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U.S. Regulatory Merger Control Regimes: Negotiating With Deal Delays In Mind

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U.S. REGULATORY MERGER CONTROL REGIMES
NEGOTIATING WITH DEAL DELAYS IN MIND

Introduction

Over the past few years, amidst the political reshuffling that followed the U.S. Presidential election of 2020, there has been an effort to change how the Federal Trade Commission ("FTC") and the Antitrust Division of the Department of Justice ("DOJ") approach antitrust merger enforcement. The effort has manifested in an increased number of deals facing antitrust scrutiny based on multiple or novel theories requiring complex and lengthy reviews and an increased reluctance to accept conventional remedies, with the FTC and DOJ instead showing a greater willingness to pursue litigation. Additionally, the FTC and DOJ are more openly collaborating with foreign regulators, a number of which have also recently stepped up enforcement activity. Whether the efforts will succeed in permanently shifting the U.S.'s antitrust regime is not yet clear, but they are already having a significant impact in current practices at the FTC and DOJ. At the same time, the national security regime enforced by the Committee on Foreign Investment in the United States ("CFIUS") continues to grow in importance. Following the 2020 implementation of the Foreign Investment Risk Review Modernization Act ("FIRRMA"), which both expanded the jurisdiction of CFIUS and established sizeable filing fees, the CFIUS review process has become more mature and its member agencies less resource-constrained—adding another hurdle to the U.S. M&A regulatory approvals landscape. Dealmakers have responded accordingly.

Key Trends in Negotiations of Merger Enforcement-Related Deal Terms

While negotiations focused on deal certainty or potential delays are nothing new, notable trends have emerged regarding specific contractual provisions in response to the increased deal uncertainty and probability of delay between signing and closing caused by the recent changes in antitrust and CFIUS enforcement. Across all U.S. public[1] and private[2] M&A transactions involving an announced deal value at signing of $100 million or more, we have not seen wholesale changes to the various regulatory risk-shifting provisions. However, for U.S. M&A transactions where the risk of aggressive investigation or enforcement is significant *ab initio,* we have seen significant changes to how these terms are drafted. To address the current regulatory landscape more directly and more appropriately account for deal delays, merger and purchase agreements are becoming more complex, tailored and creatively drafted. Specifically, we have seen an uptick in the following provisions: (i) process-heavy extensions to the outside date; (ii) efforts covenants with express limitations and details around the obligation to litigate or divest; (iii) ticking fees, reverse break-up fees and fee sharing provisions; (iv) highly tailored process covenants; and (v) nuanced closing conditions and other representations. And, while only a small portion of U.S. M&A activity is affected by either competition or national security issues, the wider nets being cast by both antitrust and CFIUS authorities are cause for a greater number of U.S. M&A dealmakers to prepare accordingly and incorporate some or all of these terms into their negotiation strategy.

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Notable Deal Terms—Outside Date Extensions

To accommodate deals with a heightened risk of regulatory-driven delays, there is increasing pressure on parties to choose wider initial "outside dates". The data indicate, however, that there has not been a sweeping lengthening of initial outside dates, with the average initial outside date actually shortening slightly across U.S. public M&A transactions with heightened regulatory risk[3] year-over-year. Instead, we are seeing parties develop more nuanced methods of addressing their rising concerns.

First, there has been a clear shift in the U.S. away from the number of deals with heightened regulatory risk with outside dates of five months or earlier—with the portion of such deals dropping from 25% in 2020 to 15% in 2021 to 11% of deals in 2022—indicating that dealmakers no longer believe a negotiated agreement with the government is achievable under such time constraints.

