bargaining leverage and risk tolerance, to the exclusion of a transaction's competitive effects.

Protracted Investigations May Mean Longer Transaction Timelines

The DOJ filed the lawsuit over a year after the parties announced the transaction on September 8, 2021. The parties announced this summer that they extended their agreement to June 30, 2023, suggesting they would prefer to accommodate a litigation timeline over abandoning the transaction. Investigation timelines of a year or more are meaningfully longer than under previous presidential administrations and are becoming increasingly common. Parties should be prepared to accommodate protracted antitrust review in their merger agreements or to extend transaction timelines if it becomes clear the agency will conduct an in-depth investigation.

Key Takeaways from the DOJ's Challenge of the Transaction

Much of the DOJ's focus on the ASSA ABLOY/ Spectrum transaction is not novel, but rather is an indication that the DOJ is holding firm on its commitment to aggressively enforce the antitrust laws. Merging parties should be cognizant of several points that are now becoming running themes of U.S. merger enforcement:

- The agencies will look at the impact of a merger on innovation, irrespective of the industry in which the transaction occurs.
- Merging parties' negotiations may be relevant to the agency's assessment of the transaction's impact on competition.
- Merger investigations can take up to a year, and with litigation, significantly longer, which should be accounted for in merger agreements.

ENDNOTES:

[1] https://www.justice.gov/opa/pr/justice-department-sues-block-assa-abloy-s-proposed-acquisition-spectrum-brands-hardware-and.

[2] https://www.justice.gov/opa/press-release/file/1535131/download.

[3] https://www.reuters.com/business/us-justice-antitrust-chief-says-hell-seek-stop-deals-not-settle-2022-01-25/.

BOARDS AND M&A: PLAYING, AND WINNING, THE GAME OF REGULATORY RISK

By Brandon Van Dyke, Clifford H. Aronson, David P. Wales, Frederic Depoortere and Kyle J. Hatton

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- With increasingly aggressive antitrust and foreign investment reviews, directors need to be fully informed about the risks of deals from the beginning of negotiations.
- Boards should insist that management and its advisers conduct a deep analysis of the regulatory risks and map out a variety of possible outcomes and responses.
- Because merger reviews are lasting longer and taking surprising turns, boards need to ensure that managements plan for the unexpected and negotiate terms that protect the parties and the value of the deal.

Boards are regularly called upon to guide management teams in answering the age-old strategic question: build or buy? But the already complex business calculus has become increasingly complicated in the past several years because of stepped up scrutiny of mergers by regulators that has made outcomes less predictable.

One need look no further than the front page to find news of transactions abandoned after governmental challenges. Meanwhile, leaders at the Department of Justice and Federal Trade Commission and other competition authorities have spoken of the need to reconceive antitrust law and have voiced support for aggressive new theories about protecting even potential competition.

Against this backdrop, boards and management teams planning an M&A transaction face increased risks that a deal may not be completed by the contractual deadline, or will fail altogether. Regulators may insist on novel and unacceptable remedies, and the value of a deal may be eroded by delays or harsh remedies.

In order to guide management, directors must be familiar with a toolkit of mitigation strategies. That includes decision-making processes, contractual provisions and tactical approaches to dealing with regulators.

In what follows, readers should bear in mind that the acquirer's perspective and priorities will often differ from the target's.

Trends We Have Observed

In the current regulatory environment, we have seen:

- a heightened interest in "fix it first" remedies, explained below;
- contractual provisions expressly addressing whether the parties are required to litigate to obtain regulatory approvals (and potential "tolling" of the drop-dead date while litigating);
- an increasing need to prepare for litigation in parallel with traditional negotiations over remedies; and
- an increased focus on whether to agree to regulators' requests for extensions of their review deadlines, given that, if the matter is going to be litigated, the parties will want to start as soon as possible.

Pre-Signing Analysis: Evaluate the Risk of a Blocked or Abandoned Transaction

To ensure that the fundamental risk of non-approval is properly assessed and mitigated, boards should focus on pre-signing preparation, careful negotiation of contractual risk-sharing provisions and a flexible post-signing strategy to obtain approvals.

First, the board must insist that management, with the help of outside advisers, conducts a probing analysis that goes well beyond traditional competition measures such as horizontal overlaps and combined market shares, which might have sufficed in the past. The analysis should consider the parties' documents and the expected reactions of customers, suppliers, employees, industry groups and competitors, because those could factor into regulators' decisions.

