The M&A LAWYER

February 2010 ■ Volume 14 ■ Issue 2

Strategic Deals Require Strategic Thinking:
Antitrust Provisions to Consider in Negotiated Transactions

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Antitrust considerations play a critical role in many negotiated transactions, affecting numerous aspects of the deal, including timing and the scope of the acquisition. With a new administration in the U.S., a newly appointed E.C. competition commissioner, the emergence of the new Chinese merger control regime, and general market uncertainties, Sellers are currently much more concerned about certainty of closing, and regulatory uncertainty in particular has become a key focus. Merger control regimes exist in more than sixty-five jurisdictions,[1] many of which, if certain filing thresholds and jurisdictional elements are satisfied, require parties to make a merger control filing and obtain approval for their transaction prior to closing. In strategic transactions involving major competitors, regulatory approval may entail the parties having to divest assets or offer other remedies to obtain clearance. Consequently, effective and efficient representation in mergers and acquisitions requires early consideration of antitrust issues.

Unless the parties are confident that antitrust issues will not be a significant factor, counsel for both parties, as an initial matter, should obtain background information regarding the products (or services) being acquired/sold and perform a preliminary analysis of antitrust risk (ranging from procedural filing and timing issues to analysis of substantive overlaps), preferably with input from the appropriate businesspeople. Once each party's antitrust counsel has completed its internal, initial competitive assessment, whether the respective counsel should discuss their views of the transaction's antitrust risk (as well as the feasibility

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One Year Subscription ■ 10 Issues ■ $488.00
(ISSN#: 1093-3255)

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of any proposed remedy) is often a major tactical consideration. The Seller usually wants to resolve the antitrust issues as soon as possible. The Buyer's counsel, however, may want to delay discussing antitrust issues with Seller's counsel for strategic reasons; namely, avoiding having to commit to accept any antitrust risk before the Seller has committed significant time and energy toward negotiating the transaction (and thus become more enthusiastic about the merits of a deal). However, in other cases, having the discussion upfront enables both parties to make informed judgments about the impact of a number of contract provisions and hopefully avoids needless posturing about hypothetical risks. The greater understanding gained through this process should allow each party to better determine whether to expend their negotiating leverage on antitrust related points or to save it for other issues.

This article discusses several of the key antitrust-related provisions contained in merger and acquisition agreements in strategic deals. In particular, it addresses antitrust clearances as a precondition to closing, risk allocation provisions (including reverse breakup fees), covenants regarding cooperation on antitrust matters, and "ticking" fees. Several other provisions that may be impacted by antitrust considerations are also briefly discussed.

Antitrust Conditions Precedent

Both parties typically want to close the deal as soon as possible after signing to ensure that market conditions do not impact the negotiated purchase price and to realize their respective benefits of the bargain. Although both the Buyer and the Seller typically want to close quickly, other conflicting interests may lead to disagreement as to the jurisdictions in which antitrust approvals or clearances should be obtained prior to closing. For example, the Seller faces the often not insignificant risk that its business will deteriorate in the period between signing and closing, in part from customer and employee defections due to uncertainty. The Seller typically is interested in receiving the consideration as soon as possible to avoid any number of risks that could intervene and cause the transaction to be delayed or abandoned. Accordingly, the Seller typically wants to limit the number of antitrust approvals that are conditions precedent to closing. In contrast, the Buyer usually wants assurances that a governmental authority will not oppose the transaction after the Buyer has paid the Seller the purchase price and tends to want a more extensive list of jurisdictions that will be closing conditions. For example, the Buyer may want to include approval from a jurisdiction it deems advisable or appropriate, even if not legally required, such as from a jurisdiction with a voluntary merger control regime.

