Clause Description

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Bloomberg Law

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Megamergers that deprive American consumers of competition are illegal. But the urge to merge is often so strong that antitrust risks rarely prevent large corporations 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 Federal Trade Commission or the Department of Justice will annul the deal.

But as a 2020 decision by the Delaware Court of Chancery shows, 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. This article briefly describes the court's analysis. Many common law contract rules can be varied by agreement. This article addresses practical drafting approaches the parties should consider to address these issues.

Background

In July 2015, Anthem and Cigna agreed to merge in a transaction valued at over $54 billion. To protect their interest if the deal ultimately failed, the merging parties entered the transaction with eyes wide open, each injecting a number of "antitrust risk allocation" provisions into their merger agreement. 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, colloquially called a "hell or high water" provision, required 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.
- The third provision obligated Anthem to pay a $1.8 billion "reverse break-up fee" if Anthem failed to gain antitrust approval by the termination date.

Entering the regulatory fray with protection donned, or so they thought, the merging parties emerged defeated. The DOJ challenged the deal and ultimately the U.S. District Court for the District of Columbia issued a permanent injunction, blocking the transaction from closing, which the D.C. Circuit affirmed.

But this three-year journey was just the beginning of this saga. 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 the battle intensified, the parties' united front before the DOJ and the courts vanished. According to Anthem, Cigna conducted a covert communications campaign against the merger, withdrew from integration planning, and sought to undermine Anthem's defense in the antitrust litigation. For its part, Cigna alleged that Anthem too did not do enough to propose remedies acceptable to the DOJ.

Pointing fingers at the other, each claimed that the actions of the other violated the antitrust risk allocation provisions of the merger agreement. 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 Anthem's 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 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 J. Travis 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 after the suit as before. How the court got to this result provides valuable lessons for antitrust and deal lawyers alike.

Effect on 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.

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, but this provision is important contractually because, unless that condition is excused for some other reason, it is what arguably relieves the parties from having to pay damages for failing to actually close in the face of an injunction.

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 Anthem's 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.

The court concluded that the question 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 materially increased the likelihood of an injunction.

Even if Anthem makes that threshold showing, the court concluded 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 enjoined.

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. The court found that Cigna withdrew from "integration planning activities," undermining Anthem's efforts to gather evidence to present a compelling efficiencies defense.

The court also concluded that Cigna 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.

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 found these material contractual breaches were not actually material to the issuance of the injunction, because the DOJ and the court would have reached the same decision anyway.

Though the burden was on Cigna, as a practical matter, Anthem had to establish that what both the D.C. District Court and the D.C. Circuit found to be illegal, really wasn't. Ultimately, Anthem could not prove but-for causation – that but-for Cigna's breach of the best efforts, no injunction would issue.

Effect on 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. Despite Cigna doing everything in its power to destroy the deal, Cigna still wanted its $14.7 billion.

Because not even Cigna could reasonably claim a breach of the general reasonable best-efforts obligation by Anthem, 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 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.

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 agreement, the parties agreed to a limitation of liability clause in the event of termination of the agreement, which limited post-termination liability for breach of any obligation, subject to certain exclusions, to "willful breach."

The court indicated that 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.

However, the court found the parties "contracted around" the common law by including a definition for "willful breach" that also required a showing that the defaulting party act with "actual knowledge that the taking of such act or failure to take such action would be a material breach of this Agreement."

This provision meant that Cigna had to show that Anthem believed it was breaching the agreement by not doing more.

This departure from 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.

Effect on Reverse Termination Fee Provisions

Cigna also argued that 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.

Lessons Learned and Practical Tips

Reasonable Best Efforts. Two key lessons come from the court's causation analysis of best-efforts clauses. The first is that the hurdle for establishing liability under a best-efforts clause is incredibly high if the common law rule stated in the Restatement applies. 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.

Even so, it would be foolhardy in the extreme to breach such an agreement, since the breaching party never knows if the other party will be able to make the required showing that the breach of the clause did materially contribute to the failure of the condition. 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. Parties must still guard against post-signing changes of heart, and strategic efforts to derail the deal. The effects of the Restatement provision can be varied by agreement. Parties should:

Make clear that a claim based on breach of the best-efforts clause does not require a showing that the merger would have been cleared but-for the 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 the provision 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.
- Because damages for breach of such a provision would be difficult to quantify—particularly in light of the court's reasoning here—parties should negotiate appropriate liquated damages in the event the provision is breached and the transaction fails to close.

Reverse Termination Fee. 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. The most important lessons to be learned from this 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, 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.
- Further, the party seeking the fee should not "jump the gun" (as Cigna did) and terminate before it was contractually entitled to do so.

Conclusion

Lawyers have been putting antitrust risk allocation provisions into their deal documents for decades. Until now, it was generally believed that these provisions, rarely tested in courts, offered the protections they promised on their face. The Anthem decision shows the exact opposite—that these provisions may actually be worthless unless drafted to take into account the types of "outs" addressed in this decision.

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 can take heart: By shining a light on the pitfalls that may result from the interplay of these common risk allocation provisions, it is now clear how to avoid them in the future.