The parties need to fully understand the relevant authorities' current enforcement priorities, and any novel antitrust doctrines that key officials espouse. In cross-border deals, they will also need to evaluate the impact on national "industrial policy." That will include any connection to highly sensitive or favored industries and other policy goals that regulators may pursue as part of their review. Today those could include climate change, data privacy, employment and even wealth distribution.

Given the more aggressive positions that regulators are taking, thought also needs to be given at this stage to the circumstances in which it will make sense to litigate over the approval.

The analysis and its conclusions should be summarized and presented to the board, with ample opportunity for directors to raise questions and request follow-up investigation. And boards should continue to be briefed as more is learned throughout the deal process and regulatory issues are negotiated in contractual provisions.

Agreement Terms To Mitigate and Allocate Risk

A variety of established M&A terms can help manage regulatory risks and specify who bears them.

Efforts Covenants

The most familiar of these is the "efforts" covenant, which requires both acquirer and target to work together to obtain regulatory approvals, including by agreeing to divestitures and other remedies.

Sometimes these are "hell or high water" covenants that require the parties to accept all divestitures or remedies that regulators demand, but, in today's market, those account for less than 10% of these clauses in strategic deals. More often, they are limited by quantitative or materiality thresholds, or sometimes a commitment to divest a specific business or segment. The key is to negotiate a level of commitment that matches the most likely outcomes. This provision will be framed based on the initial analysis of possible scenarios. It's important to keep in mind, too, that even a "hell or high water" commitment does not guarantee consummation of a deal in the face of regulatory opposition.

Reverse Termination Fees

In some situations, the target may agree to a deal even though there is a significant risk that the transaction will not be approved, even with remedies. In these cases, the target may negotiate for a reverse termination fee payable by the acquirer in the event regulatory approvals are not obtained and the transaction fails to close. These fees are intended to mitigate the potential harm the target's business may suffer if the deal fails, and, often more importantly, they provide additional incentive to the acquirer to obtain approvals.

However, while reverse termination fees have ticked up, at a typical 4% to 6% of transaction value (occasionally much more), they may be a poor substitute for completion of the intended transaction. Therefore, even if such a fee is in place, during the review process, target boards will need to keep management focused on protecting against possible harm should the deal fail.

One cautionary note: There is a tendency to go right to the size of the reverse termination fee at the start of M&A discussions. This is not typically the best approach for either the acquirer or target. While important, the size of the reverse termination fee is not the only issue to be negotiated, and often not even the most important one, and issues can be traded off against each other. The best course in any particular deal should be informed by a clear-eyed view at the outset of the potential regulatory risks, and how they might be addressed. Often this requires a preliminary exchange of sensitive, confidential information at the early stages of the talks, which can of course be in tension with other tactical and strategic considerations.

Preemptive Divestitures

To head off problems with regulators, the parties can agree to exclude assets that raise competition issues for the transaction. For instance, where something less than a whole company is being purchased, the seller might agree to retain the problematic asset. In transactions involving a whole company, the parties may agree to a "fix it first" strategy, divesting a business or asset to a third party at or near the time they sign the main agreement. These can resolve regulators' concerns early and shorten the time it takes to obtain approvals.

Timing Provisions

With extended reviews, companies need to provide for the possibility that approval may take longer than hoped for. Boards should therefore guide management to set longer deadlines and ensure that there are mechanisms in place to deal with the possibility of extended delays. They should also query management about the impact of delays on the value of the deal.

In recent deals, these issues have been addressed with mechanisms such as:

- longer outside dates for completion and provisions for extensions;
- "ticking fees" paid by the acquirer in exchange for extending the initial outside date for the primary transaction (these function like interest payments);
- an increase in the reverse termination fee if the acquirer elects to extend the outside date or requires the target to agree to a divestiture in order to secure regulatory approval (similar to a ticking fee, but not a "pay as you go" cost to acquirer, and only paid if the deal terminates);
- if legally permissible, loans from acquirer to the target that are forgiven if the primary transaction does not close;
- expanded reimbursement for the target's costs to negotiate and consummate a divestiture; and
- additional employee retention funds for the target if the deal does not close within certain time periods, typically shouldered by the target but sometimes reimbursed by the acquirer.

Providing for delays in the merger agreement can help avoid a situation where party seeks to renegotiate terms if the deal drags out longer than expected.