Prior to signing, the parties may not have had access to all the relevant data (and people) to make a definitive assessment of which countries require pre-closing approval (or clearance) of the transaction. Generally, any assessment requires at a minimum the revenues of the parties broken down by jurisdiction based on the location of the customer. Market share estimates are also needed for some jurisdictions. As a threshold matter, parties typically can exclude any country in which the target had *de minimis* turnover in the most recent calendar year. Counsel should also inquire as to whether the parties have any particular jurisdictional sensitivities regarding either the Seller's retained business or the Buyer's business; for example, a party may always notify its acquisitions in a specific country because of concerns about potential spillover effects (*e.g.*, very significant sales or the importance of the government to the Buyer's or the Seller's other lines of business). To the extent failure to obtain pre-merger approval may result in criminal penalties in a jurisdiction,[2] counsel should, in addition to considering the jurisdictional nexus, also inquire as to whether either party has any assets or personnel at risk in the jurisdiction.

There is rarely disagreement about including U.S., E.U., and Canadian antitrust clearances as a closing condition, if these jurisdictions require the transaction to be reported prior to closing. China recently revised and bolstered its merger control regime; similarly, it is anticipated that India will implement a merger control regime. Conditions precedent that require antitrust clearance from China and India have the potential to extend significantly the time between signing and closing,

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as these jurisdictions can have lengthy review periods.

For the many other jurisdictions with merger control regimes, the approach as to whether, and how, to list them as closing conditions varies. The three typical approaches are for the parties: (1) to stay silent as to other jurisdictions; (2) to specifically list each additional jurisdiction (often in a schedule); or (3) to limit the additional jurisdictions to those that are (a) required by law; (b) would prohibit the consummation of the transaction; or (c) that if not obtained (i) would result in a criminal violation; or (ii) are, or would be, reasonably likely to have a Material Adverse Effect.[3] The Material Adverse Effect may be measured with respect to the Buyer and/or Seller or to the combined company assuming that the proposed transaction proceeds.

A thorny issue could arise if the parties elect not to include as a closing condition a country with low jurisdictional thresholds (*e.g.*, Ukraine or Pakistan) and in which they have no assets or sales, and that country objects to the transaction prior to closing. If all the conditions precedent are satisfied, could the Seller force the Buyer to close, or would a U.S. court accept a Buyer's argument that closing the transaction would be illegal under the local law? Would a U.S. court really find that the parties cannot close the transaction in contravention of, for example, Ukrainian law, when there is no relevant nexus between the transaction and the Ukraine and where the Ukraine arguably has been aggressive in extending its jurisdictional reach beyond international norms?

Another difficult issue can arise when a large, and potentially competitively problematic, transaction is reportable in some jurisdictions, such as the E.U., but, for technical reasons, is not reportable in others, such as the U.S. Unlike many non-reportable transactions, which frequently sign and close on the same day, thereby obviating the need to have a separate antitrust condition precedent, in the foregoing scenario, the parties will not be able to close immediately. The U.S. antitrust agencies, the U.S. Department of Justice ("DOJ") and the Federal Trade Commission ("FTC"), may investigate a proposed acquisition even if no filing under the Hart-Scott-Rodino Act of 1976, as amended ("HSR"), is required, and an E.C. investigation may increase the risk of a DOJ or FTC investigation. Accordingly, if the Buyer thinks there is a meaningful risk that the DOJ or FTC will investigate the transaction, it may want to provide for such a possibility in the closing conditions. The Buyer typically would prefer that it not have to close the transaction if a DOJ or FTC investigation is pending, while the Seller typically would prefer the Buyer to have to close the transaction provided there is no injunction preventing it. A compromise position may be a closing condition that the Buyer need not close if an investigation is reasonably likely to issue, coupled with a short outside termination date.

Antitrust Regulatory Approval Covenants: Generally

Parties typically include covenants regarding the efforts they will undertake to obtain antitrust regulatory approvals. The parties generally agree to use some form of efforts—typically, "best efforts," "reasonable efforts," "reasonable best efforts," or "commercially reasonable best efforts." At least under New York law, courts have yet to establish definitive criteria for these different formulations and instead assess the defendant's behavior based on the specific facts of each case.

