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ANTITRUST LAW

Walk-Away Provisions

By Gordon Schnell

THE ATTEMPTED merger between United Airlines and US Air, which fell apart last summer because of a threatened regulatory challenge, has quickly receded from memory as U.S. carriers confront the truly monumental problem faced by a nation and an industry in turmoil. Indeed, under the current state of the airline industry, virtually any airline merger is not only conceivable, but likely to be approved under the "failing firm" doctrine, a justification that parties use to allow a merger to go through when one of the parties is going out of business. Nevertheless, there is still a valuable lesson to be learned from the failed United/US Air merger. That is the importance—for some parties—of having clearly articulated antitrust "walk-away" provisions in their merger agreements.

"Walk-away" provisions are typically employed in all-stock transactions at the behest of jittery sellers that want protection from a plunge in the buyer's stock value before closing. These provisions allow the seller unilaterally to terminate the deal if the buyer's stock falls below a certain level. During these times of extreme market volatility, the provisions can provide much-needed assurance to sellers that are concerned that the consideration they receive for their sale does not drop below an unacceptable point.

What is less common, but no less important, is the use of walk-away provisions to protect parties from the inordinate delay, disruption, expense and ultimate uncertainty that result from an extended merger review or challenge by government antitrust authorities.

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HSR review can delay deals beyond point of value

Under the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act), 15 U.S.C. 18a (as amended), the Federal Trade Commission (FTC) or the Department of Justice (DOJ) will review all mergers or acquisitions resulting in the buyer acquiring at least $50 million worth of assets or voting securities from the seller—assuming certain thresholds for the size of the parties are reached and no exemptions apply. For all practical purposes, a transaction that is reportable under the HSR Act may not close until the FTC or DOJ has "cleared" it.

Although the initial HSR waiting period is typically only 30 days from the date of filing, this period can be extended significantly through the government's issuance of a request for additional information or documentary material—more commonly known as a "Second Request." The Second Request waiting period is also only 30 days. However, this period does not start until the government determines that the parties have "substantially complied" with the government's request. Depending on the size and scope of the government's request, such compliance can take several months or longer, cost millions of dollars in legal and related fees and result in significant disruption of the parties' operations. This disruption can be particularly severe for the acquired entity, which is typically barred under the merger agreement from engaging in any conduct that would materially change its business.

Even after substantial compliance has been reached, the government may request additional time beyond the 30-day Second Request waiting period. While the parties may refuse this "request," it is almost always advisable to give the government all the time it needs to satisfy its concerns. If pressed, the government may challenge a transaction rather than acquiesce in the face of significant unresolved concerns. But no matter how much time the government takes and no matter how reasonably the parties behave, there is no guarantee of regulatory clearance. Indeed, of the 98 transactions for which the government issued Second Requests last year, it ultimately challenged 80 of them, through an actual or threatened lawsuit.

So, here's the potential problem: The deal is signed, all requisite shareholder and board approvals have been obtained and all closing conditions have been satisfied. But the parties cannot close the deal because they have not received HSR clearance. Worse, there is no certainty as to when they will receive clearance or whether they ever will.

Yet the parties are locked into an antitrust limbo, with neither party able to walk away from the deal without the other's consent. For the party that sees its value in the deal shrink with each passing day, this scenario can present enormous problems.

The United/US Air deal is a case in point. After more than a year of DOJ review and the likelihood of clearance

becoming increasingly remote, significant disruption in the companies' business, growing operating losses on the part of both companies, a continuing drop in the value of each company's stock, a general decline in the financial health of the airline industry and tens of millions of dollars of legal and related expenses, United wanted out of the deal. But, without the benefit of a walk-away provision, United could not abandon the deal without US Air's consent. US Air, which had much more to lose from a failed merger, would not consent.

United was therefore forced to remain locked into a deal that was proving to be a sinkhole of time, money, resources and bad publicity, and that showed little prospect of ever being cleared.

