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Navigating M&A **Divestiture Complexities**

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M&A activity in 2016 and the first half of 2017 remained at high levels, and competition authorities in the United States, European Union and other jurisdictions continued to be very aggressive, in some instances challenging high-profile deals in court, causing some parties to abandon their transactions rather than litigate, and in other instances requiring parties to commit to extensive divestitures to avoid court challenges and obtain approvals. Although the change in U.S. administration has led to some softening of expectations for near-term enforcement in the United States, the authorities have remained active in 2017, and the agencies' recent string of successes in high-profile deals ensures that companies can expect an aggressive approach to deals presenting competition issues. Against this backdrop, deal practitioners can expect to be increasingly confronted with the prospect of negotiating significant and often complex divestitures in order to obtain antitrust and competition approval for M&A transactions.

These divestiture transactions, in themselves, pose unique challenges in terms of, among other things, board process, auction and negotiating dynamics with third-party purchasers, conflicting regulatory requirements across borders, and timing coordination among divestitures and the overall transaction. While this article is primarily focused on general antitrust and competition regulation, reviews by industry-specific regulators can create similar considerations.

Board process is, of course, familiar to all practitioners in the context of M&A transactions, but divestitures pose additional complexity. Much of the complexity arises out of the need for each party's board to simultaneously consider the impact of a proposed divestiture not only in terms of the merits of the divestiture itself, but also its effects on the value proposition of the primary transaction and each party's contractual obligations under the primary transaction agreement. Moreover, the board must conduct this multilevel analysis on

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an ongoing basis: when deciding whether to go forward with a divestiture package, when negotiating with regulators and when determining whether to enter into an agreement with a particular purchaser of the divestiture package. For instance, rather than simply weighing the merits of the divestiture against the status quo operation of the standalone company and alternatives for the divested business more narrowly, the board must consider the benefits of the primary transaction, net of the divestiture, against the status quo operation of the standalone company. In assessing the net impact of the divestiture, the board may appropriately take into account not only the consideration received for the divested assets relative to the perceived value of the divested assets in the hands of the company, but also any resulting reduction in the overall value of synergies in the primary transaction. Even if one or both parties are constrained in their ability to forgo making a particular divestiture due to contractual obligations in the primary transaction agreement, each party's board must remain informed about the net impact both in terms of ensuring the accuracy of public disclosure of synergies and other benefits of the primary transaction and in terms of assessing the overall value proposition of the transaction—indeed, one can easily imagine a case, particularly in an all-stock transaction where each party is contractually obligated to make any and all divestures, where one or both parties may not want to enforce their rights to force a divestiture if the net impact becomes too high.

Given the likely absence of a credible "stay the course" alternative, a seller conducting a sale process for a divestiture package proceeds from a potentially weak bargaining position. As a result, a seller's ability to create a competitive sale process is key to its ability to increase its leverage and, thereby, maximize its return on the divestiture. However, bidders for a divestiture package can be expected to become increasingly aware of each other's identity, and credibility, as the negotiation process with the relevant regulators progresses. For small divestiture packages with a wide range of potential buyers, the impact may not be dramatic, but as the size and complexity of a divestiture package increases, the universe of credible potential buyers will decrease.

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Conducting a preemptive sale process prior to formalization of the required package with the regulators may create increased secrecy and perceived competition, but it creates a risk that the package being marketed is either smaller or larger than would be required to satisfy the regulator. If conducting an auction later in the regulatory process, it is critical to make strong arguments to the regulators to preserve as many potential "viable purchasers" as possible. However, arguments made early in the regulatory process to argue for a smaller scope of divestiture package (for example, competitors in relevant markets are strong) may weaken arguments for why a particular potential bidder should be seen as viable (i.e., that an acquisition of the divestiture package by a competitor does not create competition issues in and of itself). In any event, the company may face the additional challenge of potentially creating or strengthening an aggressive competitor. A company's willingness to consider alternative forms of consideration may broaden the pool of potential purchasers—but competition regulators have a strong bias against traditional seller financing, and equity-based consideration may create competition concerns or take too long to execute. A novel alternative that has recently been tested is a swap of businesses between the company and the divestiture buyer. Finally, the sale process will face timing constraints introduced by the regulatory calendar and outside date in the primary transaction agreement. As key dates in the regulatory calendar and the outside date in the primary transaction agreement approach, leverage for bidders will increase—and this is magnified if exclusivity arrangements are in place, unless groundwork has been laid to quickly pivot to alternative bidders and fallaway triggers have been negotiated on exclusivity if price or terms become less favorable.