Second, while the portion of U.S. public M&A deals with heightened regulatory risk with initial outside dates of one year and later actually fell from 2021 to 2022—dropping from 19% to 18% year-over-year—the number of U.S. public M&A deals with heightened regulatory risk containing extension periods increased dramatically. In 2022, 68% of such deals included an antitrust-related mechanism to extend the outside date, versus 56% of such deals in 2021. In general, automatic extensions also increased in popularity, appearing in nearly 39% of all U.S. public M&A deals with an equity value over $100 million in 2022, as compared to 34% of such deals in 2021 and 14% in 2018. Furthermore, the extension periods are becoming longer. Of the U.S. public M&A deals that contained an antitrust-related outside date extension, 46% contained extensions for six months or more in 2022, and 6% of extensions were for one year or longer, nearly two times the proportion of such deals in 2021. When combined, the initial outside date periods and extension periods are skewing longer—with 45% of deals subject to heightened regulatory risk having extended outside date periods of one year or more in 2022, as compared to only 38% in 2021. We expect this trend to continue, with automatic extensions triggered by the absence of regulatory clearance becoming the primary method dealmakers use to relieve outside date pressure.

Notable Deal Terms—Regulatory Approval Efforts Covenants

In response to the DOJ and FTC's increased penchant for pursuing lengthy litigation and their decreased willingness to accept traditional remedies, sellers have prioritized negotiating for unlimited obligations for buyers to litigate, while on the other hand, they have been more willing to accept agreements with no obligations for the buyers to divest.

In 2022, 85% of U.S. public M&A transactions subject to heightened regulatory risk specifically addressed the obligation of the buyer to contest or defend any lawsuit challenging the transaction, up from 80% in 2021, with 74% containing an affirmative obligation for the buyer to litigate, up from 69% in 2021. Furthermore, in 2022, nearly 100% of such obligations to litigate had no express limitations, as compared to only 86% in 2021. We expect dealmakers to increasingly focus on obligations to litigate, with or without express limitations, as litigation becomes a more frequent tactic for the FTC and DOJ.

Similarly, 89.5% of U.S. public M&A transactions subject to heightened regulatory risk in 2022 contained a provision specifically addressing a buyer's obligation to divest, up from 87.3% in 2019. As with obligations to litigate, divestiture provisions have become less likely to be subject to limitations in recent years, with the portion of such deals providing for an absolute obligation of the buyer to divest (*e.g.*, having no express limitation for situations such as if the divestiture would be materially adverse or

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burdensome to, or if it would cause an MAE for, the buyer) increasing from 17.5% in 2021 to 21% in 2022, and the portion of such deals providing that the buyer had no obligation whatsoever to divest rising significantly from just 23.3% in 2021 to 41.9% in 2022. And, in response to the October 2021 FTC announcement regarding its "prior approval" policy, we anticipate that many U.S. M&A agreements will specifically address whether the buyer would, or would not, be required to agree to a "prior approval" requirement in a divestiture in order to obtain approval for the transaction.

Additionally, as a hybrid response to the trends manifesting with respect to divestitures and litigation, we anticipate seeing more U.S. mergers employing a "fix-it-first" strategy—striking a deal to divest certain portions of the business, contingent upon the closing of the transaction—in the event litigation is brought, as the recent *UnitedHealth/Change Healthcare* decision has indicated that this strategy can strengthen a party's posture in litigation.

While not as prevalent as the antitrust-related provisions, deals are more frequently including CFIUS-specific efforts covenants, with over 10% of all U.S. public deals including such provisions in 2021. Consistent with the overall trend, we anticipate this percentage will continue to grow.

Notable Deal Terms—Provisions to Allocate Economic Risk

In light of less deal certainty, extended timelines and higher interest rates (which make delay even more expensive), dealmakers are employing various economic risk-sharing mechanisms, such as ticking fees, reverse termination fees (or RTFs) and fee sharing provisions. These provisions incentivize buyers to avoid delays between signing and closing and make the risk of regulatory scrutiny and delay, especially for strategic buyers, more acceptable to sellers.

Ticking Fees

Ticking fees have recently become a hot topic among M&A dealmakers as a promising mechanism to mitigate the risks caused by elongated deal timelines. A traditional ticking fee operates by providing for an increase in the per share consideration payable to the seller's stockholders following the passing of certain time- or event-related milestones, thereby compensating the seller's stockholders for the economic impact of delay between signing and closing. Despite the rise in academic interest, in practice, ticking fees are anything but common—with only four U.S. public M&A transactions including ticking fees throughout all of 2022. Moreover, those ticking fee mechanics have each been unorthodox and unique. For example, in Standard General's acquisition of TEGNA, the rate of the ticking fee stepped up over time, and in the JetBlue Airways Corporation/Spirit Airlines, Inc. merger, the *de facto* buyer is obligated to make cash payments directly to the seller's shareholders, with the shareholders able to, under certain circumstances, keep such payments if the transaction is not consummated.

