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Hell or High Water Provisions in Merger Agreements: A Practical Approach

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Editor's note: Stephen Fraidin and Joel Mitnick are partners and Ross Steinberg is a law clerk at Cadwalader, Wickersham & Taft LLP. This post is based on their Cadwalader memorandum. Related research from the Program on Corporate Governance includes Are M&A Contract Clauses Value Relevant to Target and Bidder Shareholders? by John C. Coates, Darius Palia, and Ge Wu (discussed on the Forum here); Allocating Risk Through Contract: Evidence from M&A and Policy Implications by John C. Coates, IV (discussed on the Forum here); The New Look of Deal Protection by Fernan Restrepo and Guhan Subramanian (discussed on the Forum here);Deals in the Time of Pandemic, by Guhan Subramanian and Caley Petrucci (discussed on the Forum here).

When a business is being sold, the sellers, regardless of whether it is the Board of Directors of a public company, or a private owner, take into consideration three overarching factors: price, speed, and certainty. In recent years, particularly in light of the Biden Administration's focus on antitrust enforcement and policy, antitrust clearance under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR") has become a major risk factor affecting the speed to, and the certainty of, completion of the sale of a business. This post addresses a specific type of merger agreement provision that is designed to eliminate uncertainty arising from the antitrust risk of a given transaction.

To address antitrust risk uncertainty, sellers are increasingly asking buyers to agree to what is euphemistically called a "hell or high water" ("HOHW") agreement. An HOHW agreement is designed to provide the Seller with certainty that the Buyer is required to complete the transaction come hell or high water, regardless of the position of the DOJ or FTC, and that Buyer is required to comply with its HOHW commitment by the termination date of the agreement (the "End Date"), often a year after the agreement was entered into. The End Date is increasingly important because the average duration of significant U.S. HSR antitrust investigations has increased from approximately seven months in 2011 to approximately one year today. At the same time, the average duration of a significant investigation by the E.U. is now nearly 20 months.

Antitrust Investigation Process

HSR provides for a 30-day initial review period (the "waiting period") by either the Department of Justice ("DOJ") or Federal Trade Commission ("FTC") (the DOJ and FTC are collectively called the "Antitrust Authorities"). At the conclusion of the initial 30-day waiting period, the Antitrust Agencies unilaterally may extend the waiting period for an indefinite time by issuing what is in effect a very broad based subpoena for documents and information that is colloquially called a

"second request." In order to avoid the probable issuance of a second request in deals that raise obvious antitrust issues, antitrust practitioners sometimes volunteer to extend the government's initial review period by a "pull and refile" approach that permits attempting to persuade the DOJ or FTC of the legality of the transaction without the need for a more extensive investigation. This approach involves the parties withdrawing their HSR filing, providing information to the Antitrust Authorities, and encouraging them to clear the transaction without a further investigation, and then refiling under HSR and restarting the 30-day initial waiting period. However, failure to convince the Antitrust Authorities that a deal presents no problem even after a pull and refile likely will result in issuance of the second request.

A second request often involves a lengthy, in-depth investigation of the proposed transaction and the parties to it, including depositions, discovery, and experts. Neither the DOJ nor the FTC are subject to any time limits for completion of the second request process. Rather, the process comes to conclusion when the parties declare they have "substantially complied" with the second request and when the government agrees with their claim. The fact of substantial compliance triggers a second 30-day waiting period after which the government may challenge the proposed deal in court. If the transaction is challenged, it can take years to finally resolve its legality.

What Is and What Is Not an HOHW Provision

Addressing the risk of an open-ended HSR investigation or an antitrust challenge at its conclusion is the purpose of the HOHW agreement. It is important to be especially aware of two matters regarding HOHW provisions in Merger Agreements. First, they are very rare. For example, the 2021 ABA Deal Points Study regarding public M&A transactions estimated that only about 6% of merger agreements contain HOHW provisions. This percentage may be overstated for present purposes because the ABA may be including provisions that are not truly HOHW provisions as discussed in this post. Also, the percentage of private sale agreements that contain HOHW provisions can't be known because those agreements are not publicly available, but there is no reason to believe that the percentage will differ substantially from what is present in public transactions.