Express Covenants to Litigate

Increasingly, antitrust authorities across jurisdictions have turned to litigation to challenge transactions, even where remedies have been offered by the parties. Therefore, both parties' boards are well served to guide management to seek provisions that clearly spell out when the parties are obligated to pursue litigation if regulators refuse to approve a transaction. Without these clear provisions, the parties may find themselves disputing the meaning of the more general efforts covenants as it relates to litigation.

Protecting the Benefit of the Deal

Differing Viewpoints on Safeguarding Value

Both parties and their boards should be focused on protecting the benefit of the deal, but they will benefit in different ways, and hence their approaches to obtaining approval may differ.

Acquirers will likely be most concerned about (a) being forced to make divestitures at valuation multiples lower than that of the primary transaction, (b) maximizing synergy opportunities, and (c) protecting the acquirer's existing platform—for example, by resisting consent decrees that would require it to seek prior approval for all future transactions in the sector, regardless of transaction size. (FTC officials have said they will routinely seek to impose such conditions.) Acquirer boards should help guide management to address these.

For a target, however, obtaining payment of the full negotiated deal price will be paramount, and with as little delay as possible. The target board should help to keep management focused on that end.

As a result, acquirers typically are more willing to take time to convince regulators that minimal or no remedies should be required, while the target often will want the acquirer to offer as much as possible as soon as possible. This inherent tension makes it particularly important to negotiate provisions covering who ultimately controls the regulatory process.

Managing the Divestiture Process

When a party is forced to divest assets, or that becomes likely, it may find itself in a weak bargaining position. Perceived bargaining power generally declines as the review process advances and potential bidders become aware of each other's identities and credibility.

As we mentioned above, one way to address that is through a "fix it first," or preemptive, sale arranged before a remedy package has been formalized. That allows an auction to be run with more secrecy and perceived competition.

Of course, the regulators' requirements cannot always be anticipated, and different jurisdictions may ultimately require different concessions, so there is a significant risk of a mismatch between the package marketed and what merger authorities ultimately require. That can sometimes be addressed with "accordion" options, which give the divestiture seller the right to add additional assets into the package at an agreed price.

If the target is making the divestiture, it may want to condition the sale on completion of the primary deal so it retains the asset if the larger transaction fails. But bidders may offer less if the sale is conditional, and if the sale involves an operating business and not just an asset, an extended period of uncertainty could cost the business customers or employees. That could exacerbate the damage to the target if the primary transaction falls through.

If the divestiture is not conditioned on the primary deal closing, the price may improve, but it still may fall short of what the seller would have required absent the overarching benefit of the primary transaction.

Given the impact the divestiture process can have on the value of an overall transaction, boards on both sides should request frequent updates from management as the process unfolds. These updates should include quantitative analysis of the impact of a contemplated divestiture, including the effect on synergies in the overall transaction.

Interim Operating Covenants

Target boards will also need to ask if there should be some flexibility in the target's interim operating covenants, which regulate the target's business while the deal is pending. Restrictions that may be tolerable for nine to 12 months may be untenable over 15 or 24 months. Targets should not be forced to choose between complying with the covenants and harming their business. In addition, targets will be wary of potentially committing a "foot fault" under interim operating covenant at the very time when the deal may be in jeopardy and in extended regulatory review.

Acquirer's boards, meanwhile, should guide management to consider which interim operating covenants are truly critical to protecting the value of the target business regardless of timing.

Control of Strategy and Documenting Disagreements

Where the acquirer agrees to accept all or some of the antitrust risk, most merger agreements give the acquirer express control over strategy decisions. Often there is an escalation process involving senior management if the target disagrees with the acquirer's approach.

Target boards, in particular, should strongly consider overseeing management closely to ensure it is following the escalation process and documenting any objections to the acquirer's strategy. This may lead to awkward interactions between the two companies' senior executives (the acquirer representative may ultimately "overrule" the target representative), but if target management remains silent or acquiesces to the acquirer's strategy without objecting through the formal process, it may compromise the target's ability to argue later that the acquirer's decisions violated its efforts covenant. Failing to document objections may, in some cases, affect the availability of termination rights and reverse termination fees.

Conclusion

With challenging new dimensions to the merger approval process and amplified risks, directors need to take an active role in overseeing the negotiation and progress of mergers. They should (a) insist at the outset on penetrating assessments of the regulatory risks, (b) help guide management in formulating regulatory strategy and risk mitigation, (c) monitor progress with the deal's outside date in mind; and (d) be prepared for litigation with regulators.

