# Allocation of Antitrust Risk in Mergers & Acquisitions

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# Overview

- Allocation of antitrust risk is an issue that frequently arises between parties to mergers or acquisitions that raise potential antitrust concerns
- This presentation:
  - Describes the types of contractual provisions adopted to allocate antitrust risk
  - Identifies factors that determine the type of provision adopted in a particular transaction
  - Analyzes the implications of different types of antitrust risk allocation provisions for the parties' dealings with the antitrust enforcement agencies
  - Addresses legal issues with respect to interpretation of these provisions and whether the parties can withhold these provisions from enforcement authorities because they are covered by the joint defense or "common interest" privilege

# Antitrust Risk Allocation Provisions: Purpose

- In the U.S., mergers and acquisitions are reviewed at the federal level by either the Antitrust Division of the U.S. Department of Justice or the Federal Trade Commission (mergers meeting certain dollar thresholds must be notified to these agencies under the Hart-Scott-Rodino Act)

- Purpose of this review – to determine whether the combination of two businesses that compete with respect to certain products or services will enable the merged entity to exercise "market power," i.e., the power to raise prices above competitive levels or exclude competition

- If the reviewing agency determines the transaction is likely to result in such "anticompetitive effects," it may oppose the transaction altogether, or condition approval on the parties agreeing to "remedies" such as divestitures of certain assets or businesses, or other restrictions on the merged business (e.g., require licensing of certain IP)

- Parties to a merger or acquisition for which there is a significant possibility that such divestitures or other remedies will be required typically include a provision in the merger agreement to allocate the risk of such remedies between them

# Antitrust Risk Allocation Provisions: Types

- Generally, the Purchaser wants to minimize its contractual obligations to make divestitures, hold businesses or assets separate pending divestiture, or agree to any other restrictions on the post-merger business

- The Seller usually wants the Purchaser to do whatever is necessary to obtain antitrust approval as quickly as possible so it can get its money, including agreeing to any divestitures or other restrictions requested by the reviewing agency

# Antitrust Risk Allocation Provisions: Types

- **"Hell or high water"**
  - Except to the extent otherwise provided in Section X, upon the terms and subject to the conditions of this Agreement, **each of the parties hereto shall** (i) make promptly its respective filings and thereafter make any other required submissions, under the HSR Act and any other Law with respect to this Agreement and the Mergers, if required, and (ii) **use its reasonable efforts to take, or cause to be taken, all appropriate action, and to do, or cause to be done, all things necessary, proper or advisable under applicable Laws to consummate and make effective the Mergers**, and the other transactions contemplated by this Agreement, **including using its reasonable efforts to obtain all** Permits, **consents, approvals, authorizations**, qualifications and **orders of Governmental Authorities** with the Company and the Subsidiaries **as are necessary for the consummation of the transactions contemplated by this Agreement** and to fulfill the conditions to the Mergers and the other transactions contemplated by this Agreement.

# Antitrust Risk Allocation Provisions: Types

- **Divestiture Obligation Limited by "Material Adverse Effect" or "MAE"**
  - **The Company and Parent shall** cooperate with each other and . . . **use . . . their respective reasonable best efforts** . . . (ii) **to obtain as promptly as practicable all consents, registrations, approvals, permits and authorizations necessary or advisable** to be obtained **from any . . . Governmental Entity** in order to satisfy the conditions in Article X and to consummate the Merger . . . ; **provided, however,** that, notwithstanding anything to the contrary in this Agreement, **neither Parent nor any of its Subsidiaries shall be required to agree (with respect to (x) Parent or its Subsidiaries or (y) the Company or its Subsidiaries) to any divestitures, licenses, hold separate arrangements or similar matters in order to obtain approval** of the transactions contemplated by this Agreement . . . **under applicable Competition Laws if such divestitures, licenses, arrangements or matters would reasonably be expected to have a material adverse effect on the** financial condition, assets and liabilities (taken together) or **business of Parent and its Subsidiaries and the Company and its Subsidiaries on a combined basis.**

# Antitrust Risk Allocation Provisions: Types

- **Divestiture up to certain dollar amount**
  - **Parent and Seller shall, if required by one or more Governmental Entities acting pursuant to any applicable antitrust, competition or similar laws** to obtain any of the . . . consents, clearances, approvals . . . or if required by a federal, state or foreign court, **agree to the divestiture** by Parent, Seller or any of their respective Subsidiaries **of shares of capital stock or of any business, assets or property of Parent or its Subsidiaries or Seller or its Subsidiaries and the imposition of any limitation on the ability of Parent or its Subsidiaries or Seller or its Subsidiaries to conduct their respective businesses or to own or exercise control of their respective assets, properties and stock** (including licenses, hold separate agreements, covenants affecting business operating practices or similar matters) **if such divestitures and limitations, individually or in the aggregate, would not be reasonably expected to result in the loss of annualized revenue of Parent and Seller on a combined consolidated basis of more than $225,000,000**.

