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M&A Antitrust Playbook for In-House Counsel

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Antitrust laws can impact all potential M&A transactions, so it is important to understand the likelihood of a government challenge early on when considering a deal. In some cases, that antitrust review can be done in the blink of an eye, as it is clear that a transaction causes no concerns. In other cases, transactions that appear to create significant antitrust problems are actually doable deals. Each case needs to be evaluated, and experienced antitrust counsel should be consulted for any transaction that may raise antitrust issues.

Companies that have well-developed corporate development/M&A functions likely have people within both the legal department and corporate development organization who are familiar with the antitrust overlay for their transactions. However, personnel change over time makes it inevitable that some of the key players in transactions will have limited or no antitrust experience. This article is intended to provide some key introductory principles and concepts to assist the M&A team members who are less familiar with the antitrust process. People who could benefit from spending a few minutes reading this article include:

– **Experienced company counsel for whom M&A is not a core skill.** A prime example of this group is business area counsel within a corporation whose business is contemplating an acquisition. Even if a company is a sophisticated player in the M&A world, the antitrust concerns in any individual transaction may involve a business area whose counsel does not have experience in the antitrust aspects of the M&A process.

– **In-house M&A counsel who lack significant antitrust M&A experience.** Junior in-house M&A counsel often join a company after spending time as a corporate M&A associate at a major law firm. In their role as corporate associates, these attorneys generally had limited or no hands-on responsibility for addressing the antitrust issues in a transaction, other than documenting the antitrust efforts provisions in a merger agreement. The antitrust issues typically were handled by the competition law experts within their firms. In their new role as in-house M&A counsel, these attorneys may immediately take on responsibilities for managing the antitrust process for their transactions, and they need to know the landscape on which they are operating.

– **Corporate development personnel**. Corporate development professionals are obviously key in the M&A process. Over time, if they are involved in transactions raising significant antitrust issues, these professionals likely become familiar with some of the key antitrust principles as they arise in

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> the context of specific transactions. New members of the team do not come to the team with that understanding, yet what they do can be very important to the success of the antitrust campaign. Even experienced personnel may have had limited exposure, focusing on the issues key to the transactions they have handled rather than obtaining a broad exposure to antitrust principles.

This article provides some high level insights to key substantive issues in the antitrust clearance process.

What is the Antitrust M&A Playbook?

One way I think about an antitrust M&A campaign, and explain it to people unfamiliar with the process, is to analogize to a football team's game plan. A football team needs to have an offensive playbook. This playbook lays out the different plays that the offense can run to advance the ball down the field. This playbook will include running plays, passing plays, and trick plays designed to capitalize on the strengths of the team's players. The team will practice these plays over and over so they can run them if they need to in a game.

Having mastered these plays, the coaches then have to decide which plays to run in any given game, which can vary depending upon the strengths of the opposing team. One opponent may be very good at stopping the inside run, so our team's game plan will focus on passing. Another team may be strong in pass defense, so our team will rely heavily on the running plays in its playbook. The coaches are responsible for devising the offensive game plan most likely to win the game based upon an impartial assessment of the strengths and weaknesses of both their own squad and the opposing team.

We can think about the antitrust M&A process in similar terms. The antitrust M&A playbook is known. All companies use the same playbook, as do the government investigators. It is not a secret, and it is even on the internet. We are talking about the Horizontal Merger Guidelines. We have to use that playbook—the Horizontal Merger Guidelines—to develop the game plan to advance the transaction towards the ultimate goal of regulatory clearance.

We design the M&A game plan around the facts, which include those that are known and those that are reasonably anticipated to be provable in the course of an investigation. The lead antitrust lawyers act like the coaches in this game. As we size up a deal, we obtain high level facts that allow us to evaluate what "plays" are likely to succeed in this game, and we then devise the strategy that focuses on those plays that are likely to win the game. We may decide that the merging parties who appear to be in the same market really do not compete much against each other. In that case, we would design a game plan to show the companies' products are in different relevant markets. In another case, the parties may compete directly, but there are enough other firms to prevent any adverse competitive effects from a deal. We would then devise a game plan around proving up the existence of those other competitors.

Timing and advanced preparation are critical. The game plan needs to be developed before a company engages with the government regulators on a transaction. No football coach would enter a game without knowing before the first snap what the game plan is. Likewise, it is critically important to develop the antitrust M&A game plan at the outset, because it will guide everything we do during the course of our campaign. It could influence what the parties are willing to sign up to in the antitrust efforts provisions of their merger agreement. The game plan can generate themes that we will use in presenting the transaction to the regulators, and all of the advocacy that is submitted to the government should be consistent with those themes. It is very helpful if those themes are consistent with the way in which the transaction is presented during the approval process within the company.

