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## *Antitrust Termination Fees: Rational or Emotional?*

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When AT&T broke up with T-Mobile before consummating their proposed merger, T-Mobile kept a \$6 billion engagement ring. That was the value of cash and spectrum assets that AT&T paid to T-Mobile in late 2011 as a result of AT&T's failure to gain antitrust approval for its proposed acquisition of T-Mobile. The fee was required to be paid by AT&T under the terms of the merger agreement and, at the time, was the largest antitrust termination fee (ATF) an acquirer had ever risked on a proposed transaction. Needless to say, when that fee became due, *schadenfreude* spread among deal professionals not involved on the AT&T side of the transaction, and deal professionals of every stripe began to fundamentally reconsider the use of ATFs.

Since the AT&T payment, a number of large, antitrust-sensitive transactions have not included an ATF. Transactions which would have been likely candidates for the use of an ATF but had none include Express Scripts' \$29.1 billion acquisition of Medco, AT&T's proposed \$48.5 billion acquisition of Direct TV, and Comcast's failed \$45.2 billion acquisition of Time Warner Cable. Recently, however, big ATFs have returned. The \$15 billion Intel/Altera transaction includes a \$500 million ATF, the \$56 billion Charter Communications/Time Warner Cable transaction includes a \$2 billion ATF and Monsanto's proposed \$45 billion acquisition of Syngenta includes a \$2 billion ATF. Given the apparent revived interest in risking these fees, this article will consider ways to think about ATFs and whether recent approaches have been rational or simply emotional.

### **From a Target's Point of View**

Target companies are clearly the primary drivers of ATFs. From the target's point of view there are two principal rationales for seeking an ATF.

First, if a proposed transaction does not close because of the acquirer's antitrust posture, the target will want compensation for not only the time and expenses it has incurred in getting the deal signed, but also the business disruption that the deal caused and the fact that the target has put itself in play. The interesting questions about this rationale are whether money can reasonably compensate a target for these harms and, even if it can, what is the right measure. Typically, antitrust termination fees have hovered at or a bit higher than the size of target break-up fees (around 3%-4%).



However, there is no legal or business rationale for these fees being related in size. As a legal matter, the size of target break-up fees is dictated by Delaware law while the size of an antitrust termination fee is typically within the business judgment purview of the acquirer's board. As a business matter, these fees are also dissimilar—the harm to a target of a failed deal is likely much greater than the harm to an acquirer of a topped transaction. Antitrust termination fees therefore should arguably be much larger than target break-up fees and, for a time before the AT&T payment, they were. The AT&T/T-Mobile ATF was about 15% of the deal size, and in the 2010 acquisition by Google of Motorola Mobility (which successfully closed), the ATF was about 20% of the deal size.

The second rationale for seeking an ATF, from the target's point of view, is that it is an additional way of holding the acquirer's "feet to the fire." In antitrust-sensitive transactions, the merger agreement will include highly negotiated covenant obligations of the acquirer as to the level of efforts it must exert to try to obtain antitrust approval for the transaction ("reasonable best efforts" and similar formulations). A meaningful ATF may provide a target additional tangible comfort that the acquirer will fully comply with, or even exceed, its covenant obligations.

## **From an Acquirer's Point of View**

Acquirers may be the reluctant partners in ATF arrangements, but they also have two principal rationales for agreeing to ATFs.

First, offering a meaningful ATF conveys to the target the acquirer's confidence in the ability of the transaction to overcome antitrust concerns. Since certainty of closing is obviously critical to target companies, particularly public ones, boards may take some comfort from the confidence that an ATF conveys where antitrust approval is a serious concern.

Second, a meaningful ATF may deter interlopers who might be considering trying to top the transaction. One argument that interlopers often make is that their proposed transaction is more likely to close than the original deal. Agreeing to an ATF can be seen as conveying a high degree of confidence on the part of the acquirer that antitrust issues will not stand in the way of a closing.

## **Efforts Covenants: The Other Key Piece of the Puzzle**

ATFs need also to be considered in the context of the acquirer's covenants regarding obtaining antitrust approval. Antitrust covenants come in two basic flavors. The first is a "hell or high water" covenant in which the acquirer essentially agrees to take any and all actions necessary to obtain antitrust clearances. Such actions ("Remedial Actions") could include having to sell or hold separate businesses or assets, or to agree to post-closing business conduct covenants (so-called "behavioral remedies"). The second is a limited efforts covenant, usually formulated as "reasonable best efforts" or, less commonly, "best efforts."

