used increasingly to shift some of the regulatory risk to the purchaser. In such a case, the purchaser is obligated to pay a negotiated fee if the transaction fails to close because of regulatory concerns raised by government agencies. In addition to reverse breakup fees, there are several other provisions that can be used to apportion risks between parties. Probably the most onerous of these strategies involves the use of a *hell-or-high-water clause*. Such a clause requires the buyer to accept remedies required by a regulatory authority as a precondition for the parties to close a transaction. The buyer obligates itself to do whatever is necessary, come “hell or high water,” to close the deal. The clause typically requires the buyer to accept any remedial action imposed by a government regulator, which is required as a precondition of closing. The buyer agrees to respond to burdensome document demands, possible depositions and litigation. In addition, the buyer also agrees to comply with deal modifications, including asset sales and sales restrictions, which might be imposed by competition enforcement agencies as a condition of closing.

These clauses can be modified in ways that place varying degrees of risk on buyers. For example, it is possible for the buyer to limit its risk by agreeing only to divest certain assets or assets up to a certain value in order to obtain regulatory clearance in a manner similar to baskets, hurdles and caps frequently used in M&A purchase and sale agreements. This type of solution sounds better in theory than it is in fact. Most of the time, the buyer wants the assets that the antitrust enforcement authorities are most likely going to want to see divested. Buyers often try to convince sellers that they can get competition regulatory authorities to approve a problematic deal with certain targeted divestitures. Sometimes that strategy is successful, sometimes not.

Sellers, who are typically well represented in these transactions, are often told by their counsel that a buyer with antitrust risk may have a difficult time getting a deal approved without the divestiture of an asset or assets that generated the buyer’s high bid. Counsel representation and advice is often critical for the seller to assess regulatory risk because the best financial offer is also the offer that is either the most likely to be challenged or restructured by regulatory enforcement authorities. The seller clearly wants, if possible (with reduced risk and limited delay), to ensure that it is able to preserve a higher bid from the buyer with the antitrust or other regulatory issue. It can do this, in part, by insisting that the buyer must do whatever is necessary, from a regulatory perspective, to get government approval.

Although the buyer may really want the seller’s assets that raise regulatory concerns, the buyer is only willing to risk so much to get these assets. At this point, it is critical that the buyer’s counsel is involved to assess what may or may not be doable to convince the regulatory enforcement authorities that the challenge and restructuring are unnecessary. Limiting the hell-or-high-water clause to certain assets or a capped value, with specific litigation obligations (e.g., only through a preliminary injunction hearing)

can fence-in potential unlimited risk. Sellers, though, may not be willing to accept half measures, and may opt for buyers with lower bids and fewer regulatory risks or buyers that expressly commit to do whatever is required to close a deal.

An example of an unlimited “hell-or-high-water clause” might read:

Buyer agrees to use its best efforts, and to take any and all steps necessary to eliminate each and every impediment under any antitrust, competition, or trade regulation law (including mitigation measures imposed by the Committee on Foreign Investment in the United States pursuant to Section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 (FINSIA) (50 U.S.C. App. 2170)) that is asserted by any Governmental Entity or any other party so as to enable the Parties to close the transactions contemplated by the Agreement prior to the Termination Date, including but not limited to (i) negotiating, committing to and effecting by consent decree, hold separate orders, or otherwise, the sale, divestiture or disposition of such assets, categories of assets or businesses as required by any Governmental Entity; (ii) terminating existing relationships, contractual rights or obligations as required by any Governmental Entity; (iii) terminating any venture or other arrangement as required by any Governmental Entity; (iv) licensing any portion of the business of the Buyer or of



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the assets being purchased as required by any Governmental Entity; and (v) defending through litigation on the merits any claim asserted in court by any party in order to avoid entry of, or to have vacated or terminated, any decree, order or judgment that would prevent the Closing from occurring prior to the Termination Date; provided, however, that such litigation in no way limits the obligation of the buyer to use its best efforts, and to take any and all steps necessary, to eliminate each and every impediment under any antitrust, competition or trade regulation law to close the transactions contemplated hereby prior to the Termination Date. Without limiting the foregoing Buyer shall propose, negotiate, offer to commit and effect, by consent decree, hold separate order, or otherwise, the sale, divestiture or disposition of such assets as are necessary or to offer to commit to take any action which it is capable of taking, and if the offer is accepted, to take or commit to take such action that limits its freedom of action with respect to, or its ability to retain, any of the businesses, services or assets of the seller.

Hell-or-high-water clauses are sometimes agreed to by buyers who might otherwise be foreclosed by sellers from participating in offers that have a high degree of regulatory risk. Most sellers are unwilling to risk failure of a deal, even if they know a potential strategic buyer with regulatory concerns is likely to offer a better price than competitive offerors. Hell-or-high-water provisions mitigate this risk in varying degrees, depending on the nature of the hell-or-high-water clause. In essence, the clause removes all or a portion of the regulatory risk from the seller and puts it on the buyer. Determining the type of clause that the parties use is typically a matter of negotiation, and can be a grating issue for certain buyers who have serious antitrust risk that could interfere with regulatory approval and prevent a deal from closing. Even with an agreement about the language in a risk-sharing clause, buyers and sellers still need to

be concerned that regulatory approvals take so long that their businesses and reputations suffer or that markets or financing conditions change.

