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# Are Antitrust Risk Allocation Provisions in Merger Agreements Worthless?

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## The Delaware Chancery Court Seems to Think So

Megamergers that deprive the American consumer of competition are illegal.  But the urge to merge is often so strong that antitrust risks rarely prevent behemoths from the attempt.  Long before parties sign deals, issue press releases, and file for government approval, they must decide who will bear the risk that the FTC or DOJ will put the kibosh on the deal.

For sellers, in particular, the failure to obtain adequate protections against that risk can be catastrophic, as employees start looking for their next gig, or else turn their attention to "integration" activities that will curry good favor, not with their current owner, but the prospective new one.  To address this, parties often negotiate antitrust risk allocation provisions, such as the obligation to use best efforts to obtain government approval, to divest overlapping assets, or to pay hefty termination fees if approval cannot be secured.

As a recent decision by the Delaware Court of Chancery shows, however, these provisions are only as good as their enforceability.  By rejecting cross-claims for breach of contract brought by both Anthem and Cigna – arising from their failed merger attempt – the Court cast new doubt on the value of contractual antitrust risk provisions, and, at a minimum, offers some hard lessons learned on how to better draft them in the future.

**A. The Negotiations, the Merger, and the Challenge**

In July 2015, Anthem agreed to pay over $54 billion to acquire Cigna, in a deal that would combine two of the three top health insurers, creating a new insurance behemoth covering the lives of over 50 million Americans and controlling upwards of 75% of certain relevant markets.  Antitrust issues abounded, and the subsequent challenge should not have taken anyone by surprise.

And it did not.  The merging parties entered the transaction with eyes wide open, each injecting a number of “antitrust risk allocation” provisions into their merger agreement to protect their interests if the deal ultimately could not get done.

These provisions fell into three categories.  The first required both parties to use “reasonable best efforts” to satisfy all the conditions to consummating the merger, which included obtaining regulatory approval.

The second was more specific, requiring Anthem, as acquirer, to “take any and all actions necessary to avoid each and every impediment” to the Merger that a governmental entity might raise.  Provisions such as these are often colloquially called “hell or high water” provisions because they theoretically obligate the buyer to agree to dispose up to the entirety of the acquired business (and theoretically even more) for no compensation to satisfy regulatory approval, though whether they actually require this has never been thoroughly tested in the courts.

The third provision obligated Anthem to pay a “reverse break-up fee” of over $1.8 billion if Anthem failed, for any reason, to gain antitrust approval for any reason by the termination date.

With protection donned, or so they thought, the merging parties entered the regulatory fray.  They emerged defeated.  After the parties complied with a grueling DOJ Second Request, and engaged with the DOJ over the course of its year-long investigation, the DOJ ultimately challenged the deal by filing a federal lawsuit in July 2016.  Another year later – now marking two years since the deal’s announcement – the United States District Court for the District of Columbia issued a permanent injunction, blocking the transaction from closing.  That decision was affirmed almost a year later in April 2017 by the D.C. Circuit, forever quashing the hopes of the merging parties to eliminate the competition among them.

But this three-year journey was not the end of the saga; it was just the end of its opening chapters.  The denouement was yet to come.  The drama began long before the DOJ even challenged the transaction.  Hostility among the parties emerged almost as soon as the ink was dry on the Merger Agreement.  As in many cases, it boiled down to a power struggle:  “Anthem saw itself as the acquirer; Cigna saw the parties as equals.”  Cigna believed that its CEO, David Cordani, would be appointed COO, making him second in line to run the combined company.  Anthem had other ideas, at one point stating that “there can be no future for [Cordani] and by definition for his loyalists.”  Paying $54 billion entitled it to treat Cigna as its property to do with as it pleased, or so it believed.

