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GUEST ARTICLE

Deal-Certainty Toolbox For Sellers

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Some corporate deals fly together like teenagers in love. Single-minded buyers flush with cash and bent on quick consummation can't wait to hop into the carriage with a wide-eyed seller and ride off together to who-knows-where. Sellers cruising in search of a Saturday night deal shop themselves with self-flattering offering memoranda possessing as much candor and detail as a Match.com head-shot. Woe unto the advisers who try to dial back the animal magnetism of the soon-to-be couple by seeking an adult conversation concerning the risks involved. "What about the pre-nup?" Stare. "What about the children?" Blank stare. "What if Billy Buyer is just NOT COMMITTED?" The tears flow like a cheap champagne fountain.

These are all good questions to ask in any deal, but let's look a little more closely at a particular type of deal—the antitrust-sensitive deal—in which working these issues through in the clear light of day is critical. In any sizable, antitrust-sensitive deal the parties will almost certainly be required to obtain approvals from the antitrust regulators. Absent the required approvals the happy couple cannot obtain their wedding license; this state of regulatory denial can vaporize the bliss pretty quickly. Nothing says "I don't love you any more" with greater clarity than the "I'm walking" letter hand-delivered by Billy Buyer's lawyer at the rehearsal dinner. Party off, dude.

Can this wedding be saved? Maybe yes, maybe no, but let's pause for a moment and script out the tough love lecture to Sally (the now-jilted) Seller about "This is what happens when you don't listen to me." It goes like this: "You hoped that Billy Buyer was

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really committed to closing but this is the real-deal world—hope/schmope; if you wanted him to be committed to you until death do you part, including through the thick and thin of regulatory scrutiny, you should have grabbed him by the checkbook and made him pledge his boundless commitment in writing; and if you had followed my advice, this very day my goons (i.e., lawyers) would be hunting him down and making him pay, but instead he's left for Vegas while you're crying at the altar."

Now let's transpose this good advice to the Sally Sellers of the deal world. Deal flow is up after a long drought—hooray! Sharp-eyed strategic buyers are angling for deals, looking to reel in something juicy that complements what's already on their plate—yes, yes, tell me more! The most flavorful deals for these buyers are transactions that are spiced with complementarity and sauced with synergies, meaning smaller headcount and bigger market share— yes, yes, a thousand times yes! The antitrust regulators in the United States, Europe, and other important jurisdictions are picking these deals apart, grinding them down with slow rolling, high cost investigations, and then sometimes denying approval altogether. Ouch; the honeymoon limo goes into four-wheel lockup then crashes into the wall. Lights out, litigation on.

Assurances

With increasing frequency, nervous sellers want buyer assurance that their antitrust-sensitive deal will close rather than running into the regulatory wall. Why the nervousness? Let's look at the statistics. Fiscal year 2010 produced an uptick in U.S.mergers requiring regulatory approval. According to the Annual Report of the Federal Trade Commission (FTC) and U.S. Department of Justice (DOJ), in fiscal 2010 a little more than 1,166 transactions were reported to the regulators. This 63 percent increase over fiscal 2009 occurred not because the filing thresholds materially changed (they didn't) but because deal flow improved. The FTC and DOJ challenged around 40 of the fiscal 2010 deals, two-thirds of which resulted in consent decrees or in the parties abandoning the deal.

That seems like a small number given the total deal volume, but considering that most deals have little or no antitrust significance it is a high hit rate for antitrust-sensitive deals. Think of it this way—in the United States, somewhere in the neighborhood of one deal a week died a regulatory death for antitrust reasons. And near-death experiences increased as well. Second requests for information—which are burdensome, costly, time-consuming exercises indicating that the enforcers have serious concerns about a deal—increased in fiscal year 2010 by almost 50 percent over the prior year. Moreover, the

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higher the deal value the greater the chance of a second request. In the 125 or so fiscal 2010 deals valued in excess of $1 billion, over 10 percent were closely scrutinized under a second request for information. Bottom line—if you are party to a big deal, your statistical chance of a second request is better than Russian Roulette odds, but not by much.

Why the increased energy and boldness from the regulators? Much of it stems from the new leadership at the enforcement agencies following the 2008 election. The DOJ and FTC recently issued the first update to their Merger Guidelines in almost two decades, completely overhauling the prior guidelines and articulating new approaches widely viewed as having a tendency to favor enforcement (and enforcers). So the DC cops are definitely on the beat, they have issued themselves new tools giving themselves greater advantages, they are writing far more tickets than they did last year, and the deal world has taken notice.