The scarcity of these provisions leads to the second issue—drafting. Corporate lawyers tend to copy and build on the drafting of other corporate lawyers. Merger & acquisitions lawyers rarely draft free hand. Instead, they find relevant precedents, either in their law firm, or precedents used by the client or otherwise, and use those precedents as the basis for their drafting. Sometimes they will copy verbatim from a prior document, sometimes they will tweak and improve the drafting, and sometimes they will change the language to be more favorable to their client. However, in drafting HOHW provisions, the precedents are few and far between. So, while HOHW provisions that we have found adhere to a pattern and appear to be fairly similar, a number of important issues are simply not addressed.

For purposes of this post, if the antitrust compliance covenant in the acquisition agreement is qualified in any way it is not an HOHW provision. For example, sometimes the antitrust provision will require Buyer to take any step required by the DOJ or FTC, unless it would have a "materially

adverse impact" on the value of the business to be acquired. That provision means that Buyer has the ability to fail to complete the deal and certainly has the ability to litigate the issue. [1]

As previously mentioned, there are very few HOHW acquisition agreements. And we have found only one case ostensibly dealing with these provisions: In *Akorn, Inc. v. Fresenius Kabi AG*, No. CV 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018), aff'd, 198 A.3d 724 (Del. 2018), the Delaware Court of Chancery found that the defendant who agreed to "diligently pursue[] antitrust approval" in an HOHW clause breached the agreement when, after being asked to divest certain assets by the FTC, it pursued a divestiture plan that that could have delayed clearance by more than two months as compared to a more time-efficient divestiture plan. Since the defendant abandoned its pursuit of the slower divestiture plan after a week, however, the court considered its HOHW breach technical, cured, and rendered immaterial.

In analyzing the terms of an HOHW agreement, we first would like to discuss certain issues that Seller should consider including in HOHW contract provisions. Then, we will discuss provisions that Buyer should consider including in the Agreement. Finally, we will discuss certain more general issues that are raised by HOHW clauses.

Issues for Seller

Seller should consider providing a background for inclusion of an HOHW clause. For example, the agreement might state that Seller had the opportunity to sell to several other buyers. Each of those potential buyers offered a purchase price less than the one Buyer offered, but not much less. Buyer was selected as the winning bidder in part because its price was higher and in part because of the speed and certainty provided by the HOHW clause. However, the opportunity to sell to the other bidders at their offer prices disappeared after the proposed deal with Buyer was announced.

A properly drafted HOHW clause should include an unconditional obligation of Buyer to take certain steps. While a "best efforts" standard is generally regarded as imposing substantial obligations on a party, those obligations are significantly less stringent than absolute commitment. The Southern District of New York has recognized this difference in *InspiRx, Inc. v. Lupin Atlantis Holdings SA*, 554 F. Supp. 3d 542, 557 (S.D.N.Y. 2021), stating that "[a] commercially reasonable efforts clause is not a 'hell or high water' clause tying the signatory to use all efforts possible, no matter the cost." The Delaware Court of Chancery similarly notes in *All. Data Sys. Corp. v. Blackstone Capital Partners V L.P.*, 963 A.2d 746, 763, n.60 (Del. Ch., 2009), aff'd, 976 A.2d 170 (Del. 2009), that "[t]he distinction between a 'best efforts' obligations and an unconditional commitment is also reflected in case law. . . . The [hell or high water provision] simply reflects a much stronger and broader commitment with respect to a discrete regulatory subject: antitrust approval." Additionally, regardless of whether a best efforts or flat obligation is included in the clause, if any qualification is used, the clause no longer should be regarded as HOHW. "Materially" or "material adverse" effect are indeed high bars under Delaware law but they are bars that can be cleared, nullifying the HOHW aspect of the clause. Thus the ostensible "HOHW"

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[1] There is a wide range of antitrust risk shifting provisions that are included in merger agreements, and practitioners sometimes refer to them as HOHW clauses. *See, e.g.,* John D. Harkrider, *Risk-Shifting Provisions and Antitrust Risk: An Empirical Examination*, Antitrust, Fall 2005. For purposes of this post, only clauses that contain an unqualified obligation for Buyer to close is considered HOHW.

agreement in *Akorn* that we discussed above was nothing of the sort: since the agreement was infused with a materiality qualifier, it was not a true HOHW. We have found no case law dealing with true HOHW provisions.