As peaceful relations broke down, so did their united front before the DOJ and the courts. According to Anthem, Cigna:  (i) conducted a covert communications campaign against the Merger; (ii) withdrew from integration planning; (iii) opposed a divestiture that would have increased competition; (iv) resisted mediation that may have mitigated certain of the DOJ’s concerns; and (v) undermined Anthem’s defense in the antitrust litigation, all in breach of various Efforts Covenants.  For its part, Cigna alleged that Anthem breached the Regulatory Efforts Covenant by (i) failing to pursue all of its options to change certain industry association rules that the DOJ had focused on as anticompetitive, and (ii) omitting $704 million of potential merger-specific synergies from its white paper on medical cost savings, which had been submitted to the DOJ in defense of the Merger.

Each party claimed that the actions of the other violated the antitrust risk allocation provisions of the Merger Agreement.  Cigna struck the first blow.  Even before the D.C. Circuit rendered its final decision on the antitrust issues, Cigna sent Anthem notice purporting to terminate the Merger Agreement.  It then filed suit in the Delaware Chancery Court claiming breach of the hell or high water provision, seeking $14.7 billion in “expectation” damages and $1.8 billion for failure to pay the reverse termination fee.

Anthem returned the punch with equal force.  Waiting until after the D.C. Circuit issued its final decision, Anthem then issued its own termination notice and filed suit against Cigna, claiming willful breach of the reasonable best efforts clause.  It too sought expectation damages of $21.1 billion.

It fell to Vice Chancellor Laster to referee the match and call the fight. Ultimately, he concluded that neither party was liable to the other, leaving both parties standing in the same position before the suit as after. In doing so, he rendered all of the parties' painstakingly-negotiated risk allocation provisions utterly useless. "In this corporate soap opera," Judge Laster noted, the "executive teams at Anthem and Cigna played themselves." How the Court got to this result provides many valuable lessons for antitrust and deal lawyers alike.

**B. Did the Court's Causation Analysis Effectively Gut Best Efforts Clauses?**

The court found that Cigna's efforts to derail the merger breached its obligation to "take all reasonable steps to solve problems and consummate the transaction." But despite this breach, the Court found that the merger would nonetheless have been challenged by the DOJ and blocked by the courts. An illegal merger is, after all, an illegal merger, so it makes no difference what the parties might have done to advocate to the contrary. Because there would be no consummated merger in the "but for world," there is also no basis for awarding expectation damages.

This Court's approach raises the specter that reasonable best efforts clauses are now effectively worthless. But did the Court really expose the Achilles' heel in these provisions that has gone unnoticed by deal lawyers for decades, or was the Court's decision an aberration specific to this deal? To answer this question, we must look more closely at the Merger Agreement and Court's reasoning behind it.

The starting point for the Court's analysis was the inclusion in the Merger Agreement of the "No Injunction" covenant, making it clear that there is no contractual obligation to close the transaction if there is an outstanding injunction prohibiting it. This may seem obvious, for how can the parties be obligated to consummate a merger if doing so would violate a court order? But this provision is important contractually because, unless that condition is excused for some reason, it is what arguably relieves the parties having to pay damages for failing to actually close.[1]

Here, Anthem argued that Cigna could not rely on the No Injunction Provision to evade its obligation to close, and thus, its failure to close constituted a breach.  Anthem rested its argument primarily on Section 245 of the Restatement (Second) of Contracts, which states that “[w]here a party's breach by non-performance contributes materially to the non-occurrence of a condition of one of his duties, the non-occurrence is excused.”  In its view, Cigna could not rely on the No Injunction Provision because Cigna’s breach of its best efforts obligations “materially contributed” to the issuance of the injunction. Anthem’s argument is far from obvious, because Cigna was not really relying on the No Injunction Provision for its failure to close, but instead was relying on the injunction itself.  But Anthem’s argument – that a party who prevents the occurrence of a condition precedent should not be able to rely on the absence of that condition to evade its own responsibilities – has some superficial appeal.

