Mitigating Antitrust Risk in M&A Transactions – Key Takeaways from the EU Commission's Veto of the Alstom/Siemens Railway Merger

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1. Introduction

In September 2017, Alstom and Siemens intended to create a "European Champion" through a merger of their respective rail activities. The European Commission *("Commission")* blocked the proposed merger on February 6, 2019, despite the French and German governments being strongly in favor of the transaction. The Commission found that the deal gave rise to competition concerns in the markets for the manufacturing of railway signaling systems and for high speed/ very high-speed trains. The Commission found that consumers would have been harmed as a result of reduced choice of supplier and products. Potential competition from China Railway Rolling Stock Corp *("CRRC")* was still too uncertain and could therefore not be taken into account as an attenuating factor.

The Commission's veto of the Alstom/ Siemens merger is a good illustration of how antitrust risk can jeopardize M&A transactions. The aim of this article is to provide a brief overview of the main contractual provisions parties can use to mitigate antitrust risk in their transactions.

2. Preliminary Antitrust Assessment

In transactions likely to face close antitrust scrutiny, both parties should critically assess any antitrust issues at an early stage of the deal process, the goal being to identify potential overlaps and the likelihood of there being a need for remedies. Once antitrust risk has been assessed and the parties agree to move forward with the deal negotiation, they are strongly advised to ensure that the draft transaction agreement(s) provide for the consequences that each party may face if the deal is subject to remedies or even prohibited.

The types of provision agreed upon by the parties mainly depends on their interests and relative bargaining positions. If the transaction does not raise substantive antitrust concerns, there is clearly no need to include detailed provisions regarding divestitures and remedies. However, in practice, even when antitrust risk is low, buyers tend to accept detailed clauses when sellers insist on them, as such clauses are in any event unlikely to apply. On the other hand, when antitrust risk is significant, the parties have a clear interest in having a detailed clause to accurately manage and allocate deal risk.

The initial preliminary antitrust assessment should be carried out with the greatest care and attention and the parties should not be over-optimistic, including in the definition of the relevant product and geographical markets. In particular, when negotiating the antitrust clauses and when structuring the share purchase agreement, only concrete, and not hypothetical scenarios should be taken into account. In the *Siemens/ Alstom* merger for example, one of the main arguments advanced by the parties in support of the merger was the competitive pressure exerted by China's state-backed CRRC. The Commission stated, however, that it *"assessed the likelihood of Chinese rail equipment suppliers entering the market, not in the abstract, but concretely"* and that *"no Chinese supplier has ever participated in a signaling tender in Europe or delivered a single very high-speed train outside China. And there is no prospect of Chinese entry in the European market in the foreseeable future"*.

3. Divestitures

Provisions regarding divestitures deal with the extent to which a party is required to divest, sell or license assets in order to obtain regulatory approval.

A seller-friendly divestiture clause would oblige the purchaser to make any and all divestitures necessary to obtain antitrust clearance, no matter the scope of such divestitures. Purchasers should try to avoid agreeing to such clauses. The reason for this is that if one of the competent antitrust authorities sees in the deal agreement(s) attached to the notification that the purchaser is required to do anything necessary to obtain approval, this is likely to reduce the purchaser's bargaining power vis-à-vis this antitrust authority.

Another solution could be to cap the divestiture obligation to a certain level of, for example, sales or EBITDA, or to provide that the parties will not make "material" divestitures (the meaning of "material" should be defined in the contract). Alternatively, the clause could list specific assets of the target and or/ purchaser to be divested (or not to be divested). When including such clauses, the antitrust condition precedent should set forth the ceiling/level of assets beyond which the purchaser will no longer be required to propose or accept divestitures, and hence to close the transaction.

Even if such divestiture clauses can potentially expedite negotiations with the antitrust authority, they also have several disadvantages. Indeed, by agreeing to specific assets to be or not to be divested, or at least which level of divestures both parties or either party is willing to accept, the parties provide the antitrust authority with a roadmap regarding which divestitures they are willing to agree to or avoid in order to obtain approval.

A more buyer-friendly approach would be to provide for a best efforts clause setting forth the level of effort required from the parties to ensure successful clearance of the various shareholder and regulatory hurdles to complete the transaction, including obtaining antitrust clearance. The parties' commitment can be calibrated higher by requiring them to use "best efforts" or "reasonable best efforts", or less by requiring only "commercially reasonable efforts". The purchaser may for example be required to use "all commercially reasonable efforts to resolve any objections by the European Commission".

