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When Mergers Go Bad: How Merger Agreements Deal with Antitrust Risk in Today's Market

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When parties begin merger talks, it is with an eye toward getting the deal done, getting the sellers their consideration, and determining how the combined company can do a better job for customers, employees and shareholders. What to do and what happens when things fall apart is left for the lawyers. There are a variety of reasons mergers go awry before closing, and all of them should be addressed in the parties' agreement. For transactions that combine significant industry players, antitrust should be front and center. Antitrust risk must be analyzed, evaluated and handicapped, and how such risk is shared by the parties or shifted between each other becomes critical to the negotiations and the final agreement.

A number of tools are commonplace for addressing antitrust risk, including efforts clauses, end dates, break or termination fees, material adverse event clauses, and control of investigation strategy. These provisions govern the parties' obligations in the period prior to closing, and set out parties' obligations if the transaction is not completed. Transactions can be terminated mutually, and often are. But when that does not happen, the parties' actions leading up to termination will be scrutinized for compliance with the various agreement provisions. When uncovering a breach could make the difference in who takes on the cost of the failed deal, understanding and strictly complying with the provisions of the agreement becomes critically important. Here, we discuss the most commonly used provisions, how to ensure compliance, and also provide some real world examples of how they have played out.

Efforts Clauses

Efforts clauses come in many flavors, but, in the antitrust context, all govern what the parties have agreed to do in order to obtain antitrust clearance for the transaction. The level of effort and actions that must be undertaken can range from a light touch for transactions with no significant antitrust issues, to onerous for combinations of head-to-head competitors where agency scrutiny is expected. Clauses typically include one of "best efforts," "reasonable best efforts," or "commercially reasonable best efforts," and are generally understood to imply descending levels of efforts obligations. The "hell-or-high-water" provision, obligating the buyer to undertake any and all actions necessary to gain antitrust clearance, is a tool parties use where the transaction presents real antitrust risk and they have agreed that the risk will be borne exclusively by the buyer. There are many reasons buyers agree to this, including price, different view of the risk, negotiating leverage, and the competitive nature of the bidding pool for the target business or assets. The hell-or-high-water provision typically means that the buyer must, for instance, respond to an agency "second request" and participate in a full-blown antitrust investigation of the transaction (a lengthy and expensive process), agree to divestitures or other remedies to satisfy antitrust regulators, and defend the transaction through litigation if challenged on antitrust grounds.

This provision was put to the test in the *Tribune/Sinclair* transaction where the reasonable best efforts provision in the merger agreement erupted into a dispute over the scope of the divestitures needed to gain antitrust approval. After the Federal Communications Commission rejected the merger of the two broadcasting companies, Tribune terminated its agreement with Sinclair and sued for breach of contract for its failure to use "reasonable best efforts."[1] According to the complaint, rather than taking "all actions" and doing "all things" necessary for closing, Sinclair instead refused to sell stations in the specified markets, proposed divestiture structures that risked delay or rejection, and engaged in "belligerent and unnecessarily protracted negotiations" with authorities over regulatory requirements. The parties are currently in the discovery phase of litigation.

The failed *Anthem/Cigna* merger was blocked on antitrust grounds, and also resulted in litigation over who was at fault for the deal's failure to pass antitrust muster -- and which party is responsible to the other for the termination fee.2 Cigna claimed that Anthem's merger announcement affected regulatory and antitrust reviews, and deliberately used the merger to harm Cigna, while Anthem claimed that Cigna "sabotaged" the agreement by undermining Anthem's efforts to cooperate with the DOJ in getting approval. According to the complaint, Cigna's executive officers were not satisfied with their post-closing roles and titles. The court has yet to rule.

