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Heightened Antitrust Scrutiny and its Impact on Debt Financing Costs and Commitments

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As we head into the winter months, one trend that has the potential to "chill" activity in the market is the broader and more aggressive approach to antitrust enforcement taken by the Federal Trade Commission (the "FTC") and the Antitrust Division of the Department of Justice (the "DOJ"). This heightened regulatory scrutiny has resulted in lengthier deal timelines – as long as two years – in some cases and has injected increased uncertainty into the M&A and debt financing process. Borrowers, already facing persistent inflation and steep interest rates, also are seeing increased costs on deals with long regulatory timelines in the form of additional compensation paid to lenders in exchange for lenders holding the underwritten debt commitments for longer periods of time.

This article will describe the ways in which increased antitrust scrutiny has played out on M&A transactions and the implications it has had on syndication strategy, fees and flex rights in underwritten debt financings.

A. Aggressive Antitrust Enforcement and its Potential *Chilling* Effect on M&A

> ***"In the 12 months through September 2023, the antitrust agencies filed complaints against a record 13 transactions compared to an average of six per year over the previous five years." – Bloomberg Law*** [i]

Over the last two years, the FTC and DOJ have pursued an aggressive agenda to challenge and deter transactions across a variety of industries.[ii] While the antitrust agencies have had limited success in the merger challenges that they have brought to date, the leaders of both agencies have signaled that they are undeterred and will continue to prioritize an aggressive litigation strategy. FTC Chair Lina Khan has expressed that she is "not somebody who thinks that success is marked by a 100% court record," but rather believes that "as public enforcers, we have a special obligation to bring the hard cases."[iii] Likewise, Assistant Attorney General Jonathan Kanter has made it clear that "the era of lax law enforcement is over, and the new era of vigorous and effective antitrust enforcement has begun."[iv] As a result, the increased uncertainty surrounding M&A timelines is not likely to change in the near future.

In addition, the antitrust agencies have proposed notable changes to the premerger notification rules under the Hart-Scott-Rodino ("HSR") Act,[v] as well as broad revisions to the Merger Guidelines, that could inject additional uncertainty into deal timelines.[vi] In particular, the agencies' proposed changes to the rules governing premerger notifications would significantly increase the scope of information that must be submitted by parties to HSR-reportable transactions. If implemented, the new HSR rules would "meaningfully increase the time, burden, and cost of completing transactions that are reportable under the HSR Act."[vii]

B. Implications for Underwritten Debt Financings: The Longer the Deal, the More it Costs

As heightened antitrust scrutiny prolongs deal timelines for certain transactions, companies may face difficulties obtaining underwritten debt commitments to support acquisitions and/or increased costs to do so. In the face of these increased costs, parties may even be incentivized to consider alternative financing structures altogether.

1. A *Flurry* of Ticking Fees

Ticking fee provisions play the most obvious role in increasing costs for debt financings with lengthy commitment periods. A ticking fee at its core is a fee that kicks in after a certain period of time to compensate the syndicate lenders for holding unfunded exposure for longer than usual through closing.

The timeline for when financing sources will expect a ticking fee to commence is a negotiated point. Typically, there will be an initial holiday period during which no ticking fee is payable. In many deals, that holiday period averages around 4 months (120 days), but there are also deals on either side of the spectrum driven by market dynamics. There are certain deals where lenders have been willing to provide 6+-month debt commitments with no ticking fee payable at all and, on the extreme flip side, deals where lenders have required a ticking fee after as little as 35 days. The structure of ticking fees varies from deal to deal but often will include step-ups after delineated periods of time measured from either the signing date or allocation date (or the earlier of a fixed date after signing and the date of allocation) in a syndicated financing. For example, 50% of the applicable interest rate margin paid on the underwritten debt commitments if the financing has not closed within 120 days of the delineated date and 100% of the applicable interest rate margin if the financing has not closed within 180 days of the delineated date.