Although one can easily conclude that a "best efforts" provision is the most stringent efforts provision, there are disparate interpretations of each of the above formulations. Accordingly, the parties often attempt to document the specific obligations required in the "efforts" covenants. Parties, however, may also want to consider whether they benefit from leaving the terms ambiguous rather than risk creating a negative negotiation history that could be introduced as parol evidence in construing an ambiguous term of the contract. For example, if a non-material divestiture were needed to obtain clearance, a Seller might prefer to rely on the ambiguous meaning of "reasonable best efforts" to obtain all required antitrust approvals rather than seek to negotiate for an explicit divestiture obligation and perhaps run the risk of winding up with a provision in the agreement that specifies clearly that the Buyer is not

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required to agree to make, or to make, any divestitures or accept any kind of operational restriction in order to obtain antitrust approval.

Antitrust Regulatory Approval Covenants: Risk Allocation

In any strategic transaction, a critical question is how the parties will allocate the risk that a governmental antitrust authority might challenge the transaction, including whether the Buyer will have any obligation to propose a remedy to a governmental antitrust authority (or accept a remedy offered by such an authority). If the Buyer does have a divestiture obligation, what is the scope of that obligation? Typical provisions range from remaining silent (relying on whatever general efforts covenant is included relating to obtaining regulatory approvals) to effectively requiring the Buyer to do whatever it takes to obtain antitrust clearance (a "hell or high water" provision) to providing explicitly that the Buyer has no divestiture obligation.

The parties also may agree to a variation on the obligation depending on the circumstances. For example, the Buyer's divestiture obligations may be limited to: (1) certain product lines; (2) a revenue cap (although this raises the potential that the Buyer would be obligated to divest an unexpected asset); or (3) a materiality cap.

Buyers often express the concern that an explicit divestiture obligation (including the ultimate divestiture obligation, a hell or high water) not only may increase the likelihood of the DOJ or FTC issuing a Second Request because it indicates that the parties see a potential problem but also may alter the Buyer's bargaining power vis-à-vis the government agency. These concerns are often referred to as the "road map" problem. The degree of risk depends on how obvious the parties think the potential antitrust issue is likely to be. For example, when Boston Scientific made its unsolicited bid for Guidant in 2006, it included a detailed divestiture commitment in its initial bid, reasoning that the potential overlaps were almost certain to be obvious to both the FTC (which had ordered a divestiture for the then-pending Johnson & Johnson—Guidant transaction which Boston Scientific was trying to top) and Guidant's Board of Directors and shareholders. Boston Scientific concluded that the advantage in making a specific divestiture offer in gaining the support of Guidant's Board and shareholders far outweighed any road map concerns.

In our experience, hell or high water provisions are unusual in strategic transactions and even specific divestiture obligations are not the norm. To provide additional color, we searched publicly-available sources, such as Google, PR Newswire, Competition Law360 and Securities Mosaic, to identify transactions that received an HSR Second Request in 2008 or 2009, with the assumption that parties to those transactions likely had been aware ex-ante of antitrust risk. This list was supplemented with transactions that were subject to a DOJ or FTC consent decree or preliminary injunction. These searches yielded 54 transactions.[4] Of these 54 transactions, 29 had publicly available transaction agreements, which we then reviewed. We identified only one agreement (or less than 5%) that contained a hell or high water provision and eight that contained some form of a specific divestiture obligation (*e.g.*, a revenue cap).[5]

Historically, some parties have avoided putting the explicit terms of a divesture obligation in the base transaction agreement. Instead, interpretations of the regulatory approvals efforts have sometimes been included either in a side letter memorializing counsels' conversations or in a joint defense agreement ("JDA"). Properly written, the side letter or JDA does not amend the terms of the merger agreement and does not constitute a part of the merger agreement, but rather it memorializes the parties' joint understanding of the appropriate antitrust defense of the transaction, and may include tactical points such as the timing of any settlement offers and the scope of any divestiture or other settlement agreement to which the parties might agree in the face of pending or threatened litigation. Depending on how the parties draft the provisions (and other issues), they will need to consider the scope of any disclosure that needs to be made under the securities laws or in any privilege log that may need to be submitted with any regulatory filings.