The Court agreed with Anthem, noting that the question then turns on whether Cigna was truly responsible for the injunction’s issuance, or in the language of the Restatement, whether Cigna “materially contributed” to it.  The Court concluded that Section 245 establishes a burden shifting framework.  It “is not necessary,” the Court said, that Anthem show that no injunction would have issued “but for” Cigna’s breach, just that the breach increased the likelihood of an injunction.  If Anthem makes that threshold showing, Cigna can still escape liability by showing “by a preponderance of the evidence that its breach could not have contributed materially” to failure to close the transaction because the injunction would have issued “regardless.”  Put simply, if a party materially breaches its best efforts obligations, the burden falls on it to show that the merger would still have been condemned in the but for world.

Applying this framework, the court found Anthem made a sufficient threshold showing that Cigna "materially contributed" to issuance of the injunction. Cigna, for example, engaged in a "covert" public relations effort to highlight the anticompetitive nature of the transaction. It withdrew from "integration planning activities," undermining Anthem's efforts to gather evidence to present a compelling efficiencies defense. It obstructed Anthem's efforts to develop a viable remedy, in which it would divest certain competitively overlapping local operations. And it resisted efforts to mediate with the DOJ in the hopes of avoiding a deal-blocking lawsuit. While the Court ultimately found that the covert communications scheme was not material (because it did not influence either the DOJ or the court), the other conduct did interfere with Anthem's ability to present an efficiency defense, develop an appropriate divestiture remedy, or convince the DOJ to clear the transaction in some form. Simply put, "[r]ather than seeking to complete the Merger, Cigna sought to derail it." As such, Cigna's breaches of its best efforts obligations made the issuance of an injunction more likely.

Despite this finding, the Court then found that these material breaches were not actually material, because the DOJ and the Court would have reached the same decision anyway. Engaging in a detailed review of the antitrust proceedings, the court evaluated whether Cigna's conduct altered the outcome. This created a virtually insurmountable hurdle for Anthem to meet. While the burden was technically on Cigna, as a practical matter, Anthem had to prove the negative: that the outcome would have been different if Cigna had not interfered. But those efforts were stymied because Anthem was not writing on a clean slate.

All of the arguments Anthem actually made in the antitrust case, and the mountains of the evidence it presented, by definition, failed to persuade. So as a matter of logic (if not collateral estoppel), Anthem could not rely on those arguments to show that a different outcome was warranted. Instead, it had to point to some new argument it was prevented from presenting, or some evidence it could not obtain due to Cigna's breach, and then show that this new argument or evidence was so compelling that a different result would have obtained. Anthem could not do this. The anticompetitive problems with the transaction went well beyond the local competitive overlaps that could be solved with a modest divesture, and – even if the efficiencies defense were moderately bolstered – it too would be insufficient to save the deal. As such, Anthem could not prove but-for causation – that but-for Cigna's breach of the best efforts, no injunction would issue.

So what lessons can be learned from this?  The first is that the hurdle for establishing liability under a best efforts clause are incredibly high.  If successful efforts, such as Cigna's, to kill a deal do not give rise to liability for breach of the best efforts obligations, it is hard to imagine a scenario in which liability will arise.  Indeed, parties negotiating a merger should now assume that such provisions, at least in their current form, provide them virtually no protection if they are the non-breaching party.  Of course, the opposite is still true for the breaching party.  It would be foolhardy in the extreme to breach such an agreement, since you never know if the other party will be able to make the required showing.  Indeed, Cigna engaged in a dangerous roll of the dice by attempting to undermine the deal after having agreed to do everything it could to ensure its approval.