While we may see the use of ticking fees rise slightly in popularity over the coming years, we do not expect to see ticking fees become a customary provision. Buyers will be unlikely to agree to both ticking fees and heightened efforts covenants, such as an absolute obligation to litigate, the latter of which we expect to remain a popular response to the prevailing regulatory conditions. While parties have agreed to include both in the past (*e.g.*, Thermo Fisher's acquisition of Life Technologies in 2013), we anticipate buyers resisting combining these provisions, as the prevalence and uncertainty of litigation increase (*e.g.*, AbbVie's acquisition of Soliton in 2021, where there were interim cash payments made to the seller, but no obligation to litigate) or only agreeing to them subject to a cap.

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We've also seen hybrid "ticking" antitrust-related RTF, where the RTF increases at certain intervals if the deal is not closed (or is terminated) before a specified date, used on its own (*e.g.*, Google's acquisition of Mandiant, where the RTF escalated at 12 months and 15 months from the signing date) or in tandem with other ticking fees (*e.g.,* AbbVie's acquisition of Soliton in 2021, where both the RTF and the ticking fee escalated at six months and nine months from the signing date).

Reverse Termination Fees

Antitrust-specific triggers for RTFs are becoming increasingly common, with such terms appearing in over 22% of deals subject to heightened regulatory risk in 2022, up significantly from 16% in 2021 and 15% in 2020. Moreover, unlike traditional break-up fees, RTFs are not restricted by Delaware jurisprudence to a typical 3% to 4% of equity value, so regulatory reverse termination fees have recently ranged anywhere from 2.6% to over 13% of equity value. The average antitrust-related RTF as a percentage of equity value has recently trended upward for U.S. public M&A deals, rising from 4.50% of equity value in 2020 to 5.69% of equity value in 2022. Furthermore, 35% of public M&A deals containing antitrust-related RTFs contained antitrust-related RTFs of 6% or higher in 2022, as compared to only 22% in 2021.

Fee Sharing Provisions

In addition, with dramatic increases to both antitrust[4] and CFIUS filing fees (reaching as high as $2.25 million), parties are more frequently splitting the costs of filing fees.

Notable Deal Terms—Process Covenants

Given the rise in adoption of various efforts covenants, and the growing complexity and uncertain nature of the regulatory process, it's not surprising we are seeing more antitrust-related process covenants and specific cooperation efforts covenants. In 2022, 88% of deals subject to heightened regulatory risk contained cooperation covenants, up from 78% in 2021, and over 93% of these covenants prescribed reasonable best efforts for cooperation. Beyond specific cooperation covenants, we have seen, and expect to continue to see, a growing number of buyers negotiate for strategic control of the regulatory approvals process.

Notable Deal Terms—Closing Conditions and Representations

Antitrust Closing Conditions

In 2021, the FTC injected another level of uncertainty into the antitrust approval process when it began issuing "Pre-Consummation Warning Letters" for transactions that the FTC is not able to sufficiently investigate within the HSR waiting period. Generally, these letters will advise the parties that they are permitted to close, but that they do so at their own risk because the FTC's investigation is still ongoing. Initially, dealmakers lacked clarity as to what these warning letters meant, so only 3% of deals subject to heightened regulatory risk even addressed the topic. By 2022, this number grew threefold, with over 11% of deals addressing FTC warning letters through the definition of antitrust approval and the related closing conditions. The early approaches varied, with some deals treating the receipt of such letter as a failure of the HSR closing condition, while others included a 30-day closing delay triggered by the receipt of such warning letter, which was intended to provide a window for the FTC to follow up. We anticipate

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that it will become customary for closing conditions to address warning letters, but since we are not aware of any examples of the FTC or DOJ acting with respect to any warning letter to date, they likely will not be considered an HSR failure or an open antitrust investigation, therefore permitting the parties to close over their receipt.