Reverse Breakup Fees

Parties also may seek to allocate antitrust risk by providing for the payment of a reverse break-

up fee by the Buyer if the transaction fails to close on antitrust grounds. A critical issue with reverse breakup fees is identifying the appropriate triggering conditions; potential antitrust triggers include the failure of the HSR condition precedent by the agreement's outside termination date, the failure to satisfy non-U.S. clearance condition(s) as of the outside termination date, or the transaction being preliminarily (or permanently) enjoined by antitrust authorities. For moral hazard reasons, a reverse breakup fee typically is not payable if the Seller failed to discharge its obligation under the regulatory covenants. Similar to divestiture commitments, a reverse breakup fee may be perceived as a signal of antitrust issues to governmental agencies. While a reverse breakup will not provide the government a "roadmap" to a specific remedy, the existence of a significant reverse breakup fee may give the government significant leverage in any negotiation of remedies.

In our experience, antitrust-triggered reverse breakup fees are rarely used. In light of the not insignificant probability that (i) the Seller's business will deteriorate prior to closing, and (ii) any subsequent acquisition price would be lower than the Buyer's, it would seem that the Seller would almost uniformly prefer a divestiture commitment to a reverse breakup fee, which effectively evolves into an option for the Buyer. In addition, a Seller may be reluctant to accept a reverse breakup fee because of a concern that a court would treat the reverse breakup fee as an appropriate measure of liquidated damages in the event of, for example, the Buyer's breach of its regulatory covenants. A possible exception to this exists when the parties cannot articulate a clear remedy to the potential antitrust issue. To minimize the likelihood that the Buyer is able to treat the reverse breakup fee as an option, the Seller typically would include a contractual right to seek specific performance or damages if the Buyer intentionally breaches the agreement by failing to use the requisite level of efforts to obtain antitrust clearance.

We utilized the FactSet Mergers database, also known as MergerMetrics,[6] to analyze further the relevance of antitrust-triggered reverse breakup fees in strategic transactions. For a transaction to be included in the MergerMetrics database: (1) the target company must be incorporated in the U.S.; (2) the target company must be publicly traded; and (3) the acquirer must own less than 50% of the target at the time the deal is announced and must be seeking to acquire 100% of the target's equity. Within this database, we searched for deals announced between January 1, 2005 and December 31, 2009 in which the merger agreement was publicly filed. We limited the search to deals with a transaction value of $500 million or greater and excluded financial and hostile buyers.[7] There were 375 transactions that met these criteria. Of the 375 transactions, 121 contained reverse termination fees, and only 32 of those reverse termination fees had antitrust triggers. In other words, of the 375 deals in our sample, only 8.5% had antitrust-triggered reverse breakup fees. The average antitrust-triggered reverse breakup fee was 5.84% of the transaction's value and the median was 3.92%.[8] These figures support our hypothesis that antitrust-triggered reverse breakup fees are highly unusual.

We also reviewed the regulatory covenants of the 32 transactions in our sample that had antitrust-triggered reverse breakup fees. Of those, three, or fewer than 10%, had both an antitrust reverse breakup fee and a hell or high water provision to obtain antitrust regulatory approval. This low percentage is consistent with our hypothesis that antitrust-triggered reverse breakup fees may be disfavored because of the threat that the fee would be treated by the courts as the measure of damages for a breach of the hell or high water provision.

Regulatory Approval Covenants: Other Provisions

In addition to the risk-shifting provision discussed above, the typical acquisition agreement also includes a number of other antitrust-related provisions. For example, in which jurisdictions must the parties make merger control filings and under what timetable? The answers to the former question may be different than the jurisdictions listed in the antitrust condition precedent.

Frequently, agreements provide that the parties will make their respective HSR filings, if required,

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within a defined number of business days (often 10) after signing. Filings for other jurisdictions, such as the E.U., may take significantly longer, so the parties usually agree to make these filings as promptly as practicable. The Seller in particular may want to include a provision that the parties agree not to take any action that will make antitrust approval more difficult (*e.g.*, the Buyer will not acquire a business that competes with the Seller's prior to closing).