The second lesson is related to the first.  The parties must still guard against post-signing changes of heart, and strategic efforts to derail the deal.  To do this, the parties should make clear that breach of the best efforts clause does not require a showing that the merger would have been cleared but-for breach.  Such a provision would place the burden on the party claiming breach to show that the defaulting party's conduct was material in the "relevance" sense to the ultimate issuance of an injunction.  But it should also expressly relieve that party from showing that the merger would have been cleared but for the alleged breach.  Such a provision should also preclude the breaching party from asserting lack of but for causation as an affirmative defense.  And because damages for breach of such a provision would be difficult to quantify – particularly in light of the Court's reasoning here – the parties should negotiate appropriate liquated damages in the event the provision is breached and the transaction fails to close.

**C. Did the Court's Causation Analysis Effectively Gut Hell or High Water Provisions?**

Anthem clearly wanted the deal, and it tried valiantly to persuade the DOJ of its merits and to defend against an injunction.  Indeed, the Court credited Anthem's representation that it spent over $800 million trying to secure approval for the deal.  But, although Cigna wanted to walk away from the deal and did everything in its power to kill it, Cigna still wanted its $14.7 billion.  So Cigna tried to pin the blame on Anthem for the deal's collapse, arguing that Anthem should have done more to clear the deal.  Though the causation analysis above might have killed that claim too, the court found another, more elegant way to prevent that quixotic outcome.

Not even Cigna could reasonably claim a breach of the general reasonable best efforts obligation by Anthem. So Cigna instead turned to a different provision – one that imposed special obligations on Anthem as the acquirer. In many transactions, the seller requires the buyer to take on all the antitrust risk (or as much of it as is reasonably shiftable). One common way of doing this is through a so-called “hell or high water” provision, which ostensibly forces the acquirer to do everything possible to get approval for the transaction, including divesting as much of the acquired business to a third party as needed.

The parties did not quite go this far. Under the Merger Agreement, Anthem was required to “take any and all actions” needed to obtain regulatory approval, but it did not need to take steps that would have a “material adverse effect” on the merged entity. While there has been much debate on how much value “material adverse effect” provisions actually have in light of court’s historical hostility to them, the importance of such a provision here cannot be overstated. That provision relieved Anthem from having to do the one thing that most certainly would have satisfied the DOJ (and Cigna), which is to pay the $54 billion and then spin-off the entire Cigna business lock, stock, and barrel to a third party. And because Anthem did not have to do this, Cigna was effectively forced to scrounge around for some other alleged breach of the modified hell or high water provision.

Ultimately, the Court found that, even if Cigna had identified such an act, Anthem would still escape liability because of a relatively unique (but not unheard of) provision in the Merger Agreement. Under the Merger Agreement, the parties agreed to a limitation of liability clause in the event of termination of the Agreement. Under that provision, post-termination liability for breach of any obligation (subject to certain exclusions) was limited to “willful breach.”

This raised the question of whether Anthem’s conduct was willful. As the Court explained, the common law defines willful breach as including intentional acts that are ultimately found to have breached a contractual obligation, even if the defaulting party did not believe it was violating the contract. As the Court explained, “[a]t common law, a knowing and intentional breach occurs when a party knowingly takes an action that results in a breach …; the party does not also have to know that its conduct constitutes a breach.” If this were the standard, then it may in fact be that Anthem’s failure to take additional steps to secure approval would be deemed willful.

But, the Court found, the parties "contracted around" the common law by including a definition for "willful breach" that goes further and required a showing that the defaulter act with "actual knowledge that the taking of such act or failure to take such action would be a material breach of this Agreement." Whether the parties intended to go beyond the common law definition of "willfulness" or whether this was just a mistake by over-zealous drafters is hard to say from the record. But either way, this provision meant that Cigna had to show that Anthem believed it was breaching the Agreement by not doing more.

This departure from the common law had a devastating impact on Cigna's claim. Because there were strategic pros and cons to pursuing each of the alternative remedies Cigna proposed, Anthem could have reasonably believed that the strategy it actually chose – litigating the merger – was permitted under the Agreement. That belief precluded any finding that Anthem acted with an intent to breach the Agreement, and thus, its breach – if there was one – was not "willful" as the parties had self-defined that term.

