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Merger Control Trends M&A Counsel Need to Know

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Developments in merger control around the world over the past five years increasingly affect not only strategic transactions, but routine financial transactions. It is ever more important that corporate counsel be aware of the potential impact of merger control requirements on their transactions and, particularly in strategic and multijurisdictional transactions, take in to consideration the timing and valuation implications of those requirements.

Spreading Globally

Since 1990, the number of jurisdictions with merger control regimes has increased nearly every year. Today, approximately 90 jurisdictions have some form of merger control, most of them mandatory and suspensory, preventing at least local closing until any review is complete. Some of these regimes are quite sophisticated and fairly efficient; others, including in important jurisdictions such as India, are quite new and have faced steep learning curves, sometimes at the expense of particular transactions. It is important that the parties determine as early as possible where a transaction may be required to be reported since, as discussed below, that could affect the timing of the consummation of the transaction.

Focusing Locally

Many jurisdictions are mainly focused on the local, and, sometimes, hyper-local effects of a reported transaction. Moreover, some jurisdictions have specific issues - such as employment levels - that are also considered as part of the merger control review. Accordingly, it is important to consult with counsel knowledgeable about each jurisdiction in which a filing is required to be sure there are not non-obvious issues that could impair obtaining quick clearance.

Increasing Sophistication and Complexity

Every jurisdiction, including the US and the EC, has increased the sophistication of their analyses in recent years. Merger analysis is now far less structural than it was 10 to 15 years ago, and much more focused on the specific market facts and economics of the transaction under review. This is both good news and bad news for transactions subject to review. On one side, it means that in most jurisdictions, relatively high market shares or high market concentration alone do not necessarily indicate trouble for the transaction. However, the price of this move from structuralism is a more intense, lengthy and expensive review process focused on complex analysis of industry data and, in an increasing number of jurisdictions, close review of documents from the parties and even third parties. Further, while there has been increasing convergence internationally on standards for merger control analyses, there remain jurisdictional differences, and it is necessary to consult knowledgeable counsel to obtain an accurate risk assessment.

Significant Timing Implications and Uncertainty

Almost any filing requirement will affect the timing of a transaction, regardless of whether it raises any substantive issue. A filing in a suspensory jurisdiction requires the parties to wait to close until clearance is obtained. While the time is likely to be relatively short in non-strategic transactions, the filing still prevents a sign and close and requires that financing arrangements and communications plans take account of the delayed closing. And even in non-strategic transactions, there can be some uncertainty on when clearance will be obtained, and that requires appropriate planning to make sure the uncertainty is accounted for.

In strategic transactions timing issues are much more complex. The first issue is where the transaction is reportable. Some jurisdictions have strict investigative timetables and stick to them, but an increasing number of regimes have timing flexibility for investigators, or the rel-

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evant agency has created such flexibility for itself, sometimes without any legislative or regulatory basis. For example, some agencies vary the time they take to declare the filing complete or accepted. Others sometimes "stop the clock" on the review process to give more time for investigation. The second issue is how likely is the transaction to be subject to extend investigation, such as pursuant to a Second Request in the US or a Phase 2 investigation in the EC.

It is best if M&A counsel and the parties have at least a strong sense of the answer to both these issues at a fairly early stage in negotiation of the transaction. Mergers likely to draw extensive regulatory attention that must be filed in jurisdictions where the review is likely to be lengthy – up to a year, and sometimes more – face complex issues regarding financing, employment and customer retention and transition planning that should be at least considered prior to finalising the transaction.

Merger Control Risk Allocation

Allocation of the risks created by merger control have become a significant part of the negotiation of many strategic transactions. Companies and bankers are increasingly realising that the level of risk can affect valuation, particularly where there are multiple suitors for a seller, and sellers increasingly understand that they face significant risks during lengthy reviews and particularly where there is the potential that the deal may be blocked. It is not surprising, then, that sellers increasingly want some protection from the risk created by substantive transactions that create serious merger control risk. Risk allocation most commonly occurs in the following ways:

• The seller accepts the risk in exchange for a higher purchase price. This can create issues for the buyer when shareholders assert the buyer overpaid and can impact the economics of the transaction.

• The buyer accepts all of the risk through what is known as a "hell or high water" provision that requires it to complete the deal no matter what it has to do in order to obtain clearance.

• The buyer agrees to provide the seller with a large payment, known as a reverse break-up fee, that both provides the seller with some recompense if the deal does not close and provides a strong incentive for the buyer to complete the deal. When AT&T failed to obtain clearance for its proposed purchase of T-Mobile it reportedly paid a reverse break-up fee of $4.2 billion, or about 11%. It is more common to see such fees in the range of 4-5%.

• The buyer agrees to accept the risk up to a specific limit, which can be delineated in currency, facilities to be divested, or behavioural modifications to be accepted. These provisions can be quite contentious and there is a debate about the impact of their existence on reviewing agencies.

Risk can be managed in other ways as well including short termination dates and other covenants that may be more subtle. Of course, the earlier the parties have a risk analysis in hand, the better able they are to negotiate these issues effectively and completely.

Conclusion

Merger control is an increasing part of the M&A landscape. In any deal it is important to understand what filing requirements might be triggered and what impact that will have on deal timing, and in strategic deals it is more important than ever to understand the risks merger control imposes. And the earlier the parties have information on these two aspects, the more effectively they can address them before merger control becomes a crisis.

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