The issues arise not just with respect to U.S. antitrust clearance, but outside the U.S. as well. Nidec and Whirlpool entered into a share purchase agreement for Nidec's purchase of Whirlpool's refrigeration compressor business. The agreement allocated antitrust risk to Nidec, and with antitrust clearance and the transaction still pending, Whirlpool sued Nidec to ensure it secured antitrust clearance before the April 2019 deadline.3 The suit was aimed at ensuring compliance, rather than the termination of the contract. According to the complaint, Nidec agreed to include a "hell-or-high-water" clause in the agreement, which obligated the company to take all means necessary to obtain antitrust approval by the deadline. Whirlpool alleged that Nidec had not done everything it could to satisfy the concerns of antitrust regulators in the European Union, Mexico, and Turkey. The court dismissed the suit on the basis that Nidec still had time to obtain antitrust approval. The court did not find anything in the agreement permitting a party to sue *prior to nonperformance of a condition*. The European Union ultimately approved Nidec's proposed purchase on April 12, and the company announced its successful acquisition of Whirlpool on July 2, 2019.

On what amounts to commercially reasonable efforts outside the context of antitrust clearance, the *Himawan v. Cephalon* case involves a breach of contract claim for failure to use commercially reasonable efforts to obtain regulatory approval for certain pharmaceuticals.[4] When Cephalon bought Ception in 2010, the biopharmaceutical company agreed to use "commercially reasonable efforts" to develop the antibody Rezlizumab, used to treat asthma and esophagus inflammation. The parties' merger agreement defined the term to mean efforts commensurate with those a similar company would undertake. Cephalon ultimately abandoned its efforts to develop and commercialize Rezlizumab, and was sued for breach of the efforts clause, on the basis that Cephalon did not use "commercially reasonable efforts" to achieve certain milestones related to Rezlizumab, as it was contractually obligated to do. The court allowed the case to move forward, and the parties are currently in the discovery phase of litigation.

End Dates and Break or Termination Fees

Extended investigations can impact financing efforts, impact the ongoing businesses of the parties, and have other adverse effects. A "drop-dead date" or "outside date" lets the parties agree up front how long is too long, and when it's time to move on. The implications are myriad, depending on which party has the right to terminate at the end of the prescribed period, and on what basis. Under the typical scenario, a buyer agrees and is obligated to gain antitrust clearance by a date certain, on pain of the seller triggering a termination clause and potentially a break or termination fee due to the seller. Antitrust reverse termination fees can also come into play, for instance, where a buyer agrees to pay seller a fixed fee if the deal terminates because of the failure to obtain antitrust approvals, or if buyer voluntarily terminates. Relatedly, antitrust ticking fees force the buyer to pay additional consideration if deal is not closed by a certain date or specific milestones are not met.

Several lessons can be learned from the failed Anthem/Cigna transaction. To provide for the time it would take to obtain the necessary antitrust clearance, the parties' original merger agreement provided that each could unilaterally extend the termination date from the contracted-for date of January 31, 2017, through April 30, 2017. Either party could terminate the deal and seek the reverse termination fee, if the deal did not close by April 30; however, a party could not terminate the agreement if it breached its own contractual obligations and "proximately caused or resulted in the failure of" the merger closing.

After United States District Court for the District of Columbia blocked the proposed merger between Cigna and Anthem in 2017, agreeing with the government that there may be potential anticompetitive effects in an already concentrated market, Cigna attempted – and failed – to terminate the agreement. Cigna's suit to obtain a $1.85 billion reverse termination fee and $13 billion in damages (the agreement contemplated that Cigna's sole remedy would be the fee if Anthem did not willfully breach its contractual obligations) was met by a countersuit from Anthem to preserve the merger. In May 2017, the Chancery Court denied Anthem's preliminary injunction of Cigna's termination, and Anthem decided to terminate the merger rather than push it forward. The parties are litigating the issue of the fees and damages.

The Rent-A-Center transaction demonstrates the importance of strict compliance with the technical and ministerial requirements of the parties' agreement. What appeared to one party to be a mutually agreed extension of a merger deadline led to a failure to provide the agreed formal notice of extension, and the ultimate undoing of the transaction. Vintage Capital/Buddy's Home Furnishings and Rent-A-Center, a rent-to-own company, entered into a merger agreement that provided each party the unilateral right to extend the end date of December 17, 2018, to March 17, 2019, upon written notice. Either party could likewise terminate the merger agreement by delivering a written notice to the other party if the deadline was not extended. The merger agreement provided that, upon termination, Vintage would be obligated to pay to Rent-A-Center a reverse breakup fee equal to 15.75% of the transaction's equity value ($126.5 million). The parties agreed to employ commercially reasonable efforts to obtain antitrust approval and close the deal.