Last, in some cases, after we size up the facts that are likely to be developed in an investigation, we may conclude that there is no good play to run given those facts. It is a game that cannot reasonably be won. In that case we have to advise the client that we are not likely to win, and there is a high probability that deal will be blocked (or a significant divestiture required).

Once the antitrust coaches have devised that game plan, then it becomes a "simple" exercise of doing the work. One football idiom is that once the plays are run, then it is all about blocking and tackling. In football, that can be the seemingly simple, but hard and unglamorous job of an offensive lineman blocking his defender in the right direction to open the hole that allows the back to run for a score.

In the antitrust M&A campaign, the "blocking and tackling" is the hard work of developing the evidence—the facts—that allow the play you decided to run to succeed. This can involve having your team members do the hard work needed to execute the game plan, such as: obtaining, analyzing, selecting and presenting documents to support your arguments; making sure customers understand the benefits of a deal so they will not have concerns if contacted by the government; developing customer declarations or affidavits; having the economists analyze pricing and other transactional data to support the arguments; having company personnel thoroughly prepared to present the facts to the regulators in interviews or meetings; making sure witnesses are prepared if they are deposed. All of that work is critically important and cannot be overlooked, but it is beyond the scope of this paper, which is focused on developing the game plan itself.

This work of developing the game plan should be done by experienced antitrust counsel, who will work collaboratively with the in-house team and the corporate development team in that process. I hope that through this article those team members will have a solid baseline understanding of some of the key plays we run in evaluating and defending antitrust cases.

The Offensive Game Plan: Deciding Which Plays to Run

Experienced antitrust counsel who has handled dozens, scores or even hundreds of deals can very quickly size up which plays are likely to work in a given case. Some of the most important plays in the book are summarized in the sections that follow. A few preliminary notes are in order, though.

First, sometimes plays can be run in combination, so you can run multiple plays in a given case. That said, the arguments cannot be inconsistent with each other, or rely on facts that point in opposite directions. Credibility goes a long way with the agency, and inconsistent or unsupported arguments can damage credibility. Second, sometimes "audibles" are needed, just like in football. In some cases the facts will develop differently than what was anticipated at the outset, and that may lead us to change the plays that we planned to run. That is fine, and we need to maintain that flexibility of assessing strategy in light of the facts as the case develops.

Key Plays to Consider in the Game Plan

- **The parties' products are in different markets and do not compete against each other.** This can be the simplest and most fruitful play to run if the facts will support it. Experienced antitrust counsel can evaluate product and geographic markets in the way the regulators are likely to evaluate them. Antitrust market definition does not necessarily equate to how a particular business defines markets in its business documents. Materials that have been prepared in the ordinary course already exist, and cannot be altered. However, the corporate development teams developing materials for the purpose of evaluating a deal can consider a more nuanced approach, and do not need to simply adopt the language or conventions of business analyses prepared for a different purpose.

- **The parties' products compete, but there are a lot of competitors and the parties have low market shares.** This is another easy play to run provided the facts support it. Frequently the business team's view of the competitive landscape is different from how the regulators are likely to view the situation. Thus, it is important that the in-house and corporate teams have a basic understanding of some of the factors that can lead the regulators to conclude that there is too much concentration (i.e., too few competitors). For example, if there are many competitors but the two merging firms have high combined shares, or if they are particularly close competitors, even for a given class of customers, the regulators may well have concerns.

  This latter point is particularly important. The regulators are very focused on "price discrimination" markets which can be defined around specific classes of customers who have more limited supply options. For example, in a merger of cement companies, Company A and Company B may have plants near Philadelphia, where there is one other supplier, Company C. Those plants may compete against plants located near New York for sales throughout much of New Jersey. Company A and Company B have market shares of 15% each in an area that includes Philadelphia and New Jersey, which would not appear to create a competitive concern.

  However, if customers in Philadelphia cannot realistically turn to suppliers near New York, then the regulators will view the sales of cement to customers in the Philadelphia area to be the relevant market. Since Company A and Company B have only one competitor in the Philadelphia area, the regulators are likely to challenge that transaction. This may not be an intuitive result, and may not comport with how the business defines its markets, but it is the job of the antitrust coach to identify these situations as early as possible so the game plan can take the unique facts into consideration.