In Their Own Words: Regulators' New Focuses and Priorities

Federal Trade Commission Chair Lina M. Khan articulated the new priorities of her agency in January 2022 when it solicited comments regarding changes to its merger guidelines:[1]

> "While the current merger boom has delivered massive fees for investment banks, evidence suggests that many Americans historically have lost out, with diminished opportunity, higher prices, lower wages, and lagging innovation. . . ."

> "[A]re the guidelines adequately attentive to the range of business strategies and incentives that might drive acquisitions, be it moat-building or data-aggregation strategies by digital platforms, or roll-up plays by private equity firms? More broadly, how should the guidelines analyze whether a merger may 'tend to create a monopoly,' including in its incipiency. . . ."

> "[D]o the guidelines adequately assess whether mergers may lessen competition in labor markets, thereby harming workers? Are there factors beyond wages, salaries, and financial compensation that the guidelines should consider when determining anticompetitive effects? And when a merger is expected to generate cost savings through layoffs or reduction of capacity, should the guidelines treat this elimination of jobs or capacity as cognizable 'efficiencies'?"

Jonathan Kanter, head of the Department of Justice's Antitrust Division, spoke of the new, more assertive approach of his unit in remarks delivered at a conference on September 13, 2022: [2]

> "In many sectors, just one or two powerful companies dominate. In many others, rampant oligopoly behavior deprives consumers and workers of the benefits of robust competition. We see this in higher consumer prices, lower wages and fewer new businesses being created. At the same time, we see it reflected in corporate control over the flow of information and public discourse."

> "We are litigating more than we have in decades. Since I was confirmed in November, the Division has challenged or obtained merger abandonments in six cases. Several other transactions were abandoned after parties were informed they would receive second requests."

> "[M]erger enforcement has become disconnected from the competitive realities of our economy. It has become a sometimes-artificial exercise. We focus too much on a small handful of models for predicting price effects, and lose sight of the competition actually at stake. We obsess in all cases about market definition, when in many situations direct evidence can help us assess the potential for harm."

ENDNOTES:

[1] https://www.skadden.com/-/media/files/publications/2022/09/the-informed-board/articulated-the-new-priorities.pdf.

[2] https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-keynote-speech-georgetown-antitrust.

A NEW PERSPECTIVE: CHANGES TO FTC MERGER GUIDELINES

By Lina M. Khan

Lina Khan is the Chair of the Federal Trade Commission. The following is edited and adapted from remarks she made at the Fordham Annual Conference on International Antitrust Law & Policy on September 16, 2022.

I want to focus on another core value at the center of the FTC's antitrust agenda: the rule of law. While reform agendas can sometimes be tarred as "radical," at the FTC our project is, in key respects, fundamentally conservative. As we undertake the task of ensuring our tools and frameworks can match new economic realities, we are also deeply grounding this work in statutory text, history, judicial precedent, and congressional intent.

Over the years, there has been extensive discussion of the antitrust revolution that took place 40 years ago.[1] This conversation has tended to focus on the role of the federal judiciary in narrowing the scope and reach of the Sherman Act, and a vast body of research has engaged in a debate about whether the judiciary's interpretation was wrong as a matter of legislative history.

But the judiciary did not act alone. Far less appreciated is the pivotal role that the antitrust agencies themselves played in ushering in a pivotal shift in our approach to antitrust. In many areas of competition enforcement, the agencies' post-1980 retreat did not stem from court setbacks. Rather, agency leaders *chose* not to fully exercise the authority granted to us by Congress. I worry that these decisions set us on a course that departed from the text, structure, and history of the underlying statutes, as well as from controlling law and judicial precedent.[2] Indeed, despite the ascendance of textualism, antitrust analysis has been remarkably devoid of actually grappling with the underlying statutory text.[3] Restoring antitrust to an approach that is fully faithful to the legal authorities that Congress gave us is critical for promoting the rule of law and for ensuring the democratic legitimacy of our work.

To understand how all this played out, it helps to begin with the FTC Act of 1914, the statute that created the Commission itself. The FTC Act poses something of a riddle. At the time it was passed, the Department of Justice already was bringing antitrust cases under the Sherman Act.[4] Why, then, did the United States need a second agency to enforce competition law?