An already difficult negotiating dynamic for divestiture sellers is made even more challenging when, as is increasingly frequent, multiple regulators assert worldwide jurisdiction, creating the risk of different conclusions regarding the proper scope of a divestiture remedy. In light of this risk, it is critically

important for companies to coordinate remedy negotiations in key regulatory jurisdictions such as the United States, Europe, China and Brazil. As part of such coordination, companies may try to persuade regulators to communicate with each other (including, for example, by organizing joint meetings) during the negotiations to avoid, to the greatest extent possible, conflicting outcomes or situations in which different regulators require different remedies in respect of the same underlying issue. While regulators are generally prepared to coordinate with each other, they may be hesitant (for example, during transitions in political administrations) to even privately advocate their position to other regulators in the absence of a clear policy directive by the applicable current or new administration.

Time is a critical element in the divestiture process. Companies must sequence (1) negotiating with multiple regulators on the required scope of the divestiture, (2) if required by regulators, separating the underlying business to be divested from those not being divested and appointing a trustee to monitor this "hold separate business," (3) marketing and signing a definitive agreement to sell the divestiture package (and preparing the business to be sold, which requires separating the business and may involve the preparation of carveout financial statements), and (4) obtaining any required purchaser approvals from regulators—all generally prior to closing the primary transaction (and sometimes, particularly in the U.S. absent extenuating circumstances, closing the divestiture itself prior to, or substantially concurrently with, the primary transaction). If multiple divestitures are required, these processes will multiply and often overlap. In any event, they must be successfully navigated against the backdrop of the outside date in the primary transaction agreement. As a result, constant monitoring is required with respect to the outside date, public disclosure of the anticipated timing of the closing of the primary transaction, and any changes in the circumstances of the parties to the primary transaction. Under certain circumstances, timing pressure relative to the outside date in the primary transaction could even create opportunities for one of those parties to exert leverage and attempt to renegotiate the terms of the primary transaction agreement.

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In addition to bargaining at signing for an appropriately lengthy outside date, addressing any needed extensions early in the process, while those parties are most likely in a similar position to where they were at the time of signing (and therefore still aligned in their interest in completing the primary transaction), can reduce the opportunities for attempted renegotiation.

In light of the various challenges previously discussed (whether in terms of board process, auction and negotiating dynamics, conflicting regulatory requirements or timing), the thoughtful practitioner naturally turns an eye to identifying any approaches that can make such complex terrain more navigable. While conceding that these are no panacea, in the authors' experience certain planning techniques have served to mitigate some of the difficulties arising from the divestiture process. First, preparing a board faced with the probability of divestitures from the outset for the ongoing decision-making process, both by reviewing fiduciary duties and the type of multilevel considerations involved, will, in the authors' view, make for more informed and efficient deliberations along the way. Second, promptly beginning the process of separating out potential divested assets internally (including potentially preparing audited carveout financials), even before a divestiture has become inevitable, and negotiating a saleable package of divested assets with regulators expeditiously after a divestiture becomes unavoidable can provide a divestiture seller with an increased prospect of competition in its sale process and diminish somewhat the negative bargaining impact of time pressure. Next, maintaining a coordinated strategy across jurisdictions can reduce the chances of inconsistent divestiture requirements across jurisdictions and preserve a swifter, more focused sale process. Finally, ensuring that the client and its board are focused on the outside date of the primary transaction and its interplay with the unfolding divestiture transaction can provide the best chance of completing a transaction on its original terms.

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