# Antitrust Risk Allocation Provisions: Types

- **Disclaimer of any obligation to agree to divestitures or restrictions**
  - Notwithstanding anything in this Agreement to the contrary, **in no event will Parent or Sub be obligated to propose or agree to accept any undertaking or condition, to enter into any consent decree, to make any divestiture, to accept any operational restriction, or take any other action that, in the reasonable judgment of Parent, could be expected to limit the right of Parent or the Surviving Corporation to own or operate all or any portion of their respective businesses or assets**. With regard to any Governmental Antitrust Entity, neither the Company nor any Company Subsidiary . . . shall, without Parent's prior written consent in Parent's sole discretion, discuss or commit to any divestiture transaction, or discuss or commit to alter their businesses or commercial practices in any way, or otherwise take or commit to take any action that limits the Parent's freedom of action with respect to, or the Parent's ability to retain any of the businesses, product lines or assets of, the Surviving Corporation or otherwise receive the full benefits of this Agreement.

# Antitrust Risk Allocation Provisions: Factors

- The type of provision to which the parties agree depends on factors such as:
  - Degree to which the transaction raises substantive antitrust concerns
  - Relative bargaining power of the Purchaser and Seller
  - Type of remedy likely to be required by the reviewing agency
  - Importance of other issues that may cause a party to trade off its preferred type of clause

# Implications of Different Provisions

- As these factors suggest, the type of provision agreed upon will depend largely on the interests and relative bargaining positions of the parties
- Often, no one type of antitrust risk allocation provision is objectively “best” for any given transaction
- However, different types of clauses may raise issues the parties should consider

# Implications of Different Provisions

- Transaction that does not raise substantive antitrust concerns
  - Don’t include detailed provisions regarding divestitures or other remedies
  - These may cause the reviewing agency to believe there is a problem where none exists
  - Better to limit language to “plain vanilla” provision – e.g., agree to cooperate in making HSR filings and to submit filings and answers to follow-up questions promptly

# Implications of Different Provisions

- As Purchaser – try to avoid "hell or high water" clauses
  - Telling the reviewing agency the Purchaser is required to do anything necessary to obtain approval reduces the Purchaser's bargaining power with the agency
  - This may be to Seller's disadvantage too as Purchaser may spend more time trying to persuade the agency no remedy is required to avoid a material adverse divestiture or other remedy

# Implications of Different Provisions

- Avoid provisions that require divestitures of specific product lines or assets
  - Divestitures are supposed to be no broader that what is required to address the competitive concerns raised by the transaction
  - As a practical matter, however, the parties should assume that any divestiture or other remedy specified in the agreement (e.g., license of specific IP) will become the **minimum** required by the reviewing agency
  - Provisions that include specific dollar amounts raise similar concerns

# Implications of Different Provisions

- MAE provisions are more favorable to the Seller if based on a broader definition of the affected business
  - No divestiture required that will result in an MAE on the **combined businesses of the Purchaser and Seller –** makes it more difficult for the Purchaser to avoid a divestiture than
  - No divestiture required that will result in an MAE on **either the relevant business of the Purchaser or the Seller**

# Best Efforts

- Many antitrust risk allocation provisions include language that the parties will use their "best efforts" or "reasonable best efforts" to obtain antitrust approval
- What do these provisions mean? In general:
  - "Best efforts" is not a guaranty, but a promise to take reasonable actions
  - No meaningful difference between "best efforts" and "reasonable best efforts"

# Best Efforts

- Some states, including Illinois -- a general obligation to use "best efforts" is not enforceable
- Even in states where this is not the case, parties should try to define with some specificity what constitutes best efforts, or what is not required to meet this standard, (e.g., divestitures, hold separate, licenses), without identifying specific assets or product lines for the reasons discussed above
- See, e.g., "Best Efforts Standards under New York Law: Legal and Practical Issues," David Shine, (2004) Glasser Legal Works; "'Best Efforts' Promises Under Illinois Law," James M. Van Vliet, Jr., 88 Ill. B.J. 698 (Dec. 2000)