The answer is that Congress determined the Sherman Act wasn't enough. In the famous *Standard Oil* case, the Supreme Court had announced that it would interpret the Sherman Act using the open-ended "rule of reason." A restraint of trade might be illegal, or it might not; it would depend on whether a federal judge decided it was reasonable. Lawmakers in Congress were alarmed. They worried that the courts' approach delayed resolution of cases, delivered inconsistent and unpredictable results, and gave the judiciary outsized and unchecked interpretive authority.[5] In light of this deep concern, a 1913 Senate committee report called for legislation "establishing a commission for the better administration of the law."[6]

Congress passed the Federal Trade Commission Act with the explicit goal of avoiding the pitfalls of the Sherman Act. At the heart of the FTC Act is Section 5, which prohibits "unfair methods of competition"—language that marked a clear distinction from the Sherman Act. With this text, Congress distinguished between *fair* and *unfair* methods of competition and charged the FTC with fleshing out that distinction based on its expertise. The crucial point is that lawmakers deliberately avoided borrowing language from the Sherman Act or from judicial interpretations of it. They wanted Section 5 to apply to conduct that threatened open and competitive markets even if it did not fall within the four corners of the Sherman Act.

Time and again, the Supreme Court has reaffirmed that Section 5, by its plain text, does not only apply to practices that violate other antitrust laws, such as the Sherman Act.[7] At the same time, the Court has emphasized the Commission's expertise in competition matters, and consequently awarded "deference"[8] and "great weight"[9] to the Commission's determinations that a given method of competition is unfair.

Through the late 1970s, the FTC frequently brought Section 5 cases against conduct that would not necessarily violate the Sherman Act, what we now typically call "standalone" Section 5 cases . . . But starting in the 1980s, the Commission backed away from bringing standalone Section 5 cases. Some commentators have suggested that this was because the agency lost a trifecta of cases in the early 1980s—and it's true, this series of losses stung and dissuaded agency leaders for years to come. Looking closely at these cases, however, consider efficiency claims only in "extraordinary cases." *See generally* Richard A. Miller, Notes on the 1984 Merger Guidelines: Clarification of the Policy or Repeal of the Celler-Kefauver Act?, 29 ANTITRUST BULL. 653 (1984).

[24]Fox, supra note 3, at 37 ("Chairman Miller was 'really very concerned about using simple concentration indexes as even a prima facie basis for whether a law violation has occurred.' " (citing Interview with James. C. Miller, III, 51 ANTITRUST L.J. 3, 9 (1982))).

[25]U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, VERTICAL MERGER GUIDELINES (2020), available at https://www.ftc.gov/system/files/documents/reports/us-department-justice-federal-trade-commission-vertical-merger-guidelines/vertical_merger_guidelines_6-30-20.pdf.

[26]U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (2010), available at https://www.justice.gov/atr/horizontal-merger-guidelines-08192010.

[27]*F.T.C. v. Procter & Gamble Co.*, 386 U.S. 568, 577, 87 S. Ct. 1224, 18 L. Ed. 2d 303 (1967) ("All mergers are within the reach of § 7, and all must be tested by the same standard, whether they are classified as horizontal, vertical, conglomerate or other.").

[28]Judge Posner was not alone in noticing this departure from controlling precedent. For example, in the late 1980s the National Association of Attorney Generals issued their own guidelines, emphasizing how far the federal agencies had strayed from the law. National Association of Attorneys General Horizontal Merger Guidelines, 800 Trade Reg. Rep. Pt. II, at 67 (1987). *See also* Fox, supra note 3; *Matter of The Echlin Manufacturing Co.*, 105 F.T.C. 410, 502-03, 1985 WL 668902 (1985) Matter of The Echlin Manufacturing Co., 105 F.T.C. 410, 1985 WL 668902 (1985)(Bailey, Comm'r, dissenting) (noting that "[w]hat is emerging in Commission merger decisions is by and large the rule that, according to the 'new' economic learning, a merger is almost always legal").

[29]*Hospital Corp. of America v. F.T.C.*, 807 F.2d 1381, 1385, 1986-2 Trade Cas. (CCH) ¶ 67377 (7th Cir. 1986)

[30]*Id.*

[31]*See, e.g.,* Makan Delrahim, Deputy Asst. Att'y Gen., U.S. Dep't of Just. Antitrust Div., Antitrust Enforcement Priorities and Efforts Towards International Cooperation at the U.S. Department Of Justice (Nov. 15, 2004), https://www.justice.gov/atr/speech/antitrust-enforcement-priorities-and-efforts-towards-international-cooperation-us.