Given the FTC's delay in approval, the merger was unlikely to be completed by the initial end date. Rent-A-Center decided that it would not unilaterally extend the end date, and that, if Vintage did not extend, Rent-A-Center would terminate the merger agreement. Vintage did not extend the end date by the prescribed deadline. On December 18, Rent-A-Center delivered a termination notice to Vintage and demanded that Vintage pay the breakup fee. Seeking a declaratory judgment, Vintage filed suit against Rent-A-Center, seeking to invalidate Rent-A-Center's termination notice on the basis that the extension deadline had been extended by the conduct of the parties -- and that Rent-A-Center breached its implied covenant of good faith and fair dealing.5 Rent-A-Center asserted a counterclaim for breach of contract, on the basis that it validly terminated the merger agreement, which then obliged Vintage to pay Rent-A-Center the termination fee. The Court found that Vintage "simply forgot" to deliver the extension notice, despite Vintage's arguments that an extension notice was constructively delivered or waived due to the joint timing agreement that both parties entered into with the FTC, agreeing not to close the merger for a 45 day waiting period starting on October 29. The purpose of the agreement had been "to avoid rushing the FTC into unfavorable action." Vintage was ordered to accept the termination as valid. The court requested supplemental briefing on the applicability of good faith and fair dealing, before it would make its decision on whether the termination fee must be paid. On May 28, the parties ultimately dismissed the case with prejudice.

Material Adverse Event Clauses

Revenue or material adverse effect/material adverse change thresholds are sometimes employed to limit the level of divestitures a buyer is required to make to gain antitrust clearance. Rather than agreeing to take all action necessary to gain clearance, the material adverse effect/material adverse change provision allows the parties to agree the transaction will not go forward on what might be onerous terms that devoid the transaction of its intended value, benefits or purpose. The provision also may sometimes identify specific assets that the buyer must agree to divest if necessary for clearance, while leaving others off the table. This raises the obvious question of the provision's impact on the parties' ability to fairly negotiate remedies with the agency -- where the agency knows precisely what the buyer must agree to divest to gain clearance. While the concern is real, the agencies have historically not used the provisions as a sword, or roadmap, but rather to negotiate remedies based on the bonafide antitrust concerns in the transaction.

Still, provisions that identify specific assets slated for potential divestiture are generally disfavored. While MAE provisions are not often litigated, the Fresenius/Akorn merger addresses the exercise of a termination provision in the parties' merger agreement triggered by an MAE clause. When Fresenius agreed to acquire Akorn, the companies sought antitrust clearance from the FTC, and were on the path to a negotiated remedy. Both parties agreed to use reasonable best efforts to complete the merger, and Fresenius committed to taking all necessary actions to secure antitrust approval. Closing was conditioned upon these representations; failure of the representations to be "true and correct" would allow Fresenius to terminate the agreement.

Akorn made extensive representations about its compliance with regulatory requirements. However, according to the complaint, Akorn lacked necessary compliance and quality control functions.6 In the second quarter of 2017, Akorn's business performance steeply declined. Though Akorn reassured Fresenius the decline was temporary and due to the sudden loss of an important contract, Akorn's performance continued to spiral downward. It was not until October 2017 that Fresenius received a letter from an anonymous whistleblower that Akorn had failed to comply with regulatory requirements, in both product development and quality compliance. Fresenius began investigating, and ultimately discovered issues that undermined Akorn's compliance representations. In April 2018, Fresenius provided notice of termination of the Merger Agreement, citing several bases for its decision, including the fact that its obligation to close was conditioned on Akorn not having suffered an MAE.

The Court of Chancery ultimately found that Fresenius fulfilled its contractual obligations. While it is difficult to establish an MAE, the court specifically noted how markedly different this situation was from an unjustified "buyer's remorse" case, given that Fresenius responded to Akorn's sudden and aggressive decline and began investigating, while nevertheless planning to go forward with the merger.