Additionally, given the increased likelihood of litigation, we anticipate an increase in the number of provisions that prescribe various specific circumstances under which parties may close. For example, we anticipate that more deals will prescribe that the parties may close between the FTC or DOJ failing to obtain a preliminary injunction and the FTC or DOJ filing a related appeal.

CFIUS Closing Conditions

We also anticipate that an increasing number of deals will include closing conditions related to CFIUS clearance. Of all U.S. public M&A deals in 2022 with a foreign buyer or ultimate parent, 40% contained CFIUS clearance closing conditions, up from 36% in 2021. We also expect that any definitive agreements including a declaration (*i.e.,* a short-form CFIUS filing) obligation, will also contemplate the parties' obligations upon receipt of a CFIUS "shoulder shrug" letter—a letter similar to the FTC warning letters, in which CFIUS issues a nondecision in response to a declaration and indicates to the parties that it has not made a formal decision, but reserves the right to request a long-form filing in the future. Like with FTC warning letters, we expect most sellers to negotiate for the ability to close after receiving nothing more than a shoulder shrug letter. Some buyers may accept such obligation to close despite the uncertainty; however, we do anticipate many buyers wanting the regulatory safe harbor provided by CFIUS approval, which can only be achieved by following up the shoulder shrug letter with a long-form filing, further delaying the deal.

We also anticipate seeing more detailed and novel process-related closing conditions, specifically with respect to CFIUS. We have already seen a growing number of U.S. public and private M&A deals with highly prescriptive—sometimes elaborate—procedural conditions such as (a) agreeing not to inform CFIUS of the transaction, (b) voluntarily making a declaration and, if requested, a long form CFIUS filing, (c) agreeing not to voluntarily file with CFIUS or inform them of the transaction, but if CFIUS ever shows interest in the deal, CFIUS clearance will spring to become a closing condition and (d) agreeing to inform CFIUS of the deal and that the parties do not intend to file, and if CFIUS responds with a request to file, CFIUS clearance will spring to become a closing condition. If the parties to a transaction do not plan to file with CFIUS, it has become more common for sellers to represent to buyers that they are not the type of business that will trigger a mandatory filing with CFIUS.

Footnotes

1. References to "U.S. public M&A" or similar phrases mean, unless otherwise specified, all mergers and acquisitions of U.S. reporting companies with an announced deal value at signing of at least $100 million, excluding REITs and, for certain data, also excluding debt-only issuers, and for certain other data, excluding all companies in the banking and insurance industries. The data sets reviewed contained 124 to 129 U.S. public M&A transactions for 2022.
2. References to "U.S. private M&A" or similar phrases mean, unless otherwise specified, all transactions with a publicly filed transaction agreement and an announced transaction value at signing of at least $25 million involving the acquisition of (i) all or substantially all of the assets of a private U.S. company, (ii) at least a majority of the outstanding stock of a private U.S. company or (iii) one or more business units of

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a U.S. company, excluding bankruptcy sales and certain other outlier transactions. The data sets reviewed contained 163 to 177 U.S. private M&A transactions for 2022.
3. References made to "deals subject to heightened regulatory risk" or similar phrases mean U.S. mergers and acquisitions of U.S. reporting companies (excluding REITs and debt-only issuers) with an announced deal value at signing of at least $100 million, where a Hart-Scott-Rodino or other premerger filing is required and the transaction agreement specifies any efforts the parties need to take to get antitrust approval. This data set includes 105 public deals for 2022, 120 public deals for 2021, 68 public deals for 2020 and 110 public deals for 2019. The deals in this data set represent 85% and 75% of all public U.S. M&A deals for 2022 and 2021, respectively.
4. *See* Merger Filing Fee Modernization Act of 2022 (the "Act"), which was passed as part of the Consolidated Appropriations Act, 2023.

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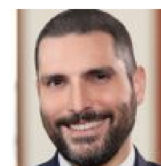

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