Another important consideration is what obligation the parties will have to coordinate their dealings with government agencies. For example, do they agree that they will not have any substantive meetings or conversations with government agencies unless the other party is present? Do they agree to provide each other (or their counsel) with advance notice and an opportunity to review any communications and submissions (subject to applicable law and privilege)? Particularly where the Buyer has agreed to a risk-shift provision, the Buyer usually will want more control over the government agency process. In addition, Buyers sometimes resist an obligation to share information with the Sellers regarding settlement offers.

These regulatory approvals covenants also may establish the parties' obligations to litigate in the event of a challenge. The obligation may be imposed on the Buyer alone or on both parties. The obligation may be to litigate through a final, non-appealable judgment or something less. The obligation may also differ if the plaintiff is a governmental authority or a private party. The Seller's counsel will want to ensure that a decision by the Buyer to litigate does not relieve the Buyer of its divestiture obligation (if there is one).

In addition to the above covenants, the Seller may want to include several provisions to facilitate closing the transaction as quickly as possible. A provision regarding the timeframe in which the parties will respond to any Second Request that may be issued is one such provision. Another such provision is an agreement that neither party will withdraw its merger control filings, extend any waiting periods or enter into a timing agreement without the consent of the other party.

Ticking Fees

So-called "ticking fee" provisions provide another means of motivating the Buyer to move quickly. Such a provision obligates the Buyer to pay interest on the purchase price if the transaction does not close by a specified date. Interest typically would not be payable until some specified period of time has elapsed and may increase over time. For example, if the closing occurs more than 120, but less than 150, days after the signing, the interest rate may be 6% per annum and might increase 1% per month thereafter.

Data suggest that the use of ticking fees is exceedingly rare, at least in deals involving public U.S. targets. A March 2009 study by MergerMetrics found that just over 1% of transactions in its database contain ticking fees.[9] In our reverse termination fee examination above, of the 375 deals in our search, only four (or 1.07%) contained ticking fees. Such fees ranged from between 6% and 8% of the transaction value, per annum. The fee increased in only one transaction, the acquisition of ADVO, Inc. by Valassis Communications, Inc., starting at 6.75% per annum and increasing by 0.1% per month thereafter.[10]

Additional Potential Antitrust Issues in Agreements

Although beyond the scope of this article, below are brief summaries of other potential antitrust issues that may arise in transaction agreements.

Pre-closing ("ordinary course") covenants. Ordinary course covenants are designed to protect the value of the assets/business the Buyer is purchasing and typically restrict certain actions the Seller can take in the pre-closing period. Covenants that are too restrictive can amount to "gun jumping" in violation of the HSR Act or to a potential problem under Section 1 of the Sherman Act. The DOJ and FTC do review agreements' ordinary course covenants and may pursue an enforcement action if they think the covenants are too restrictive.[11] Potentially problematic covenants include those significantly restricting the Seller's: (i) pricing or discounts offered to cus-

tomers; (ii) current and future R&D projects; (iii) planned capital expenditures and capacity expansions; (iv) ordinary course hiring decisions; and (v) ability to execute key competitive strategies.

Non-competition covenants. Under the common law, generally, covenants that are reasonable with respect to the: (i) restricted activity; (ii) geographic scope; and (iii) duration will be enforced if necessary to protect the goodwill of the assets or business being purchased or to protect against the disclosure of confidential information. If "ancillary" to the sale of a business or asset, non-competes are generally lawful under the rule of reason. If the restriction is not ancillary, it may be found to constitute a horizontal agreement not to compete in violation of Section 1 of the Sherman Act. Potentially problematic non-compete provisions include bilateral non-competes (*i.e.*, each party agreeing not to compete in a certain area) and restrictions on products/customers/areas unconnected with the business being sold.

Representations and Warranties. Transaction agreements typically include Buyer and Seller representations and warranties regarding, inter alia, "consents and approvals" and "no conflict." The consents and approvals representation need not necessarily mirror the closing conditions. For example, the closing conditions may only include antitrust clearance from the U.S. and E.U. but the representation may have a broader formulation. The "no conflict" representation typically provides that the execution of the agreement and consummation of the transaction will not conflict or violate any order, writ, injunction, decree, statute, rule or regulation. Usually, there should be at least a carve-out for antitrust consents.