These hell-or-high-water clauses are sometimes combined with termination or “drop dead” dates and reverse termination fees, so that if the deal is not closed by the drop dead date — typically nine months or more after the purchase agreement is signed — then the reverse termination fee is payable to the seller (even if the buyer has done everything required by the regulatory authority).

Another device is a “ticking fee” provision, which can be used to motivate a buyer. Such a provision obligates a buyer to pay interest on the purchase price if the transaction does not close by a specified date. Interest might not be payable until a set time has elapsed, and then may increase over time.

Risk sharing: Not just for antitrust

Although antitrust concerns are typically an important consideration in using risk-shifting strategies like reverse breakup fees and hell-or-high-water provisions, they are not the only reason. Today, an increasing number of countries make national security assessments when determining whether to permit merger transactions to proceed. The entity in the United States best known for making these national security assessments is the Committee on Foreign Investment in the United States (CFIUS). With the more aggressive posture of CFIUS over the past few years, use of risk-shifting mechanisms related to national security review is a strategy that should be considered seriously. Given the number of CFIUS-notified transactions that have been subject to scrutiny, and which have resulted in the abandonment of those transactions, sellers should consider seriously the implementation of strategies for shifting some of the closing risk to buyers in transactions where there are likely to be national security

considerations. Even if the parties decide not to use a reverse breakup fee strategy, consideration should be given to hell-or-high-water language in the purchase agreement. It is not just antitrust risk that can be mitigated through the use of such strategies. It is also possible to mitigate the concerns that sellers of certain technologies and infrastructure have by walking away from transactions where CFIUS imposes operationally challenging provisions that might not otherwise be acceptable to buyers.

In the United States, the transactions that put companies from China, Russia or countries in the Middle East in control of US companies are likely to receive heightened scrutiny from CFIUS. In addition, where acquisitions by foreign entities involve “critical infrastructure” or “critical technologies” it is even more likely that the acquiring company will be required to take certain actions that restrict its freedom with regard to the US entity or assets being acquired. A reverse termination fee can be used to incentivize the buyer to follow through with a transaction where a CFIUS agency requires the buyer to take sometimes costly and inconvenient actions to reduce the likely national security implications of a transaction. Similarly, a hell-or-high-water contractual commitment would obligate the buyer to do whatever might be required in order to obtain CFIUS approval to close the transaction.

Availability of risk balancing strategies for buyers and sellers

Use of reverse termination fees generally appeal to both the seller and the buyer for different reasons. For a seller concerned about the regulatory risk presented by a preferred buyer who may be offering to pay more money, it provides partial compensation in the event that the deal does not close because of governmental intervention (antitrust, national security, etc.). Such fees also provide an incentive

for the buyer to do what is reasonably necessary, given the additional cost of paying a reverse termination fee, if regulatory clearance is not obtained. In that regard, the buyer also benefits, because the termination fee sets a specific ceiling (almost like a liquidated damages provision) on the buyer's risk, assuming compliance with the contractual obligations in the purchase agreement. Notably, a record-high termination fee valued at about US\$ 4 billion was paid to T-Mobile when its acquisition by AT&T collapsed because of regulatory opposition from the Department of Justice and the Federal Communications Commission.

As regulatory risks around the world increase, reverse breakup fees and other strategies including hell-or-high-water provisions should become more prominent in global transactions. Although these risk-shifting provisions have long been used in private equity deals, as competition enforcement agencies became more aggressive, parties appear, at least anecdotally, to be using this strategy with greater frequency in their transactions. In strategic transactions, where the merging parties are direct and sometimes substantial competitors of one another, and the likelihood of antitrust enforcement is high, parties can use hell-or-high-water provisions to force the buyer to do virtually anything the government wants. This includes having the buyer agree to either structural remedies (e.g., sales of assets) or behavioral remedies (e.g., restrictions on sales or marketing) in order to get governmental approval. These restrictions may make the proposed transaction financially non-viable for the buyer. This uncertainty is likely to be unacceptable to a buyer, who would prefer the certainty of a reverse termination fee if regulatory problems arise and cannot be resolved. Sellers, too, want to close the deal, and if it does not they want to be compensated and put into at least as good a position

as they would have been had the sale been consummated.