# Are Antitrust Risk Allocation Provisions Privileged?

- It is well accepted that a "joint defense" or "common interest" privilege exists with respect to pre-closing communications between merger parties for purposes of addressing potential antitrust issues raised by a transaction or responding to a reviewing agency investigation without waiving the parties' individual attorney-client or work product privileges, see e.g., *In Re Sulfuric Acid Antitrust Litigation*, 2006-1 Trade Cas. (CCH) P75,315 (N.D. Ill. 2006) (recognizing the joint defense privilege in non-litigation contexts)

- Parties often memorialize their intention to rely on the joint defense privilege, and the rules they agree upon governing exchange of information pursuant to this privilege, in a written joint defense agreement or "JDA," which is itself privileged

# Are Antitrust Risk Allocation Provisions Privileged?

- Some counsel have advised clients they can avoid disclosure to the government of what they would be willing to divest to obtain regulatory approval by inserting their antitrust risk allocation provision in the JDA and claiming privilege
- The antitrust agencies have indicated that they do not consider such provisions to be privileged
- Arguably, such provisions are terms of the merger agreement on which the parties have adverse, not common, interests that do not support a joint defense privilege claim

# Are Antitrust Risk Allocation Provisions Privileged?

- Alternatively, an antitrust risk allocation provision could be inserted into a schedule to the merger agreement; parties usually submit only the body of the merger agreement with the Hart-Scott-Rodino filing, not the schedules
- The reviewing agency could take the position that the risk allocation provision is a material term of the merger agreement and that, without it, the HSR filing is not complete
- Also, withholding the provision on privilege or other grounds suggests to the reviewing agency the parties have something to hide
- Better practice – include provision in merger agreement but avoid the types of provisions and language described above that may disadvantage the parties in dealing with the reviewing agency

# Conclusion

- Antitrust risk allocation provisions address an important issue that can have a material effect on the interests of parties to a merger or acquisition
- What a party wants the provision to say will depend on a number of factors including, most significantly, whether the party is the Purchaser or Seller
- Both parties should be aware, however, that the type of provision used may have implications for how the reviewing agency deals with the transaction, and should take this into account while negotiating a provision that protects their interests

# Questions and Comments

# Allocation of Antitrust Risk in Mergers & Acquisitions – An EU perspective


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# Overview

- This presentation:
  - Describes the types of antitrust allocation provision used in the EU
  - Analyses the legal issues arising in relation to these provisions
  - Summarises similarities and differences between the EU and US approaches

# Antitrust Allocation Provisions: Purpose

- EU review of mergers
  - EU merger control - European Commission
  - National merger regimes – national competition authorities of one or more of the 27 Member States
- Analysis – will the merger significantly impede competition or substantially lessen competition?
- If so:
  - Prohibition or
  - Clearance subject to structural or behavioural remedies

# Antitrust Risk Allocation Provisions

- Motivations of Purchaser and Seller are the same the world over:
  - Purchaser – minimise/eliminate seller interference with (i) timetable and (ii) decision to offer remedies
  - Seller – ensure (i) deal can be done as soon as possible and (ii) remedies are provided to facilitate this
- EU and Member States –
  - Approach differs from US approach
  - But influences are the same – whether there are issues, bargaining power etc.

# Antitrust Risk Allocation Provisions

- EU: most common provision:
  - **The European Commission issuing a decision under Article 6(1)(b) on terms [reasonably] satisfactory to the Purchaser.**
    - Clearance at end of Phase I - no Phase II
    - Purchaser prefers subjective test for acceptability of any remedies – terms satisfactory to it
    - Seller prefers objective test– but difficulties in interpretation of "reasonable"
    - Most like US "disclaimer" provision
- "Hell or high water", MAE and financial limitation clauses are still relatively unusual, although use is increasing

# Antitrust Risk Allocation Provisions

- Tactics
  - European Commission has access to " all documents bringing about" the transaction
  - If no substantive concerns – simple provision suffices
  - If substantive concerns – requirement to do all necessary to obtain clearance, and detail of how, could reduce bargaining power
  - Privilege

# Antitrust Risk Allocation Provisions

- UK: provisions influenced by voluntary nature of UK regime - no requirement to obtain clearance before implementing a transaction
  - Seller – uses this to justify absence of antitrust allocation provision
  - Purchaser – aims to avoid possible fire sale where likely competition issues so will argue for antitrust risk allocation provision