- **The parties are not close substitutes, even if they are in the same "market".** Sometimes the market definition questions can be very close calls, but are not determinative of the outcome in any event. Many companies sell differentiated products rather than commodities. If a transaction will combine two products that may be in the same market, the transaction still is unlikely to create a competitive concern if the products each compete most directly against products other than those of the merger partner. Thus, even if there is some level of competition between the merging parties products, it may be possible to prevail by demonstrating a lack of close competition between the products.

- **The parties' high market shares are not reflective of current competitive dynamics.** In some cases, market share data can be highly misleading and not reflect the likely competitive impact of a transaction. In one case on which I worked, we were brought in to evaluate the combination of two companies that had what appeared to be a combined ninety percent market share. At first blush, it appeared to be a transaction that would be challenged. When we looked more closely, though, that market share was based upon ongoing revenues from an installed base of customers that paid annual subscription fees to the companies.

  In most cases, the competition to win those contracts had taken place many years earlier, and most customers had not considered their competitive options since that contract award. When we looked at the competitive bids that had taken place for the few years prior to the planned combination, we were able to show that the merging firms' shares of wins were much lower than that ninety percent "installed base" market share. The merging parties also often lost to companies other than each other on those recent competitive bids. The ninety percent installed base share was not relevant to evaluating the competitive strengths of companies competing for the current and future contract awards, which was the relevant competitive issue. The DOJ ultimately cleared that combination which looked impossible at the outset.

- **A party's past success overstates its competitive position going forward because of limited resources.** This is the *General Dynamics* defense, named after a Supreme Court case. In some cases a company will have a strong position, but it has limited ability to compete going forward because it lacks capacity to compete. In *General Dynamics,* for example, a company had a high share of coal sales, but all of its coal reserves were committed under existing contracts so it could not compete for any new coal supply bids. The transaction was allowed to proceed even though it resulted in a company with a very high share of current sales because one of the companies would have no competitive significance looking forward.

- **Entry is easy.** Even if a transaction combines two of few suppliers of a product or service, the combination will not adversely impact competition if there are other firms that could readily provide that service if the companies combined and tried to raise prices. The agencies have a high standard for evaluating entry arguments and will not credit entry unless it is timely, likely and sufficient in scale to prevent any anticompetitive effects. The most important source of facts on this issue will be the potential entrants, and the outcome of the entry analysis likely will rise or fall on the facts provided by those companies.

  Thus, broad statements offered by the merging parties to show that certain companies have the capability to enter or have entered in other geographies or closely related products likely is not sufficient. An entry defense cannot be abstract, but instead needs to be factually supported, in effect demonstrating which company (or companies) would enter if prices rose by a very small amount, that it could do so quickly and would be accepted by customers, and that the new supplier's presence would quickly restore prices to pre-merger competitive levels. The lack of prior entry into a market can also undermine an entry defense or that shows that firms offered up as being poised to enter have not done so even though the market in question has been concentrated,

The "Hail Mary" Plays That Seldom Work

In a football game, sometimes a team faces a desperate situation and has to run a high risk play that is not likely to succeed, but is its best option. At the end of the game with time running out, a team may simply have its receivers run to the end zone and lob the ball down hoping one of the receivers will catch it among a gang of defenders. This "hail mary" play is seldom successful, and a team will very infrequently run the play. However, it is in the playbook to be called upon in special circumstances. There are some "hail mary" plays in the antitrust playbook as well.

- **Failing firm / failing division.** This is a legal defense to an otherwise anticompetitive merger or acquisition, but it is a very difficult test to meet and very seldom succeeds. The agencies require that the failing firm or assets would be unable to meet its financial obligations in the near future and could not be reorganized in bankruptcy. In addition, prior to crediting the defense, the agency requires that the failing business be "shopped" to alternative buyers who would not raise competitive problems, and that the seller not receive reasonable alternative offers from other buyers who would keep the business operating in the marketplace.

- **Power buyers will prevent competitive harm.** The agencies will not assume that just because a buyer is large that it can protect itself from an anticompetitive price increase resulting from a merger or acquisition. There may be room for arguments based on power buyers, but those are more likely to be secondary arguments or tertiary arguments.

- **Efficiencies.** It is important for merging companies to have a procompetitive angle to their transaction, and showing that the transaction is motivated by a desire to achieve efficiencies supports those arguments. However, efficiencies are more likely to be a story or theme for a transaction rather than being a likely defense to an otherwise anticompetitive transaction. The agencies impose a very high burden of showing that any claimed efficiencies are not achievable without the transaction, and are specific and verifiable rather than vague or speculative claims.

