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Behind the Headlines — A Closer Look at Antitrust Reverse Termination Fees

While much attention has been devoted to headline-grabbing reverse termination fees payable to the seller by the buyer upon failure to obtain required antitrust approvals, it is important to realize that the reverse termination fee is just one facet of a complex matrix of provisions in the merger agreement that ultimately determines the risk-sharing between the parties on this issue.

Perhaps no topic has engendered more conversation among dealmakers in recent months than the allocation between merging parties of the risk of obtaining antitrust approval of a proposed acquisition. With the increase in strategic combinations and the expectation of a more robust regulatory environment under the current administration, many recent merger agreements feature painstakingly negotiated provisions to address these risks. While much attention has been devoted to headline-grabbing reverse termination fees payable to the seller by the buyer upon failure to obtain required antitrust approvals in such deals as Google/Motorola Mobility ($2.5 billion or 20% of deal value) and AT&T/T-Mobile (~$6 billion of value/15%), it is important to realize that the reverse termination fee is just one facet (as often absent as not) of a complex matrix of provisions in the merger agreement that ultimately determines the risk-sharing between the parties on this issue.

Examples of just some of the other provisions that feature in this matrix include:

1. *Efforts Covenant* – The level of efforts the buyer must exert in seeking the antitrust approvals and the timing, deadlines and required scope of such efforts.

2. *Divestiture Covenant* – The level of divestitures the buyer is contractually required to accept in order to obtain the required approvals, which can range from silence to the proverbial “hell or high water”.

3. *Closing Conditions* – What level of challenge from an antitrust authority is required before the buyer can assert that it is not required to close.

4. *Termination and Fee Triggers* – The events which allow each of the parties to terminate the agreement and the conditions under which the payment of a reverse termination fee is required.

5. *Features of a Fee* – For example, whether the fee is the “sole and exclusive” remedy of the seller for buyer’s failure to obtain regulatory approval and whether the fee increases (a so-called “ticking fee”) with the passage of time from signing of the agreement.

A brief comparison of the operation of just a few of these provisions from four recent high-profile deals that featured antitrust concerns highlights the importance of looking beyond the simple existence or amount of any antitrust fee.

In the Hertz/Dollar Thrifty transaction (which failed for other reasons), Hertz agreed to pay a reverse termination fee of $44.6 million (about 4% of deal value) in the event the transaction did not close because of failure to obtain antitrust approval. Hertz also agreed that its commitment to use “reasonable best efforts” to obtain the approvals included an obligation to agree to divest its Advantage brand and additional assets that produced no more than $175 million of revenues. Putting these provisions together, the fee served two purposes: (1) it offered Hertz an arguably attractively-priced option in the event the antitrust authorities sought more significant remedies — while Hertz was obligated to divest up to the stated threshold to obtain the approval, if the remedies sought exceeded that threshold Hertz could choose to either accept the larger remedies or pay the reverse termination fee and (2) it compensated Dollar Thrifty in the event antitrust approval was not obtained either because Hertz exercised its option described above or because approval could not be obtained notwith-

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standing the proffered concessions. Note however, that the agreement did not state that the reverse termination fee was Dollar Thrifty's "sole and exclusive" remedy in the event of failure to achieve antitrust approval, meaning that Dollar Thrifty had the option of suing Hertz for specific performance or unlimited damages if, for example, it did not offer to make the agreed divestitures up to the stated threshold.

In the Express Scripts/Medco deal, there is a notable absence of any reverse termination fee. While the agreement includes a detailed divestiture covenant outlining certain specific levels of concessions relating to mail-order and specialty pharma facilities and customer contracts that Express Scripts must offer to obtain approval, if the authorities insist on remedies in excess of these stated levels Express Scripts or Medco are free to walk away from the transaction without any liability (including no reverse terminate fee).

In the Google/Motorola Mobility agreement, the eye-popping reverse termination fee is not linked to any specific divestiture covenant at all. Rather, Google is simply required to use its "reasonable best efforts" to obtain antitrust approval with no identified levels of mandatory concessions. However, if the deal does not close because of the failure to obtain antitrust approval (regardless of whether or not Google offers any concessions), Google is obligated to pay the $2.5 billion reverse termination fee to Motorola Mobility. As such, the enormous fee represents an unattractively-priced option for Google and virtually compels Google to offer whatever remedies are necessary to obtain the antitrust approvals (i.e., almost the same practical effect as a "hell or high water" divestiture covenant). Moreover, the agreement preserves Motorola Mobility's ability to seek, in addition to the fee, damages capped at an additional $1.0 billion if Google's failure to comply with its antitrust efforts covenant (e.g., to use "reasonable best efforts", a somewhat amorphous notion) resulted in the failure to obtain approval.

Finally, in AT&T/T-Mobile (noting that many key agreement schedules that address these issues have not been publicly disclosed), the agreement includes a fairly complex risk sharing mechanism whereby AT&T has agreed that its "reasonable best efforts" include making concessions relating primarily to customers and spectrum where the impact of such divestitures (determined under an intricate formula) is less than $7.8 billion. In addition, AT&T is obligated to pay a reverse termination fee and transfer certain spectrum to T-Mobile (with an estimated aggregate value of about $6 billion) if the deal is not approved notwithstanding these concessions. This fee is the sole and exclusive remedy, meaning that, absent fraud, T-Mobile is not entitled to seek damages beyond the fee in the event the approvals are not obtained. Interestingly, the agreement also includes an adjustment (again under a complex formula) whereby the purchase price to Deutsche Telekom is reduced to compensate AT&T for the impact of required market and spectrum divestitures to the extent such impacts exceed $3.9 billion up to the $7.8 billion threshold. As such, it appears that AT&T alone bears the impact of divestitures up to the $3.9 billion level, while the parties share the risk of remedies in the band from $3.9 billion to $7.8 billion via the purchase price adjustment (offset, in part, by a right for Deutsche to share in the proceeds of the relevant divestitures).

With the recent DOJ challenges to the AT&T and H&R Block/TaxACT transactions, it is likely that allocation of antitrust risk will continue to be a key negotiation in strategic combinations. While the amount of any antitrust reverse termination fee payable by the buyer is an important component of this allocation, it must be understood within the context of the total antitrust risk allocation package. As the examples above show, the headline number often tells only a small part of the full story.

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