Ultimately, 14 months after the deal was announced, US Air agreed with United to terminate the transaction, but only after the DOJ threatened to block it. The parties abandoned the transaction the same day. One public source put the cost to United for this failed merger effort at more than $100 million. See John Schmeltzer, "United Merger is Officially Off; Regulators See a Lessening of Competition," *Chicago Tribune*, July 28, 2001, at 1. If United had originally insisted that the merger agreement contain a walk-away provision, it might have been able to avoid much of this mess.

Instead, the agreement had what is known as a "reasonable efforts" clause, which obligates the parties to "use all reasonable efforts" to obtain necessary government approvals. This is a common provision used to define the parties' obligations to secure HSR clearance and other regulatory approvals. Standing alone, the reasonable-efforts provision requires the merging parties to endure the time, expense, disruption and uncertainty of a lengthy government review or legal challenge to the merger. This means that for parties like United—which have seen the value of their proposed deal precipitously diminish—there is nothing they can do but ride out the regulatory storm. They are entirely at the mercy of the government and the other party to the deal.

The benefits of antitrust walk-away provisions

Antitrust walk-away provisions can provide an escape hatch for this otherwise unforgiving scenario. They are easy to draft and best located in the section of the merger agreement which outlines the parties' rights to terminate the deal. They simply provide either party with the unilateral right to abandon the deal upon the occurrence of one or more regulatory events. There is room for creativity, depending on the parties' stomach for a regulatory fight or delay.

The provisions can protect parties from the delay, disruption, expense and uncertainty caused by a merger review or challenge.

For time-sensitive deals, a walk-away provision can be triggered if HSR clearance is not received within the initial 30-day waiting period. For those parties with more tolerance for government resistance or delay, the provision can be triggered by events that may arise further along the HSR review process: the issuance of a Second Request; any extension of the Second Request waiting period; a government demand for a consent decree or divestiture; actual or threatened litigation by the government to block or materially delay the transaction; a court order for a preliminary injunction, consent decree or divestiture; a court order prohibiting the transaction or materially restricting the buyer's ability to operate the acquired business or assets; or any such court orders that are final and nonappealable. Alternatively, the walk-away provision can be triggered if HSR clearance does not occur before a particular "drop-dead" date.

The existence of an antitrust walk-away provision does not necessarily mean that the parties have decided that they will not pursue the merger if the HSR triggering event occurs. The provision simply provides each party with the opportunity to reevaluate its decision to pursue the merger in light of a changed or more clearly defined regulatory landscape. For a party caught off guard by the government's opposition to a deal, or for one that will suffer from an extended government review or challenge, this opportunity can prove to be invaluable.

Walk-away provisions can serve an additional purpose. They may temper the HSR clearance demands of an otherwise overly aggressive enforcer. If either party has the right to abandon the deal in the face of a threatened consent decree, divestiture or suit, the government may be reluctant to pursue these avenues for fear of scuttling a deal with which it has only limited concerns. On the other hand, the government may be more inclined to play hardball with parties that are locked into using all reasonable efforts to secure HSR clearance.

There is one tricky aspect to the use of this otherwise straightforward contractual tool. Both parties must agree to the use of the walk-away provision, and on the specific regulatory event that triggers it. This is by no means a simple task.

The consequences from a delayed, challenged or abandoned deal may impact each party very differently. This diversity of interest can make reaching any agreement on termination rights extremely challenging. This challenge is compounded by the difficulty of predicting how a particular deal will be received in Washington. Even the most seasoned antitrust counsel can be surprised by the sometimes whimsical tendencies of the antitrust authorities or the steeliness of a particular government enforcer.

Despite this challenge, any party that has limits as to how far it is willing to go to secure HSR clearance should consider walk-away provisions. The protections afforded by these provisions, and the adverse consequences that may befall a party in their absence, make them too important to ignore.

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