# Antitrust Risk Allocation Provisions

- Compromise:
  - The Office of Fair Trading deciding on terms [reasonably] satisfactory to the Purchaser that the Transaction will not be referred to the Competition Commission and the period for appealing this decision having expired without an appeal being made
    - Clearance at end of Phase I - no Phase II
    - Purchaser prefers subjective test for acceptability of any remedies – terms satisfactory to it
    - Seller prefers objective test– but difficulties in interpretation of "reasonable"
    - Most like US "disclaimer" provision

# Antitrust Risk Allocation Provisions

- Tactics
  - If no substantive concerns – no provision – depends on Purchaser bargaining power and risk aversion
  - If substantive concerns – requirement to do all necessary to obtain clearance, and detail of how, could reduce bargaining power
  - Privilege

# Best and Reasonable Endeavours

- Best and reasonable endeavours provisions tend to be used only for timing of filing and responses to competition authorities
- "Endeavours" – a spectrum of clauses, whose interpretation depends on the other provisions of the agreement and the commercial context (*Rhodia v Huntsman*, February 2007)

# Best and Reasonable Endeavours

- Best Endeavours:
  - More stringent than reasonable
  - "they do not mean second-best endeavours" (1911!)
  - Obligors are required to take all those steps in their power which are capable of producing the desired result…being steps which a prudent, determined and reasonable [obligee], acting in his own interests and desiring to achieve that result, would take (Court of Appeal, 1980)
  - Not an absolute obligation or guarantee, but may require significant expenditure

# Best and Reasonable Endeavours

- Reasonable Endeavours:
  - Less tangible
  - Involves balancing the obligation against all relevant commercial considerations
  - May require limited expenditure

# Questions and Comments

# Covenants Not to Compete in Mergers & Acquisitions


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# Overview

- Merger and other types of agreements often contain clauses restricting the seller from competing with the business being sold, or from soliciting or hiring the seller's former employees.

# Overview

- As early as 1899, courts recognized that covenants not to compete do not violate the antitrust laws because
  - It [i]s of importance, as an incentive to industry and honest dealing in trade, that, after a man ha[s] built up a business with extensive good will, he should be able to sell his business and good will to the best advantage, and he could not do so unless he could bind himself by an enforceable contract not to engage in the same business in such a way as to prevent injury to that which he was about to sell. (*United States v. Addyston Pipe & Steel*, 85 F. 271, 280 (6th Cir. 1899), *modified*, 175 U.S. 211 (1899).)

# Examples

- Covenant Not to Compete
  - Restriction designed to protect the buyer (the "covenantee's legitimate property interests") and, thus, ensure the successful sale of the business.
- No-Hire/Non-Solicitation Provision
  - Restriction designed to make the asset being sold more attractive to buyers (*e.g.*, as an ongoing business) and, thus, ensure the successful sale of the business.
- Confidentiality/Non-Disclosure Agreement
  - Restriction designed to facilitate the exchange of information, and protect the fruits of due diligence.

# Covenant Not to Compete (with No-Hire/Non-Solicitation Provision)

- Seller agrees that it will not:
  - directly or indirectly, for a period of [time] following the date hereof, own, manage, operate, control, be employed or engaged by or otherwise participate or have any interest in any Person which is engaged in, or otherwise engaged in, the Business in this [geography], or (ii) otherwise solicit, divert, take away, interfere with or disrupt relationships with, or attempt to do any of the foregoing with respect to, any customer, supplier, employee, independent contractor, agent or representative of [Buyer].

# Confidentiality/Non-Disclosure Agreement

- You agree that:
  - for a period of [time] from the date of this Agreement, neither you nor any of your subsidiaries nor your or their Representatives shall, actively solicit, interfere with, or endeavor to entice away, any person who is at the date of this Agreement, or who is during discussions between [Party] and you, a director, employee, consultant or individual employed by or seconded to work for [Party] or its affiliates, or offer to employ, or assist in, or procure the employment for, any such person, *provided that* this restriction shall not prevent you from employing such person who responds to a general advertisement for recruitment without any other direct or indirect solicitation or encouragement by you.

# Confidentiality/Non-Disclosure Agreement

- Note the exception for "general advertisement for recruitment without any other direct or indirect solicitation or encouragement by you."
- At least one court has held that "[t]he use of headhunters, no matter how widespread or acceptable in the industry, simply does not constitute a 'general advertisement.'" *Global Telesystems, Inc. v. KPNQwest, N.V.*, 151 F. Supp.2d 478, 483 (S.D.N.Y. 2001).