The specification of steps that Buyer is required to take to obtain HSR clearance should not be exclusive. By using the concept of "including," Seller has effectively not permitted Buyer to omit taking a step that was omitted from the list of required steps but that proves to be important. Seller should also consider providing that time is of the essence, and that no concept of materiality of breach should be applied to a determination of whether Buyer breached its HOHW obligations. This would be in the deal to prevent the week-long delay that occurred in *Akorn* and should have allowed the court to find that Fresenius had breached their HOHW obligations.

The HOHW clauses we have found generally focus on the obligations of Buyer to take certain steps to "resolve any objections asserted with respect to the Transaction under the HSR Act or any other antitrust law…" and to "take all actions." This focus assumes that there are steps or actions that Buyer can take to resolve antitrust obligations. That focus may have been somewhat limited but not unreasonable in the past, when the Antitrust Authorities could be expected to have specific objections to a transaction. For example, the FTC or DOJ might have agreed to permit a transaction to be completed only if a particular business or asset were divested. Even in the past, though, there was a possibility that the FTC or DOJ objections to a transaction would be to its entirety, and could not be resolved by divestiture. For example, the FTC or DOJ might have believed that the only viable competitor was a party to the transaction. In the current environment, the possibility that the Antitrust Authorities might object to a transaction in its entirety has substantially increased. FTC Chair Lina Khan has taken a position against corporate "bigness," stating in an interview with *The New Yorker* that "[t]here's a very real risk that the economy emerging post-COVID could be even more concentrated and consolidated than the one leading up to it" and noting that she is actively considering "the merger surge, and what we're going to do about it." Similarly Tim Wu, Special Assistant to the President for Technology and Competition Policy, has written *The Curse of Bigness: Antitrust in the New Gilded Age*, in which he equates mergers with monopolization.

If the Antitrust Authorities' fundamental issue with a transaction is its size—something that could become even more likely should legislation like the Prohibiting Anticompetitive Mergers Act become law—that issue can only be resolved in litigation, and not by any step Buyer could take. Neither the DOJ nor the FTC are likely to be under any time pressure to certify substantial compliance with the second request. After such certification, if litigation is brought it may take a substantial period of time for it to be resolved, particularly if the Antitrust Authorities seek to exhaust all appeals, including to the Supreme Court. Under those circumstances, the typical HOHW provision will fall short of Seller objectives. Buyer will have offered concessions to the Antitrust Authorities and had them rejected. The only concession satisfactory to the Antitrust Authorities will be termination of the transaction. The End Date will be near or will have been extended. Buyer will simply be unable to legally acquire the business. Under those circumstances, the HOHW provision will have failed to work for Seller.

Seller should consider taking the HOHW clause one step further, and providing that if for any antitrust related reason Buyer is unable to legally acquire Seller by the End Date, Buyer is required to pay to Seller (or Seller shareholders, as the case may be) the entire purchase price, regardless of Buyer's inability to acquire the business. Because of the extreme nature of that

remedy, this clause (the “Impossibility Clause”) should not be expected to be understood or implied, it should be explicit. Based upon our experience, a Seller often believes that if it is able to persuade Buyer to agree to HOHW, an Impossibility Clause is understood to be part of the deal. Unfortunately, given the wording of HOHW provisions in the past, and the unusual nature of the remedy, we think it is highly unlikely that an Impossibility Clause would be inferred by a court.