  > The efficiencies can save an otherwise problematic transaction only if the claimed efficiencies meet those thresholds, and if those efficiencies can be shown to offset any potential anticompetitive effects. Here, the agencies will look for the efficiencies to be passed through to, and benefit, customers. Given these high burdens, efficiencies are likely to be more important in framing a transaction for the regulators and customers than they are in defending what would be an otherwise anticompetitive transaction. Nevertheless, they are an important element of the overall process.

Special Teams: Remedies

While the vast majority of the plays in a football game involve one team's offense running plays against the other's defense, there are a handful of plays each game involving the kicking or punting of the football—a "special teams" play. These plays, while few in number, can be pivotal to the outcome of the contest, like the last second field goal to win the game. Likewise, in the antitrust M&A process, there are some ancillary aspects of the substantive review process that are important to keep in mind.

In many transactions the competitive concerns can be isolated to a single product area, or a few product areas. When the parties are willing to remedy the competitive concern through an isolated divestiture or other remedy, the overall transaction can proceed while the area of concern is fixed through the remedy. There are a few principles to keep in mind as in-house counsel and corporate developers consider transactions where some form of remedy may be required.

- **One small competitive problem will hold up a large transaction.** If the government determines there is a competitive problem in one product market, that issue will generally prevent the entire transaction from closing. There is no concept of proportionality here. Parties should assume that any area deemed to be a problem will require a remedy, such as a divestiture, to allow the transaction to proceed.

- **Conduct remedies are unlikely to be successful to resolve a competition issue from a combination of competitors.** In general, the agencies prefer to preserve competition through structural remedies that divest one party's products to an independent competitor. Conduct remedies, by which a merging company commits to alter its behavior going forward, are unlikely to satisfy the regulators. For example, a party may be willing to agree not to raise its prices for several years after completing a transaction in order to get the deal through the agency review process. The government is not likely to accept such an offer, which will require ongoing monitoring, and also may not preserve all facets of competition, such as innovation or marketing competition.

- **The agencies like clean, structural remedies without ongoing entanglements.** Parties will sometimes argue for creative solutions to resolve a competitive concern. For example, rather than divesting production assets, parties might prefer to divest the brand or product line, and enter into a commercial arrangement such as a supply agreement requiring them to support the divestiture buyer. That type of arrangement may be perfectly reasonable commercially, but it is not likely to work in the context of a divestiture required by an antitrust agency. The agencies generally insist on clean divestitures so the buyer has all of the assets needed for it to compete in the market independently of the merging parties, except perhaps for a very short transition period.

- **The fundamental question is whether the divestiture buyer will use the assets to compete as effectively as their pre-transaction owner did.** The government will require the buyer to provide and support its business plan for the operation of the acquired assets. Since the assets will generally be acquired at a low price, a divestiture buyer may have a business case that "works" even if the divested business operates on a smaller scale, or less effectively, than it did pre-merger. While that may make economic sense for the buyer, it does not accomplish the remedial goal of the divestiture, and will not satisfy the regulators. It is critically important to bring a strong buyer to the government who can demonstrate its ability to operate the assets as or more effectively than were prior to the merger. Of course, it is also important that a divestiture to a buyer will not create its own competitive problem. Divesting assets to a buyer that is already a competitor in a concentrated market is not likely to satisfy the regulators.

- **"Buyer up front" is increasingly required.** The government wants to be sure that a divestiture will be effective. A "failed divestiture" that does not protect competition is embarrassing for the government, and so the regulators are cautious in evaluating divestitures to minimize the chances of failure. One way to increase the likelihood of success is to require the divesting party to reach an agreement with a buyer that the government can vet prior to allowing a transaction to proceed—a so-called "buyer up front."

  That buyer is then specified in the consent order resolving the antitrust review of the primary transaction, and the order will generally require the merging parties to divest the specified business to the divestiture buyer within a few days of closing the primary transaction. Having a buyer up front allows the government to be sure that the package of assets that the seller proposes to divest is sufficient to maintain competition. If the potential buyer indicates that additional assets need to be included in the group of divestiture assets in order for the business to continue without interruption, the government can ensure that the consent order includes those assets.

  This process also allows the government to ensure that there are strong, credible buyers who are eager to operate the divested business before the main transaction is completed. If there are no such buyers, then this may alter the government's willingness to allow the main transaction to close. A buyer up front is not always required, as some consent orders will allow a period of time (such as 60 or 90 days) post-closing in order for a buyer to be identified and the divestiture to be completed. However, increasingly, those post-closing divestiture scenarios are limited to situations in which the government has had significant experience in similar divestitures so it is confident it can identify the appropriate package of assets and that acceptable buyers will be available.