The lessons learned from this are obvious, and it depends on which side of the transaction you are on. First, the decision shows the power – and the danger – of a hell or high water provision, and the importance of a material adverse effect limitation on that obligation. If not for that limitation, Anthem might have had to fork over billions of dollars, even if it got nothing in return. And its failure to do so, might have put it in breach. By excluding the "nuclear option" from the hell or high water provision, Cigna's ability to claim a willful breach became more difficult, because Cigna would have to show that those alternatives were both feasible and would have prevented a challenge.

Second, the decision shows that limitations on liability can have profound effect, especially if the parties define terms – whether intentionally or unintentionally – in ways that depart from the common law. If not for both the limitation of liability provision and the contractual departure from the common law's definition of willfulness, Cigna might have prevailed.

As an acquirer, therefore, it is important to put limits around hell or high water provisions.  Even in deals with many bidders, where there may be immense pressure to accept the target's terms, the impact of these provision can be muted by "material adverse effect" limitations and  limitations on liability provisions.  As the Anthem decision shows, the latter may be especially useful because their impact on the hell or high water obligation is not immediately obvious, and such limitations may be more palatable because they appear (on their face) to be mutual.  As a seller, it is important to be wary.  Are you really getting what bargained for?  Or, are the protections which seem so seller-friendly actually worthless because they are undermined by limitations of liability provisions or general causation requirements?

**D. Did the Court Gut Reverse Termination Fee Provisions?**

Cigna believed it had an ace in the hole.  Even if the hell or high water provision failed, it thought it was protected by a reverse termination fee, which obligated Anthem to pay over $1.8 billion in damages if the deal failed to close and certain other conditions were met.  The Reverse Termination Fee provision involved a complex piece of drafting, running many paragraphs long and incorporating many other provisions throughout the agreement.

Ultimately, the Court found that Cigna was not entitled to any reverse termination fee because it attempted to terminate the agreement (and collect the fee) before it was entitled to do so.  Indeed, the attempt to improperly terminate the agreement, the Court found, was itself a breach by Cigna of its obligation to use reasonable best efforts to consummate the transaction.  Thus, by the time Cigna's right to terminate matured, it was already in breach of its obligations, allowing Anthem to terminate for cause and avoid the reverse termination fee.

The facts here were egregious.  It is not often that a party engages in a concerted effort to derail the deal, and then seeks damages from the innocent party when those efforts succeed.  But there are still lessons to be learned.  The most important of which is that parties facing a long, drawn out regulatory battle might eventually grow tired of the fight, which in turn may cause parties to strategically attempt to terminate the deal to take advantage of (or avoid) a reverse termination fee.  The solution to this, as the Court itself pointed out, is to "address this issue by providing contractually that a reverse termination fee would remain due even if the Merger Agreement is terminated" for any reason.

**E. Conclusion**

The Anthem decision is a welcome insight into how courts interpret antitrust risk allocation provisions that lawyers have been putting into their deal documents for decades.  These provisions are rarely tested in the courts, and – until now – it was generally believed that they offered the protections they promised on their face.  Oh, how wrong we were.  The Anthem decision shows the exact opposite – that these provisions may actually be worthless.  Anthem and Cigna are now in the same position as they would have been had they not agreed to any antitrust allocation provision.  But deal lawyers take heart:  By exposing the many drafting flaws responsible for this ironic outcome, it is now clear how to fix them in the future.

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[1] It is unclear whether the presence or absence of the "No Injunction" provision was really relevant to the outcome.  Certainly, the fact that there was an injunction preventing consummation of the merger is relevant.  But the usefulness of the "No Injunction" provision, which simply says the parties won't do what they are otherwise prohibited by law from doing, does not seem to add much.  Moreover, if the injunction prohibits the closing of the transaction, it is only because the contract of merger is itself an illegal agreement and thus unenforceable by either party.

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