The court considered various factors in determining the occurrence of an MAE, including (i) whether the magnitude of the effect was material; (ii) whether the reason for the effect falls within an exception; and (iii) whether Fresenius knowingly accepted the risks resulting in the MAE.

On whether the magnitude of the effect was material, the court considered whether "the effect 'should substantially threaten the overall earnings potential of the target in a durationally-significant manner.'" In doing so, the court specifically noted Akorn's dramatic decline, the fact that its poor performance "represented a departure from its historical trend," the fact that recent analyst valuations showed no signs of abatement. Given the record "established the existence of a sustained decline in business performance that is durationally significant," the court found that Akorn had suffered a general MAE.

The court next analyzed whether the reason for the MAE fell within one of the contract's exceptions, which allocated certain categories of risk to Fresenius, including "systematic risks 'generally affecting (1) the industry in which the Company and its Subsidiaries operate.'" This exception had a carve-out for events disproportionately affecting Akorn "as compared to other participants in the industry," in which case risk would be assumed by Akorn. The court found that Akorn's decline was primarily driven by problems specific to the company, like its product mix as opposed to the entire industry, and that even if it were simply victim to industrywide effects, that Akorn was disproportionately affected. The court found the risk fell on Akorn.

Finally, the court determined that the events resulting in a general MAE were unexpected, noting that Akorn "dramatically underperformed Fresenius's less optimistic estimates." Interestingly, the court noted that even if Fresenius had foreseen these events, that would not have changed the outcome of the decision, because the contract definition of an MAE did not contemplate Fresenius assuming the risk for anything anticipated or uncovered during due diligence. The court determined that Akorn's compliance misrepresentations resulted in a $900 million loss. Akorn subsequently appealed to the Delaware Supreme Court, which upheld the ruling dismissing Akorn's claims. On August 19, 2019, Fresenius filed a summary judgment motion for $46 million in litigation fees. The court's decision is pending.

Control of Investigation Strategy/Cooperation Provisions/Clean Teams and Joint Defense Agreements

Other important provisions addressing antitrust in merger agreements include those dealing with control of the antitrust clearance strategy. A buyer will typically want full control and final decision making authority to the extent the buyer is assuming all or substantial antitrust risk. Where the risk is more evenly shared, parties typically agree to share control of antitrust strategy. In each case, parties will typically agree to work cooperatively towards the end goal of securing antitrust clearance.

Similarly, transactions that present real antitrust risk typically require the parties and their advisors to share documents and information that inform on the competitive landscape and the parties' internal competitive positioning, along with counsels' views and assessments. Exchanges of competitively sensitive information often will be subject to confidentiality agreements and clean team procedures, where distribution of the most competitively sensitive information is limited to a select group, or outside advisors. Clean team agreements and protocols protect the parties' business interests in ensuring that competitively sensitive information is not provided to personnel who would be able to act on it in the marketplace, while also protecting them from assertions of improper information exchanged among competitors potentially in violation of Sherman Act Section One. A joint defense agreement also may be necessary to protect privilege when sharing advice or information beyond each party's own counsel, allowing the parties' advisors to work cooperatively without risking the waiver of privilege and potentially subjecting counsels' work product or advice to agency disclosure.

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1 *Tribune Media Co. v. Sinclair Broad. Grp., Inc.*, No. 2018-0593-JTL (Del. Ch. filed Aug. 9, 2018).

2 *In re Anthem-Cigna Merger Litig.*, No. 2017-0114-JTL (Del. Ch. filed Feb. 14, 2017).

3 *Whirlpool Corp. v. Nidec Corp.*, No. 1:19-cv-02155-DAB (S.D.N.Y. filed Mar. 8, 2019).

4 *Himawan v. Cephalon, Inc.*, No. 2018-0075-SG (Del. Ch. filed Feb. 1, 2018).

5 *Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.*, No. 2018-0927-SG (Del. Ch. filed Dec. 21, 2018).

6 *Akorn, Inc. v. Fresenius Kabi AG,* No. 2018-0300-JTL (Del. Ch. filed Apr. 23, 2018).

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