If Seller is successful in including an Impossibility Clause, there are other factors Seller should consider. If the Impossibility Clause is triggered, Seller or Seller shareholders may ultimately become creditors of Buyer. Depending on the relative size of Buyer and Seller, Seller may be wise to treat the transaction as both an acquisition transaction and as an extension of credit. As an extension of credit, Seller should evaluate the creditworthiness of Buyer. Seller may require collateral for the extension of credit, such as a financial institution supported letter of credit. If Buyer is itself a financial institution, Seller will need to determine the extent to which Buyer’s credit is in fact supported by unrestricted funds. Additionally, Seller may wish to include in the contract the kind of covenant protection creditors will often utilize. Seller should consider whether there is collateral that may be available to secure Buyer’s obligation. Finally, Seller should determine whether Buyer will require any approvals—regulatory, creditor or otherwise—to perform under the Impossibility Clause. If any such approvals are required, they should be obtained no later than when shareholders of Seller approve the transaction. Seller should also require that the obligor under the Impossibility Clause be an entity with substantial assets, not a shell corporation organized solely to be a party to the transaction.

If Seller is publicly held, once the Impossibility Clause is invoked and enforced, we assume that the purchase price would be paid to Seller’s public shareholders. But would they surrender their ownership interests in Seller? To whom? The same issue arises in a private transaction. It is not uncommon for Seller to require that Buyer pay a significant reverse termination fee (“RTF”) if a transaction cannot be completed for antitrust reasons. In Peter D. Lyons, Beau W. Buffier and Jessica K. Delbaum, *Strategic Deals Require Strategic Thinking: Antitrust Provisions to Consider in Negotiated Transactions*, 14 No. 2 M & A Law (2011), the authors found that 8.53% of publicly filed merger agreements contained such RTFs, with a median value of 5.84% of the transaction and mean of 3.92%. The inclusion of a RTF as an optional remedy in a HOHW clause is likely to lead a court to not enforce an Impossibility Clause. This is what is theorized in *Strategic Deals Require Strategic Thinking*. After all, the Impossibility Clause is, in effect, a specific performance clause. If an RTF, or liquidated damages, is also provided, it is highly likely the court will take that approach in granting Seller relief.

One of the most difficult issues for Seller to deal with in the context of HOHW provisions is bankruptcy. Depending on the relative size of Seller and Buyer, and the creditworthiness of Buyer, the threatened enforcement of the Impossibility Clause could result in Buyer filing for bankruptcy. For example, if you assume that Buyer has an equity value of $10 billion, and it is required to pay Seller $5 billion in cash and can legally acquire no assets or business in return, it is unlikely that Buyer will be able to make such a payment either independently or through financing, but instead will need to file for Chapter 11.

If Buyer enters into Chapter 11, Seller would be considered an unsecured creditor and have low priority in its claims against Buyer’s estate. The specter of bankruptcy makes HOHWs an uncertain proposition for Seller as it raises the possibility that Seller will not receive the full value of the potential transaction if Buyer fails to perform. Before Seller enters into an HOHW

agreement, it must therefore conduct due diligence on Buyer's financials with a focus on the likelihood of Buyer declaring bankruptcy should Buyer not be able to consummate the transaction.

Issues for Buyer

Some of the HOHW clauses include a type of specific protection for Buyer that explicitly permits Buyer to reject the Antitrust Authorities' effort to impose a remedy on Buyer, as quid pro quo for clearing the transaction. It is entirely understandable why Buyer desires this protection. However, if Seller agrees to provide Buyer with this protection, it has effectively gutted the force of an HOHW clause. That is, there is some, not entirely unrealistic scenario, where Buyer will be legally entitled to not perform for antitrust reasons. If Seller agrees to that protection for Buyer, it should understand that it is not receiving complete HOHW protection. Moreover, depending on how that provision is drafted and interpreted by a court, it may violate the Impossibility Clause if that clause were included in the Agreement.