  For example, the government has overseen many divestitures of construction aggregate (crushed stone) assets, and therefore has allowed transactions to close with "hold separate" agreements that identify the assets to be divested and specify a several month period in which to complete the divestiture. From a planning perspective, however, a business generally should assume that the government will require a buyer up front. Timing to find an appropriate buyer, negotiate an agreement, and vet the buyer and the divestiture agreement through the government regulators needs to be built into the transaction planning process.

Conclusion

There is a lot of room for creative advocacy by companies and their counsel in the antitrust M&A process, but that creativity generally involves refining and proving up arguments that are based on a fairly standard playbook—the Horizontal Merger Guidelines. Every transaction should start with a candid assessment of the known and reasonably anticipated facts to shape the game plan that will be used to achieve victory. The work on these projects should be directed by counsel to maintain any applicable privileges, so in most companies in-house counsel will be a key resource and bridge between outside counsel and the business. The Corporate Development personnel also will be key players in this process.

Managing Regulatory Risk in Bank M&A

By Brian Christiansen, David Ingles & Sven Mickisch of Skadden, Arps, Slate, Meagher & Flom LLP

We expect the slowly developing but increasingly perceptible trend toward community and regional bank consolidation in the United States to continue in 2015. In connection with growing bank M&A activity, closing risk in the current bank regulatory environment has become a top-of-mind issue for senior executives and boards of directors of banks mulling potential M&A transactions. For those institutions looking to enter the bank M&A fray, a proactive strategy for managing regulatory risk will be key to successfully executing bank M&A transactions in 2015.

However, significant delays in transaction closings due to regulatory concerns or issues in well-publicized situations such as M&T/Hudson City, Cullen/Frost/WNB Bancshares and BancorpSouth's pending acquisition of two community banks in Louisiana and Texas, among others, have made an impression in the minds of many bank executives. Indeed, perceptions of the regulatory climate for bank M&A remain a significant chilling factor for a resurgence in deal activity in the banking industry. Both buyers and sellers are concerned about "hanging out there in the market" for prolonged periods of time due to difficulties in obtaining regulatory approvals, which create potential franchise disruption and instability as well as openings for market/shareholder criticism. As a result, boards of directors of potential sellers are requiring a more comprehensive understanding of the buyer's regulatory standing in earlier stages of transaction discussions, with buyer executives considering an acquisition are seeking greater comfort from regulators prior to any deal announcement regarding the prospects for timely transaction approval.

We believe understanding and managing regulatory risk will remain a dominant theme for bank M&A in 2015. In particular, bank executives and boards will need to focus on the following three areas of managing regulatory risk to successfully navigate bank M&A discussions in 2015:

– **Regulatory Reverse Due Diligence—**Reverse due diligence on a buyer's regulatory standing must be among the top priorities of seller boards from the outset of transaction discussions. Navigating regulatory reverse due diligence frequently involves thorny issues, including the limitations involved in communications around confidential supervisory information, but now has become a critical step for potential sellers in identifying regulatory concerns in connection with a transaction.

  Likewise, potential buyers increasingly are called upon to proactively provide sellers with comfort regarding their regulatory standing and "approvability" and will face many of these same issues in seeking to meet these seller requests, particularly at the early stages of a deal when a buyer is not yet in a position to obtain from the target bank the confidential financial and operating information necessary for the buyer to adequately assess the facts relevant for regulatory approval of the deal.

– **Pre-Announcement Regulatory Strategy—**Virtually no bank M&A transaction in today's environment is getting signed without significant pre-announcement discussions with the regulators. A considered pre-announcement regulatory strategy is essential to putting the proposed transaction in the best position to close without significant delays. A successful pre-announcement regulatory strategy requires balancing the risks of meeting with the regulators too early in the process when the parties do not yet have the requisite facts in place to properly respond to regulators' questions about the transaction with the potential costs and delays in transaction timing if regulatory conversations begin too late in the process.

In addition, appropriate sensitivity to the regulatory dynamics in pre-announcement discussions is critical to accurately gauging regulatory receptivity to the transaction while remaining realistic about the degree of comfort that can be gained from such discussions.

– **Regulatory Risk Allocation—**Deal parties increasingly are focusing on the regulatory provisions in transaction agreements, including the covenant to seek regulatory approvals, the definition of a "burdensome regulatory condition" exception to the buyer's obligation to obtain regulatory approvals and complete the deal, and termination rights that affect risk allocation relating to the regulatory process (including the "drop-dead" date). These provisions form the backdrop for post-announcement deal dynamics in the event regulatory concerns or issues arise while the deal is pending.