Outside the United States, existing enforcement schemes are being rejuvenated with new and more aggressive leadership (Europe), entirely new enforcement regimes have been announced but not yet fully developed and tested (China), and old regimes are being rapidly modernized in newly emerging economic powers (Brazil). Even a relatively small deal is likely to touch one of these jurisdictions, and a sizable deal may very well touch them all. With the proliferation of regulatory regimes the chance of a deal "Getting to No" in at least one jurisdiction is much higher than it used to be.

Life in regulatory limbo places great strains on a business which is for sale but not yet sold. The dual processes of negotiating a transaction and then overseeing an extensive, prolonged and costly merger investigation consume immense amounts of management bandwidth and other crucial resources needed by a company to run its business. These distractions can be uncontrollable, and they can seem never-ending to a commissioned sales force whose incomes dive as customers take a "wait and see" approach to new purchases. Competitors use these circumstances to maximum advantage. Key employees can be wooed away, the employees who remain are often fixated on their uncertain future, the recruiting pipeline freezes up, critical customers can be picked off by rivals offering greater vendor stability, and the seller's ship drifts slowly downstream in the uncertain regulatory current while almost everybody aboard looks to their self-interest.

Toolbox

For a deal that closes, these costs are worthwhile if the price is right, but for a deal that doesn't close there is no price—just investigative pain and distraction, usually followed by the marketplace perception that the jilted company is damaged goods. On the buyer's sunnier side of the table, things are different. Buyers who for regulatory reasons fail to close suffer less damage to their employee or customer base, or to their marketplace reputation, because they are widely seen as having been on the hunt and in the driver's seat. These asymmetric impacts expose sellers to real risks if they enter into antitrust-sensitive deals with uncommitted buyers.

Knowing these risks, what can a seller in an antitrust-sensitive deal do to protect itself against being left at the altar when the regulators bark and an uncommitted buyer balks? More than you might think, actually. Let's open the toolbox and take a look at the "deal certainty" tools inside, starting with the biggest power tools.

First, there is the highest voltage clause in the toolbox, the so-called "Hell Or High Water" (HOHW) clause. It comes in various flavors but always with maximum intensity. Simply stated, the HOHW clause obligates a buyer to do whatever it takes— whatever— to obtain all necessary regulatory approvals, and it prohibits the buyer from using the lack of regulatory approvals as a justification for not closing.

Components of a HOHW clause usually include the following: (1) the buyer promises to use its best efforts to obtain all regulatory approvals needed to close—nothing excepted, no excuses; (2) if regulators refuse to approve, the buyer will litigate through a final appeal in order to obtain approvals or overturn any regulatory denials; (3) if necessary, the buyer will divest any and all assets (including those it currently holds as well as those it may acquire), and will grant any licenses or make whatever other commercial arrangements with third parties that are necessary to resolve problems that create regulatory obstacles. Pretty powerful stuff, but simple, elegant and enforceable, with the kind of punch that says to the seller's internal and external audience "This deal is going to close, come Hell Or High Water." With that kind of certainty in the air, a company's marketplace transition from "saleable" to "sold" becomes much smoother. Buyers who sign HOHW clauses are going to be around for the landing as well as the takeoff because they have no parachute.

The next tool in the seller's toolbox are clauses approximating a true HOHW clause. The most potent of these clauses are sometimes called a "synthetic HOHW clause," and these clauses provide increased optionality but can have an almost punitive component. While they leave some walking opportunities for a buyer who runs into an insurmountable regulatory wall, the buyer's option comes at great expense. These synthetic HOHW clauses almost always require the buyer to litigate with the regulators up to a point, to offer regulatory fixes like divestitures within some defined parameters, and to make a substantial payment (the Reverse Termination Fee, or RTF) in order to compensate the frustrated seller for the pain and business interruption experienced during the failed effort to sell. The synthetic HOHW clause can also include custom-tailored sweeteners like a buyer commitment to transfer scarce assets to the frustrated seller on very attractive terms if the deal craters for regulatory reasons, or a commitment to enter into other commercial arrangements advantageous to the seller.

Finally, in the bottom of the deal certainty toolbox lie a more varied set of smaller tools designed for limited applications. These include measures like a buyer commitment to make a smaller, contingent RTF linked to the seller's diminished stock or business performance over a defined period; the buyer's commitment to issue public statements and make other efforts to address marketplace speculation that the buyer walked after discovering information adverse to the seller; or a requirement that the buyer enter into limited commercial relationships between itself and the frustrated seller, or sometimes even a buyer commitment to facilitate commercial dealings between the frustrated seller and third parties. In this bottom tier of the tool box there is much room for creativity, but also a higher level of optionality and a lower level of buyer commitment to the deal.

So the word to the wise seller in an antitrust-sensitive deal is this: Why bother wondering whether your buyer has the staying power to see your deal through to closing? Proper use of the deal certainty tools can ensure that the buyer is standing at the altar with you right through the last "I do," come hell or high water. ❖

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