Drop-Dead Date. In deciding upon a date after which either party may terminate the agreement (a so-called "drop-dead date"), the parties should consider whether it provides enough time to obtain the expected antitrust approvals. Oftentimes, parties will elect to have a relatively short drop-dead date that provides for an extension (typically +90 days) in the event all closing conditions have been satisfied except for the antitrust regulatory closing condition.

Material Adverse Effect. If the Seller is concerned that its business is likely to deteriorate significantly during a prolonged antitrust review, Seller's counsel should be careful that the Buyer cannot use the material adverse effect provision to avoid any divestiture commitments or to avoid payment of reverse breakup fees.

Conclusion

Given the number of provisions that involve antitrust considerations and their potential impact on the transaction, the parties and their advisors are well-served by conducting antitrust due diligence early in the process and by carefully considering potential antitrust issues when initially drafting and negotiating agreements.

NOTES

1. *See* Global Competition Review, Getting the Deal Through: Merger Control 2010 (2009), *available at* http://www.gettingthedealthrough.com/books/20/merger-control; Global Legal Group, The International Comparative Legal Guide to: Merger Control 2010 (2009), *available at* http://www.iclg.co.uk/index.php?area=4&kh_publications_id=124.
2. *E.g.*, Canada, Greece, and Ireland.
3. *See, e.g.*, Whirlpool Corp., Agreement and Plan of Merger among Whirlpool Corp., Whirlpool Acquisition Co., and Maytag Corp. (Form 8-K), at § 7.01(b) (Aug. 22, 2005).
4. Although many companies disclose the receipt of a Second Request, particularly public companies, which must disclose material information, Second Requests are not public and therefore the FTC and DOJ likely issued more than 54 Second Requests in 2008 and 2009. For example, we know that in FY 2008 (October 1, 2007 through September 30, 2008), the FTC and DOJ issued 41 Second Requests. *See* Fed. Trade Comm'n Bureau of Competition and Dep't of Justice Antitrust Div., Hart-Scott-Rodino Annual Report Fiscal Year 2008, *available at* http://www.ftc.gov/os/2009/07/hsrreport.pdf.
5. *See, e.g.*, Pfizer Inc., Agreement and Plan of Merger among Pfizer Inc., Wagner Acquisition Corp., and Wyeth (Form 8-K), at § 6.3(d) (Jan. 29, 2009).
6. http://www.mergermetrics.com.
7. Specifically, we excluded deals classified by MergerMetrics as involving any one of the following features: (i) a tender offer; (ii) a short-form merger; (iii) a management buyout; (iv) a

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leveraged buyout; (v) a going private transaction; (vi) a special purpose acquisition company acquirer; (vii) a financial buyer; or (viii) a club deal.

8. The maximum, 39.81%, was in Monsanto Company's acquisition of Delta and Pine Land Company, a transaction that the Antitrust Division of the Department of Justice had challenged previously. The minimum, 0.11%, was in CapitalSource Inc.'s proposed acquisition of TierOne Corporation and just covered expenses.
9. Jim Mallea, Research Spotlight: Tick, Ticking, Ticking Fees.... (Mar. 31, 2009), https://www.mergermetrics.com/pub/rs_20090331.html.
10. ADVO, Inc., Agreement and Plan of Merger among Valassis Commc'ns, Inc., Michigan Acquisition Corp. and ADVO, Inc. (Form 8-K), at § 2.01(c) (Jul. 5, 2006), as amended by Amendment No. 1 to Agreement and Plan of Merger among Valassis Commc'ns, Inc., Michigan Acquisition Corp. and ADVO, Inc. (Form 8-K), at § 2 (Dec. 20, 2006).
11. *See United States v. Computer Assocs. Int'l,* 2002-2 Trade Cas. (CCH) ¶ 73,883 (D.D.C. 2002); *see also United States v. Qualcomm Inc.*, 2006-1 Trade Cas. (CCH) ¶ 75,195 (D.D.C. 2006).