  In addition, deal parties have considered other contractual provisions to further address regulatory risk allocation, including regulatory reverse termination fees, ticking fees in the event of regulatory delay, covenants restricting purchasing activities of a buyer that would impede or delay regulatory approval, and provisions that permit a seller to explore alternative third-party proposals if the transaction closing is delayed due to buyer regulatory issues. On the whole, these other risk-allocation provisions have not become a part of the final transaction documentation with any regularity or frequency, but they increasingly form part of the toolkit of deal makers during transaction negotiations.

European M&A Dos & Don'ts for Non-European Buyers

By James Robinson, Partner of Morrison & Foerster LLP

Inbound M&A in Europe by non-European buyers increased in 2014 by 68.6% compared to 2013, representing over a third of USD 901.4 billion total European M&A.[1] For non-European buyers, the basic framework of transactions may be similar, but there are a number of important dos and don'ts to help get European M&A deals over the line.

– **Culture**. Do not underestimate the differences in lifestyle, social protection and history. This is not just an issue to consider for M&A between the Americas or Asia and Europe but, especially, where the target has operations across Europe, among countries on the same continent.

– **"European Law"**. There is a harmonization of laws across Europe but this does not mean that the law is the same across Europe. While there are some directly applicable EU laws, in practice, each country implements European level legislation locally and even so slightly (or not so slightly) differently.

– **Due Diligence Planning**. Do prepare with proper controls, communication and reporting systems, as well as by allowing additional time for the distance and time zones involved, to conclude physical diligence meetings. Online data rooms are prevalent but on pan-European deals physical meetings are important for more effective integration planning (and cultural adaptation) post-acquisition.

– **Disclosure and Warranties**. The approach to disclosure (against purchase agreement warranties) may be very different. While specific disclosures are often included, in Europe there is a common acceptance of general disclosure of information provided to a buyer during the diligence process.

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[1] Source: Mergermarket global and regional M&A: 2014.

This, combined with an avoidance of indemnities (except for specifically identified issues), may mean a less absolute set of contractual protections in your purchase agreement than you may get elsewhere.

– **Labor Law**. Europe has very wide labor and social protection legislation, though this again varies among countries. Most sizeable companies will have employee works councils or unions on a country-by-country (and/or subsidiary-by subsidiary) basis. This is important both in terms of due diligence as well as deal structuring. You may need to establish a timetable for employee consultation and/or make (binding) statements as to future workforce intentions. One labor law advantage in Europe is the ability in an asset deal to automatically transfer employees along with a business (often termed Transfer of Undertakings or TUPE).

– **Antitrust and Corruption (FCPA)**. Awareness of these issues is high in Europe. So basic European compliance policies will normally be more adequate than elsewhere, especially in the more developed European economies (though compliance must of course still be subject to due diligence). However, each country has different rules for antitrust matters. So don't assume that you can simply confirm compliance with a "Brussels standard".

– **Merger Filings**. While Brussels does offer a "one-stop shop" EU merger filing, each transaction will need to meet the relevant thresholds to qualify. If it does not, the merger may have to be filed in multiple countries with different forms, languages, timetables, fees and possibly results. Be aware, however, that if the merger qualifies to be filed in three or more individual EU countries, there is the possibility of electing to "move up" to a single European-wide filing in Brussels (with no filing fee).

– **Deal Litigation Risk**. The possibility of shareholder activist or trade union litigation of a proposed deal varies significantly among European countries. For example, it is rare in the UK but more common in Germany and the Netherlands.

– **Taxation**. Tax efficient structures should be considered early on. This is not just about choosing an optimal acquisition vehicle. It may also be beneficial to structure a mix of asset and stock deals given the tax approach of individual countries (as well as real estate transfer taxes and stamp duties, which should not be underestimated). It is also important to carefully review the tax impact of the target's operations in due diligence, especially given the higher focus on transfer pricing by European tax authorities.

Rep & Warranty Insurance: Negotiating Tips & Market Trends

By Kate Sherburne of Faegre Baker Daniels LLP

Representation and warranty insurance (R/W insurance) continues to gain momentum. As recently as two years ago, presenting a R/W insurance policy was a way to enhance the attractiveness of a bid in a competitive auction. Today, some targets are demanding that all bidders come to the table with such policies. Further, some private equity firms are using the policies in every deal. Bottom line—if you have not worked on a deal with R/W insurance yet, you probably will very soon.