Another issue to consider is whether such ticking fees are payable if the borrower terminates the debt commitment letter. In the U.S. leveraged loan market, the ticking fee is commonly structured such that if the acquisition and related debt financing do not close, then no ticking fee is payable – no deal, no fee.

However, there are also deals where lenders have requested that the ticking fee be payable on the *earlier of* (y) termination of the commitment letter and (y) the closing date, such that the lenders are entitled to compensation for holding the commitment to purchase the loans even if the debt commitment letter is terminated.

2. S*ay It Ain't Snow:* Duration-Based Market Flex Provisions

In syndicated debt financings, a typical "market flex" provision allows the majority arrangers, in consultation with the borrower, to alter certain terms of the debt financing within prescribed limitations if necessary to make the terms more attractive to potential investors if needed to achieve a "successful syndication" (which typically means that the arrangers have sold their underwritten term loan commitments down to $0).

The specific deal terms that are subject to the arrangers' flex rights vary from deal to deal, but one of the most common flex provisions is to allow the arrangers to increase the interest rate margin and/or original issue discount on the loans up to a cap.

Some financings with long-dated commitments will provide that the arrangers are entitled to additional flex rights to increase further pricing in the form of duration-based step-ups. For example, a debt financing commitment might provide that the arrangers can increase the pricing by up to 100 bps and then, on top of that, allow the arrangers to increase the pricing even further after delineated periods of time, such as an additional 50 bps of pricing flex if the financing has not closed within 120 days after signing and an additional 50 bps of pricing flex if the financing has not closed within 150 days after signing.

3. ***Frost-trating*** **Alternate Transaction Fees**

An additional consideration is the role of the alternate transaction fee (the "ATF"). The scope of the ATF and the exceptions thereto will be highly negotiated, but it functions as a "deal-away" fee paid to the underwriting arrangers if the company consummates the specified acquisition with an alternative debt financing within a specified period of time for which the arrangers were not offered the opportunity to participate. Often, the fee is 50% of the underwriting fee that the arrangers would have otherwise received.

The longer the regulatory timeline, the greater the likelihood that market conditions can change and that such changes could be material. For example, a borrower who obtained a debt financing underwritten with interest rates at their peak may be better off terminating its debt commitment letter and seeking new debt commitments months down the line if interest rates were to lower materially. For this reason, close attention should be paid to the negotiation of the alternate transaction fee, including any ROFR rights the lenders will have if the borrower chooses to terminate and on what conditions.

In addition to negotiations around the length of the ATF (commonly 12 months, but can be as short as 6 months or as long as 18 months), the scope of the protection is another negotiated point. In some financings, the protection only applies if the borrower obtains a "third party senior secured *syndicated* credit facility", such that the borrower could terminate the debt commitment letter and obtain an alternative privately placed credit facility within the ATF period without needing to pay the existing arrangers any fee. In other deals, it picks up "any debt financing" (whether or not syndicated), but would not pick up "debt securities", such that an alternative bond deal would not get picked up. The ATF typically does not cover an all equity deal.

Commitment letters often do not allow for partial termination of the debt commitments. Where it does, sponsors and borrowers may want the ability to do a partial (less than 100%) replacement of debt commitments with equity. In those deals, it will be important for the parties to negotiate how this scenario impacts the debt commitments and fees.

For example, the arrangers may allow the equity commitments to take out the debt commitments dollar-for-dollar, but only up to a capped percentage to ensure there is a large enough remaining debt commitment for it to remain a liquid tranche. Borrowers also would want to ensure that the underwriting fees and OID in the fee letter are tied to the reduced amount of the debt commitment. In some deals, arrangers may require a reduced arrangement fee to be paid on the portion of the debt commitments that were underwritten, but subsequently replaced with equity.