Valuation of risk

Compensating the seller for a failed transaction — and providing additional compensation that will allow the seller to return to the market to find a new buyer who is likely, for a variety of reasons, to pay less than the original buyer — should be provided by the reverse termination fee. Once a deal is announced, sellers know that customers, suppliers and employees are at risk. Often, if a transaction is stopped because of regulatory issues, the seller is not nearly as strong as it was prior to the deal's announcement. It most likely will have lost customers and suppliers, as well as valued employees. How does one value this risk? A 2008 study reported in the American Bar Association's publication, *Antitrust*, indicates a range of reverse termination fees, post-2003, from 0.4 percent to 16 percent of the equity value of the transaction. The study also showed that "the risk of a second request or enforcement action is approximately 15 times higher for the agreements identified in the survey." In addition, while reverse breakup fees in the past tended to match standard breakup fees in terms of the value of the transaction, over time reverse breakup fees have risen higher to reflect the potentially greater damages suffered by the seller due to a failed transaction.

The authors indicated that this shows a "strong correlation" between reverse termination fees and the likelihood of significant antitrust concerns. This makes sense.

In most large, global transactions the buyer and seller are represented by skilled competition counsel. They assess the regulatory risk in terms of the likelihood of government interest. They assess whether there is likely to be a second request; whether arguments can be constructed to convince the competition enforcement authorities that the deal

should be allowed to go forward; and whether such convincing will require the divestiture of assets or restrictions on the buyer's behavior going forward. Finally, they try to determine how long it will take to get all of the regulatory approvals necessary to close the transaction. In most cases, and as one would expect, the buyer and its counsel have a much more positive view about all of these questions. The give-and-take on these issues between buyer's and seller's counsel, along with financial and non-financial valuation factors and negotiating positions (including the seller's risk in trying to determine or prove damages due to a failed transaction, and the buyer's risk in facing potentially large damages from the seller in case of a failed transaction) will be the most important factors in determining the final amount of the reverse termination fee.

With regard to such risk valuation it is important for buyers to be in possession of as much relevant information from the seller as possible. The provision of confidential information from the seller to the buyer, both of whom are competitors, is sometimes difficult for the seller. Buyers, though, face a serious risk if they make determinations about the likelihood of regulatory success, without having to pay a reverse termination fee, on an assessment of antitrust risk which is based on inadequate information. The buyer, of course, knows about the problematic documents in its own files, but has no knowledge of similar documents in the files of the seller. It is important for sellers to work through all of the issues of risk allocation and be familiar with the information in its files that could cause antitrust concern and increase the risk of regulatory disapproval.

Termination date

In transactions that are likely to raise regulatory concerns there is also typically a termination date when either party can walk away from the transaction. If the purchase agreement also

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includes a reverse termination fee, the termination date can become very significant to the parties. Again, the buyers and sellers have different interests when they set the termination date. Although buyer's counsel typically downplay the significance of regulatory concerns in a transaction between direct competitors, buyer's counsel also, and seemingly at odds with its position concerning regulatory risk, typically want the termination date as far in the future as possible. CFIUS, in the United States, is usually not a consideration with regard to the termination date. Antitrust, though, can be a significant issue when determining a termination date because of the lengthy time period it typically takes the antitrust enforcement agencies to investigate a transaction.

In the United States, the initial merger control waiting period is 30 days. Sometimes, if competition issues arise early in the review or if the government runs out of time, the reviewing agency will ask that the merger control form be pulled and refiled to give the reviewing agency 60 days to make an initial assessment about the competitive impact of a transaction. It is possible that after a 60-day review, the competition enforcement agency sees serious issues with the transaction and decides to send the parties a request for additional information, known as a

second request. Counsel for the parties can spend a month or so negotiating compliance with the second request, trying to reduce the burden on the parties. Compliance itself can take many months. Only after both parties have substantially complied with the second request and waited an additional 30 days can the transaction be consummated, and only then if the government decides it does not want to enjoin the deal or does not want to impose conditions on consummation. If the merger control form is filed when the purchase agreement is signed, and everything goes very smoothly, it is unlikely that a deal which receives a second request could be consummated sooner than six months (and most likely longer) after the deal is signed, and the US merger control forms are filed with the competition authorities.

If there are other merger control obligations outside the United States, the time period is likely to be extended. In China, for example, it can take months before the merger control form is actually accepted for review by the Ministry of Commerce of China (MOFCOM). In large, global transactions, then, there is not only uncertainty about the substantive results of a government antitrust review, there is also uncertainty about the timing of the approval. All of this leads buyer's

counsel to insist on a termination date as long as reasonably possible into the future after the purchase agreement is signed. The study cited above indicates that the termination date range is from two to 18 months, with a mean of 350 days and a median of 365 days. Again, though, risk assessment is a critical part of the negotiation setting the termination date.

Conclusion

All of this means:

- Large international transactions have increased regulatory risk given the plethora of merger control regulations and the increasing national security issues being enforced;
- Regulatory risks can be allocated through provisions in a purchase agreement;
- These provisions can include reverse termination fees, hell-or-high-water provisions and termination dates;
- Both buyers and sellers have an interest in identifying, quantifying and understanding their maximum risk; and
- A combination of strategies can balance risk in a way that provides greater certainty and fairness to the parties in transactions that are likely to involve regulatory uncertainty. **ACC**

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