Recent Trends

As a result of the increased demand, we have seen a tightening of the market over the past year in pricing, exclusions from coverage and attention from insurers:

– **Pricing—**Insurers have shifted their focus to larger transactions. A year ago, insurers generally targeted middle-market transactions ranging in size from $15 million to $1.5 billion. More recent information sets the target at $50 million to $2 billion. While lower-middle-market deal participants are still able to find R/W insurance, it is often coming at a higher premium than a year ago (closer to 5 percent of the policy limit instead of the 2-4 percent range typically quoted by insurers). In addition, some brokers are charging a fee beyond the typical 15 percent brokerage commission that is paid out of the premium. That additional fee, which is paid directly by the insured, is typically 75 bps of the premium amount.

– **Coverage—**The scope of R/W insurance coverage also appears to be tightening. In addition to the common exclusions (issues identified in the disclosure schedules and environmental reports; asbestos claims; issues covered in purchase price adjustments; issues that were known by a deal team member; breaches of covenants; claims for non-monetary relief; criminal fines/penalties; and, in a seller-side policy, fraud of the seller), it is becoming harder to insure matters that tend to lead to large losses, such as product liability claims, underfunded benefit plans, health care billing practices, California wage and hour laws, and big pharma issues.

– **Reasons to Obtain a Policy—**The potential reasons to obtain a policy only appear to be growing. In particular, the Delaware Chancery Court's decision in *Cigna Health and Life Insur. Co. v. Audax Health Solutions*, C.A. No. 9405-VCP (Del. Ch. Nov. 26, 2014), which further called into question the ability to bind a non-signatory shareholder to post-closing obligations under a merger agreement, may be another reason to seek a policy in a private company merger.

Ten Negotiating Tips

Despite the tightening of the market, R/W insurance is becoming increasingly common. Following are a few practice pointers for negotiating your first policy:

1. **Hire a Reputable Broker—**Not all brokers are created equal in this space. The best are former deal attorneys who understand the issues well and know how far you can push particular insurers on policy points. Brokers are typically paid a commission out of the policy premium (generally 15 percent of the premium), but some have started charging an additional fee (approximately 0.75 percent of the premium) directly from the insured.

2. **Conform Relevant Policy Terms to your Purchase Agreement—**You should minimize the gap in coverage between indemnification under your purchase agreement and matters covered by the policy. In particular, you should pay attention to the following:

   – Definition of "Loss" (including coverage of defense costs—costs of defending against excluded types of policy claims may be covered by the insurer even though the underlying claim is not covered)

   – Provisions regarding the calculation of losses, such as materiality scrapes, impact of recovery of insurance proceeds and tax benefits, requirements to mitigate losses, etc.

- Whether amounts recovered from the purchase agreement escrow, other insurance or third parties will count toward the retention under your policy (they should).
- Survival periods, including longer periods for fundamental representations (and related definitions), recognizing that an insurer will not give coverage that survives indefinitely. R&W insurance policies are claims made policies, but you can usually obtain a 30 day tail to make a claim so long as the breach occurred during the policy period.
- Scope of covered parties.
- The type of information that must be included in claims notices under the purchase agreement vs. to the insurer.
- The rules of interpretation for information included in the disclosure schedules (i.e., whether such information is imputed to other schedules).

3. **Don't Fall on Your Sword Trying To:**
   - Obtain coverage for the common exclusions noted above.
   - Delete the requirement that the insured attempt to recover against other applicable insurance policies first. But, deductibles paid under those other policies should count toward your retention.
   - Delete the requirement to mitigate losses. Depending on the insurer, you may be able to limit the requirement to provide that the insured is required to mitigate to the extent required by the purchase agreement and applicable law with a commercially reasonable efforts standard.
   - Delete subrogation rights. But, the insurer should not have a right of subrogation against the deal parties (other than seller in the limited case of seller fraud).

4. **Limit the Knowledge Exclusion—** The policy will not cover matters that are known to the deal team—you can't sandbag the insurer. The deal team should be limited to 2-3 people. Also, "knowledge" should be limited to the actual (not constructive) knowledge of those individuals. Coverage should only be excluded if a team member knew of a fact and knew that it was a breach.

5. **Indemnification Process for Third Party Claims—**The insurer will want to be involved in the third party claims process to the greatest extent possible. You are not going to be able to settle a claim with the insurer's money.

6. **You Don't Need to Arbitrate—**Most policies will be drafted to require arbitration of disputes with the insurer. Insurers are flexible on this point.

7. **Your Diligence Reports Will End Up in the Hands of the Insurer—**Obviously, the reports need to be accurate. But resist the urge to suggest in the report that line item indemnities be used to mitigate risk. As you might imagine, the result could be decreased coverage under the policy.