Buyer, however, should consider requiring at least certain protections for itself and its executives. First, Buyer should consider requiring that the HOHW provision specifically not require that either Buyer or any affiliate be required to agree to any criminal or civil liability under the antitrust laws. However unlikely it may seem, there is a possibility that the DOJ or FTC will believe that it has uncovered in the HSR investigation evidence of criminal or civilly liable behavior on the part of Buyer or any of its affiliates. Depending on the drafting of the HOHW clause "take all actions" could be interpreted as requiring a guilty plea or entering into a consent judgement, or encouraging affiliates to do so. It would be particularly troubling if the FTC or DOJ interpreted the HOHW clause that way and encouraged them to gain such relief.

It is obviously crucial that the Impossibility Clause be legally enforceable. There is contract law doctrine to the effect that remedies that are commercially unreasonable are unconscionable and will not be enforced. "Unconscionability is one of the most amorphous terms in the law of contracts. . . . [and in determining unconscionability] 'courts have focused on matters such as the commercial reasonableness of the contract terms.'" [2] The introductory language to the HOHW clause suggested above should be helpful. It explains, in language that would be agreed to by both parties, the context in which the HOHW clause was agreed to.

In addition, Seller and Buyer should consider requesting certain commercial protections if the Impossibility Clause is to be invoked. These protections are in the interest of both Seller and Buyer, so the parties should be able to agree on them. They are in the interest of both parties because they are reasonable commercial terms that would result in the application of the Impossibility Clause in a commercially reasonable—and thus more likely enforceable—way. Buyer should receive notice a substantial time (30-60 days) before the Impossibility Clause is invoked. During that period Buyer should be entitled to find a replacement buyer ("Buyer 2").

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[2] 7 Corbin on Contracts § 29.1 (2021) (quoting *NEC Technologies, Inc. v. Nelson*, 267 Ga. 390, 391–92, (1996); *see also* 8 Williston on Contracts § 18:13 (4th ed.) ("Generally, in a form contract, terms will be deemed oppressive or too one-sided, taking unfair advantage of one's position, when they either alter the fair import of the negotiated or bargained-for terms or are clearly unreasonable," and noting that warranty limitations that limit remedies in all events are unconscionable); *Midwest Builder Distrib., Inc.v. Triangle Pac. Corp.*, No. 97 C 326, 1998 WL 325260, at *2 (N.D. Ill. June 11, 1998) (defining substantively unconscionable remedies as "so commercially unreasonable as to deprive the party of any meaningful remedy").

Buyer 2 should be required to be an entity with the financial resources to complete the transaction, and to satisfy all of the requirements of the DOJ and FTC and should be acceptable to Seller, whose acceptance could not be unreasonably withheld. Buyer 2 should be required to make a prompt HSR filing. If the price to be paid by Buyer 2 is lower than the price agreed to be paid by Buyer, Buyer should be required to pay the difference to Seller. If the price paid by Buyer 2 is higher than Buyer's price, the difference should first be applied to defray Buyer's expenses with the balance being paid to Seller or Seller shareholders. Seller should be required to cooperate with Buyer and Buyer 2 to effectuate the transaction.

Finally, commentators have observed that HOHW provisions may provoke increased scrutiny by the Antitrust Authorities. The reasoning is that, for example, an HOHW clause, or a more limited divestiture clause, would be used only if the parties understood that a proposed deal presents serious antitrust risk. These concerns often lead parties to include divestiture provisions that are not focused on a business, but, for example, on a business with a particular amount of annual revenue or net income. Those provisions are sometimes thought to be a roadmap for the government to extract concessions. We are skeptical that any of those provisions risk alerting the Antitrust Authorities to potential issues. The Antitrust Authorities are highly competent and motivated to identify these issues.

Conclusion

Regardless of whether the company is publicly or privately owned, before it enters into a HOHW agreement, counsel should explain to the relevant governing body, such as a Board of Directors, what the implications of HOHW are. Those implications (and related risks) are so significant to both Buyer and Seller that it is far from adequate to read the clause to the Board and advise the Board that it is unlikely to be employed.