4. **Syndication Timeline: Weighing the *Froze* and Cons**

In syndicated financings with long timelines between signing and closing, borrowers and arrangers should also ensure they are aligned regarding timing of the syndication launch. Most financings will permit the arrangers to commence syndication "promptly" after the signing date, but in financings with longer commitment periods, parties should consider whether it makes sense to delay the syndication and provide that the syndication commencement date will be "mutually agreed" by the sponsor and arrangers. There will inherently be competing interests as it relates to the syndication timeline with arrangers wanting to de-risk quickly and borrowers wanting to launch when market conditions are most favorable.

This also can help companies control which parties will receive increased fees and at what point in the transaction. For example, a financing with a longer commitment period may result in higher underwriting fees paid to the arrangers, but if syndication does not commence until a later date, it can help delay when the ticking fees commence and may decrease the risk that pricing flex rights are triggered if market conditions have improved. It is important for both borrowers and the financing sources to consider the overall fee package when thinking about economics and timing.

> ***"While antitrust laws haven't changed, the stepped-up enforcement means dealmaking has gotten costlier, as well as more uncertain and time-consuming." – Bloomberg Law*** [viii]

5. Where *Snowman* has Gone Before: Creative Structures for M&A Deals

In addition to being more expensive, underwritten debt financings may be harder to obtain to begin with as there may be limited demand for financings with very long commitment periods. As such, companies also have started to consider alternate transaction structures.

Sponsors may be able to structure deal consideration to be 100% equity at closing with a debt financing transaction to occur post-closing on a best efforts basis.

We have also seen a trend in transactions with long regulatory approval timelines to, in lieu of seeking new debt commitments, agree to amend the target's existing debt to permit the change of control with the goal of then launching a best efforts refinancing after the transaction closes. This approach avoids having to pay a ticking fee on a long commitment and provides the company greater flexibility in deciding when to raise additional debt based on market conditions.

We expect lengthier regulatory timelines will result in more creative solutions, like this, to avoid paying higher economics.

C. Looking Ahead: How to Stay Warm in this *Frigid* Regulatory Environment

As federal antitrust agencies maintain their aggressive posturing towards regulatory approval for large mergers and acquisitions, transaction parties should continue to expect delayed timelines for certain transactions. Companies in such transactions must be cognizant of the risk of increased financing costs stemming from such extended timelines and keep them in mind when comparing debt financing proposals from various lenders and modeling their pro forma capital structures and internal rates of return. Nevertheless, transaction parties can seek to minimize financing costs through careful negotiation, cautious and timely antitrust and syndication planning and, in some cases, creative workarounds to avoid having commitments outstanding for a long period of time.

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ENDNOTES

[i] Leah Nylen & Michelle F. Davis, US Antitrust Enforcers Are Chilling Big Mergers, Bloomberg Law (May 10, 2023).

[ii] Steven Newborn, Michael Moiseyev, Jeffrey Perry, Brianne Kucerik, Megan Granger, Rob Meyer, Kristin Sanford, Rachel Williams & Anne Corbett, "Draft Merger Guidelines Seek to Reshape Antitrust Enforcement Landscape", July 20, 2023.

[iii] Pro Market, "Q&A with FTC Chair Lina Khan, 'The Word "Efficiency" Doesn't Appear Anywhere in the Antitrust Statutes'", June 3, 2022.

[iv] Prepared Remarks of Assistant Att'y Gen. Jonathan Kanter, "Antitrust Enforcement: The Road to Recovery", April 21, 2022.

[v] FTC Press Release, "FTC and DOJ Propose Changes to HSR Form for More Effective, Efficient Merger Review", June 27, 2023.

[vi] FTC Press Release, "FTC and DOJ Seek Comment on Draft Merger Guidelines", July 19, 2023.

[vii] Brianne Kucerik, Michael Moiseyev, Jeffrey Perry, Mark Perry, Michael Naughton, Rob Meyer, "FTC and DOJ Propose Major Overhaul of HSR Premerger Notification Process," June 29, 2023.

[viii] Leah Nylen & Michelle F. Davis, US Antitrust Enforcers Are Chilling Big Mergers, Bloomberg Law (May 10, 2023).

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