One of the key lessons drawn from the *Siemens/Alstom* merger is that parties should avoid offering complex remedies late on in the antitrust review process. Indeed, Siemens waited until day 110 of the 125-day review process to make a substantial modified offer. Ms. Vestager, the current EU Competition Commissioner, said this offer was received *"way, way over the usual deadline"* and, in any event, did not adequately address the Commission's competition concerns.

4. Obligation to Cooperate

The draft transaction agreement must provide for an obligation on the parties to fully cooperate with each other in good faith with respect to the antitrust filing. ▶▶

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The aim of such provision is to ensure that the buyer has sufficient information at its disposal to prepare the relevant documentation requested by the antitrust authorities. Furthermore, such clause should also ensure that the seller is informed in due time of any discussions/correspondence that the buyer has with the competent antitrust authorities. Ideally, the seller should also have the opportunity to make prior comments on any submissions the buyer makes to the authorities.

The obligation to cooperate becomes even more relevant in the EU as the Commission (as well as several national competition authorities, including the French one) has increasingly requested more documentation from the parties over recent years - witness in this respect the 90,000 internal emails alone reviewed by the Commission in *Olympic/Aegean Airlines* (2011). With respect to the Alstom/Siemens merger in particular, it is understood that the parties were completely overwhelmed by the extent of the document requests made, and that had to be responded to, within a very short timeframe. It is therefore recommended not to wait too long to start gathering relevant information for the purposes of the antitrust review.

5. Termination

The termination clause in the transaction agreement provides for the time period during which the parties are bound by their obligations under the contract. Such obligations will last at least until the so-called drop dead/long stop date. This is the date by which either party may unilaterally terminate the agreement without cause.

A termination clause may also provide for the possibility for a party to terminate the agreement in the event of the occurrence of certain events, including in the event that any antitrust authority launches an in-depth/Phase II investigation.

If the level of antitrust risk is significant, the parties may provide for an early drop dead/long stop in order to allow them to avoid long negotiations with any antitrust authority as the case may be. In contrast, a late drop-dead could oblige the parties to negotiate with the authority(ies) with no certainty of obtaining the necessary approval(s) and close the deal.

6. Reverse Breakup Fees and Ticking Fees

The transaction agreement can also provide that a reverse break-up fee must be paid by the purchaser to the seller in the event that the transaction does not close because of a failure to obtain all necessary antitrust clearances. The rationale for such clause is to mitigate the risk of a transaction not clearing antitrust review and to indemnify the seller for a part of the direct and indirect costs he had to bear during the acquisition process. In practice, the amount of reverse break-up fees usually ranges between 4% to 7% of the purchase price. In deals where the likelihood of antitrust risk is high, the seller should negotiate a high breakup fee so as to be protected from the risks associated with a lengthy review process, and which may ultimately result in a prohibition or abortion of the transaction (loss of customers and employees, decrease in valuation if deal fails, etc.).

Some agreements provide for "ticking fees" which are payable by the purchaser to the seller for delays in closing beyond a certain date. Unlike a reverse break-up fee, the seller is not required to wait until the transaction is terminated to be compensated. Indeed, the purchaser is required to start paying once the date on which the antitrust clearance should have been obtained is reached. Ticking fees are an incentive for the purchaser to make concessions to settle the antitrust issue and to get through the antitrust clearance review quickly.

In bidding processes relating to deals that are likely to or may raise competition concerns, sellers often compare the antitrust clauses in the offers and share purchase agreements provided by each potential purchaser, and even ask each bidder to attach to its offer a memorandum drafted by its legal advisors providing for an antitrust analysis of the transaction. Such practice tends to favor private equity funds over industrial actors who, if they are competitors of the target and want to be awarded the deal, may have to offer a higher price (including through a reverse break-up fee) in order to compensate *inter alia* the fact that any closing will occur at a later date and that therefore the seller(s) will receive its money later.

7. Payment of Antitrust Related Expenses and Fees

Parties should keep in mind that antitrust investigations can be extremely expensive due to the length of the procedure(s) and the number of advisors and professionals (lawyers, economists, translators, etc.) involved. Hence, in deals where antitrust issues are highly likely, smaller sellers should negotiate that part of the costs related to antitrust are borne by the purchaser. Purchasers should in turn negotiate a cost ceiling that they will not surpass in the context of the antitrust review of the transaction.