8. **Confidentiality, Privilege and Non-Reliance—**Insurers and brokers are accustomed to entering into confidentiality agreements and non-reliance letters in connection with obtaining access to deal information and due diligence memos. You will also want to properly contemplate and protect any attorney-client privileged information during the process.

9. **Lenders as Loss Payees/Additional Insureds—**If you have financing in connection with the transaction (or otherwise), you should consider including the lender as an additional insured or loss payee under the policy. This will typically come without a price from the insurer and will save you a headache with the lender.

10. **Buy-Side Policies Typically Provide More Coverage—**Coverage under a buy-side policy will not be subject to exclusions for the actual knowledge, fraud, or willful misconduct of the seller, which may remove significant obstacles to obtaining coverage for a claim. Either party may pay for the insurance, regardless of who is the insured. The vast majority of policies are issued to the buyer.

Break-Up Fees in Delaware: A Delicate Balance for All Parties

By Paul Scrivano and Noah Kornblith of O'Melveny & Myers LLP

The negotiation of the "deal protection" package in a public company M&A transaction almost always involves the inevitable discussion as to the amount and percentage of the break-up fee. In general, the Delaware courts have upheld break-up fees within a range of 3% to 4% of equity value as reasonable and not preclusive. Delaware courts also have accepted somewhat higher break-up fees in certain deals (*e.g.*, 4.3% in *In re Topps Company Shareholder Litigation*, and 4.4% in *In re Answers Corporation Shareholder Litigation*), depending on the circumstances.

Despite the contentious negotiations surrounding break-up fees and other deal protection devices, often the interests of an acquirer and a target are not dissimilar in fashioning reasonable and not excessive "deal protection". In Delaware deals, if an acquirer successfully pushes for too high a break-up fee (or other deal protection devices that are too stringent), it can jeopardize the entire "deal protection" package. Delaware courts have gone so far as to throw out "deal protection" packages deemed preclusive, and have expressed a general reluctance to "blue pencil" contractual terms in merger agreements. Similarly, targets seek to avoid any excessive break-up fees or other deal protection devices that could be deemed to go "too far", thereby opening the door to injunctive relief that halts the transaction.

The recent Delaware Chancery Court decision in *In re Comverge, Inc. Shareholders Litigation* highlights an additional risk to the target board for agreeing to a break-up fee that is seen to be extraordinarily excessive: the exculpatory provisions in a certificate of incorporation (that would otherwise insulate directors from personal liability for breaches of the duty of care) may not always apply.

Comverge involved the sale of a distressed company that agreed to a break-up fee and expense reimbursement in the amount of 5.5% to 7% of equity value. In *Comverge*, the Delaware Chancery Court stated that even at the low end, the 5.5% break-up fee tested the limit of what had been considered a reasonable break-up fee.

In addition, if the deal was terminated, Comverge was required to repay a bridge loan made by the acquirer. Although that bridge loan provided important liquidity to *Comverge* presumably in an effort to retain value for its stockholders, the court aggregated the full amount of the bridge loan repayment with the break-up fee and expense reimbursement, concluding that the total termination payments could have amounted to a 13% payment by Comverge. The *Comverge* court noted that a termination payment of 13% was "so far beyond the bounds of reasonable judgment that it seems inexplicable on any ground other than bad faith" by Comverge's board of directors.

Comverge is a reminder that the Delaware courts tend to evaluate termination payments on an aggregate basis and do not necessarily discount or offset potential values derived from deal enhancements like bridge financing. These possibilities were understood by acquirers and targets when 19.9% new stock options were used as deal protection devices in "pooling of interests" stock mergers up through mid-2001, with the total notional profit under the stock option often being capped at a reasonable break-up fee level. After *Comverge*, target boards should be mindful that in some deals there are certain deal protection devices providing for payments (e.g., commercial agreements or licenses triggered upon termination) that, depending on the circumstances, might also be aggregated and evaluated as termination payments by the Delaware courts.

Targets and acquirers also should take note of the discussion in *Comverge* relating to a target board's agreement to termination payments "so far beyond the bounds of reasonable judgment." At some point beyond the bounds of reasonable judgment, the Chancery Court might find such payments amount to bad faith. Bad faith, if proven, is not entitled to the exculpatory provisions that most Delaware public companies have in their certificates of incorporation. While the *Comverge* decision came at the motion to dismiss stage, and may ultimately be decided differently on the merits, it is a reminder of some of the risks associated with termination payments that a court might see as "so far beyond the bounds of reasonable judgment."

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