Either of these covenant flavors can be, and often are, softened by further agreements that limit the lengths to which the acquirer must go to satisfy its obligations. These limits can include (i) having no obligation at all to agree to Remedial Actions, (ii) having no obligation to agree to Remedial Actions if they would have a material adverse impact on the acquirer and/or the target, or (iii) having no obligation to agree to Remedial Actions that would result in more than a specified dollar amount of revenue or earnings having to be divested.



## The Recent Relationship Between ATFs and Efforts Covenants

The 20 most recent transactions with a purchase price of over \$1 billion and which included an ATF show the following:

Five of the 20 had “strong” antitrust covenants, *i.e.*, hell or high water, best efforts or reasonable best efforts, in each case without any limitation on the obligation. The other 15 all had “limited” covenant obligations, *i.e.*, the acquirer is not required to agree to Remedial Actions that exceed a specified revenue amount or that would have a material adverse effect on the target, the acquirer, or both.

Of the five transactions with “strong” covenants, three had ATF amounts at or about the amount of the target’s break-up fee and two had ATF amounts significantly above the amount of the target’s break-up fee. Of the 15 transactions with “limited” covenants, seven had ATF amounts at or about the amount of the target’s break-up fee and eight had ATF amounts significantly above the amount of the target’s break-up fee.

And so we see that the relationship between the size of ATFs and the scope of an acquirer’s antitrust covenant has recently been all over the board. About half the deals with “strong” antitrust covenants had large ATFs, while the other half had small ATFs. And about half the deals with “limited” antitrust covenants had large ATFs while the other half had small ATFs. Rationality is clearly not driving the complexion of these provisions.

## A Proposed Framework for Negotiating ATFs and Efforts Covenants

### *From a Target’s Point of View*

In considering how to structure an ATF and an efforts covenant in an antitrust-sensitive transaction, targets may want to focus on:

- *Decoupling the size of the ATF from the scope of the efforts covenant.* A target’s focus will be on limiting closing risk. The scope of the efforts that the acquirer will be willing to undertake to satisfy the antitrust regulators should therefore have much greater significance to a target than the existence or size of an ATF. Acquirers have demonstrated their willingness to risk (and sometimes to pay) big ATFs. As the above summary of recent transactions shows, however, acquirers are much more hesitant to agree to broad efforts covenants. Targets should therefore not be distracted by ATF negotiations.
- *Decoupling the size of any ATF from the size of the break-up fee.* As noted above, ATFs and break-up fees serve different functions and only break-up fees are constrained in size by law. More importantly, however, while the use of “crown jewel” assets as break-up fees has generally disappeared from practice, targets might want to seek an ATF that consists of more than just cash (as in the AT&T/T-Mobile transaction). In the event a transaction fails, cash is cool but baubles are better. Assets received as, or as a part of, an ATF may allow (and at least may give the market the perception of allowing) a target to emerge from a failed deal in a strategically better position than when it entered into the deal.
- *Using two-tier ATFs to exert additional pressure.* Two-tier break-up fees have been around for a while and are often used to provide for a lower break-up fee during a “go shop” period so as to potentially increase the attractiveness of the target during the period. ATFs could be structured in a similar manner—increasing amounts the more time that passes without receipt of antitrust approval. The typical long runway of regulatory review would obviously



have to be factored in when deciding when the ATF would increase in amount, but an increasing fee may put additional pressure on acquirers to resolve issues with the regulators.

## ***From an Acquirer's Point of View***

In considering ATFs and efforts covenants, acquirers may want to focus on:

- *Decoupling the size of the ATF from the scope of the efforts covenant.* From an acquirer's point of view, an ATF is "just" money (assuming there are no other baubles included) and amounts paid as an ATF are likely tax deductible to the acquirer, thereby further reducing the apparent pain. The demands of regulators, however, may have the effect of fundamentally changing the nature of the acquirer's business or the benefits the acquirer was expecting to obtain from the target business. Therefore, acquirers should generally be willing to trade big ATFs for meaningful covenant limitations.
- *Using specificity of obligations as opposed to an ATF.* In many antitrust sensitive transactions, the likely scope of the remedies that regulators will require is apparent to the parties at the outset. Rather than negotiate fees for failure, and rather than limit covenants in vague ways that rely on concepts of materiality, acquirers may be better off deciding what they will risk, and specifying such in the merger agreement. Practitioners sometimes worry that this approach may provide blind mice regulators with a "roadmap." But this should not be a real concern given the sophistication of antitrust regulators, and should be far outweighed by the potential benefits of the specificity approach.

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