# Antitrust Basics

- Ancillary
  - Is the restriction necessary to protect the purchaser's interest in what is being bought?
- Reasonable
  - Is the restriction reasonable in scope in terms of duration, territory, and product space or line of business.

# Antitrust Basics

- "[C]ovenants not to compete which are unlimited as to space or time are invalid and unenforceable." *Compton v. Metal Prods.*, 453 F.2d 38, 45 (4th Cir. 1971).
- Duration: depends on the circumstances.
- Product and territorial scope: generally speaking, limited to where the seller operated at the time of the transfer.

# Antitrust Risks

- "Cover" for a *per se* unlawful agreement between competitors to limit their competition with each other. *See*, *e.g.*, *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46, 49 (1990) (holding that covenant not to compete made pursuant to an agreement between two bar review courses where one party licensed the other to sell its courses in Georgia and agreed not to compete in Georgia, and the second party agreed not to compete outside of George, amounted to an unlawful *per se* territorial allocation). *See also In re Polygram Holdings, Inc.*, 136 F.TC. 310 (2003) (noting that "restraints on activities 'outside the ambit of the joint venture' cannot be hidden under its cloak").

- Agreements by actual or potential competitors not to compete with each other are *per se* unlawful – that is, automatically unlawful and without any consideration of "reasonableness" in particular circumstances.

# Antitrust Risks

- Buyer and seller of cable assets each agree to reciprocal non-competes:
  - "own, manage, operate, control, or engage or participate in the ownership, management, operation, or control of, or be connected as a stockholder, officer, director, agent, employee, consultant, partner, joint venturer, or otherwise with any business or organization, any part of which engages in the business of operating a cable television system, subscription television system, multipoint distribution system, direct broadcast system, private operational fixed microwave service, or any similar system or service (or obtaining or holding any authorizations or franchises for any of the foregoing)," located within fifteen (15) miles of the legal boundaries of a community in which the other currently, or at any time in the future, own or operate a cable television system.

# Antitrust Risks

- Buyer and seller enjoined from enforcing the mutual covenants not to compete, and prohibited from entering into similar agreements not to compete with the seller or buyer of a cable television system or cable television service in any geographic area in the future. *Boulder Ridge Cable TV*, 118 F.T.C. 950 (1994).

# Practical Considerations

- Totality of the circumstances
- "Blue penciling" – some courts will uphold an overbroad covenant "to the extent that a breach of the covenant has occurred within a reasonable geographic area and time period, and, where applicable, with respect to a product reasonably related to the legitimate purpose of the restraint." *Lektro-Vend Corp. v. Vendo Co.*, 660 F.2d 255, 267 (7th Cir. 1982).
- State law considerations

# Questions and Comments

# Covenants Not to Compete in Mergers & Acquisitions – An EU Perspective


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# Approach – EU and EU Member States

- Non competes are recognised as beneficial: protecting the purchaser's investment in the target
- Will be cleared automatically as part of the merger if they can be shown to be "ancillary"
- Approach applies in EU and national jurisdictions

# "Ancillary"

- Directly related and necessary to the implementation of the transaction
- Directly related:
  - Economically related to the transaction
  - Intended to allow a smooth transition to the new owner
- Necessary:
  - The transaction could not be implemented without the non-compete – or could be implemented only with considerably greater difficulty
  - Assessed according to what the implementation of the transaction reasonably requires

# "Ancillary"

- Permitted scope of non-competes: four considerations
  - Duration
  - Subject matter
  - Geographic scope
  - Persons subject to non-compete

# "Ancillary"

- Duration
  - Transfer of know-how and goodwill – 3 years
  - Transfer of goodwill alone – 2 years
  - Transfers of assets alone (land, IPR) are not ancillary – not "necessary"
- Subject-matter
  - Products and services forming the economic activity of the target when transferred
  - Includes products/services at advanced stage of development, even if not yet marketed

# "Ancillary"

- Geographic scope
  - Area in which target offered products/services before transfer
  - Includes territories target was planning to enter
- Persons
  - Vendor, its subsidiaries and commercial agents
  - Not resellers, customers
  - Not purchaser
- Ban on shareholdings in competitors permitted, unless purely financial investment

# "Ancillary"

- Similar approach to non-solicitation and confidentiality clauses
- Based on English "restraint of trade" doctrine

# Not “Ancillary”?

- Risk of unenforceability
- Assess qualification for exemption

# Questions and Comments