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“No Shop” Clause Radioactive for Merger’s “Failing Firm” Defense

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Last week a Delaware federal district court unsealed its earlier opinion blocking the merger of two radioactive waste disposal companies. The court rejected the parties’ failing firm defense, citing the merger agreement’s “no shop” provisions as evidence that there had not been a good faith effort to find an alternative buyer. *United States v. Energy Solutions, Inc., et. al.*, Case No: 1:16-cv-01056 (D.Del. July 12, 2017).

In 2015, Waste Control Specialists LLC (“WCS”) agreed to enter into exclusive negotiations with EnergySolutions Inc. (“ESI”) a year after WCS had ended an effort to solicit bids from other buyers. The parties eventually signed a merger agreement that included the following deal-protection provisions:

- WCS was prohibited from directly or indirectly entering into or participating in any discussions or negotiations regarding an alternative transaction.
- WCS was prohibited from furnishing non-public information relating to the company to any person.
- WCS was prohibited from directly or indirectly, soliciting or initiating an alternative transaction.

The Department of Justice sued to enjoin the $367 million merger, alleging that the transaction would create a monopoly with the merged firm offering the only available low-level radioactive waste disposal service in 36 states. The companies asserted a failing firm defense, arguing that WCS was losing money and would likely shutdown if the deal was blocked.

A failing firm defense is available when “the possible threat to competition resulting from an acquisition is deemed preferable to the adverse impact on competition and other losses if the company goes out of business.” Such a defense requires a showing that (1) the failing firm’s resources were “so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure,” and (2) there was “no other prospective purchaser for it.”

The parties contested whether WCS was in imminent failure. The court noted that there was evidence to support both arguments, but did not decide that issue. Instead, the court focused on whether there were any other prospective purchasers for WCS. For defendants to establish that ESI was the only available purchaser, they had to show that WCS “made good faith efforts to elicit reasonable alternative offers… that would both keep it in the market and pose a less severe danger to competition.” The court found that WCS had not made a good faith effort as part of its sale process.

In rejecting Defendants’ failing firm defense, the court noted that WCS initially engaged with one other bidder, but then abruptly ended those discussions without obtaining a bid. WCS then entered into a 30-day exclusivity period with ESI to discuss a possible transaction, which the court characterized as engaging a single-bidder. Furthermore, the deal-protection provisions made it impossible for WCS to entertain other offers. Taken together, the court found that the exclusivity period and the deal-protection provisions prevented WCS from making a good faith effort to elicit reasonable alternative offers.

While deal-protection provisions such as a “no shop” clause may be common in merger agreements, parties contemplating a merger that is likely to draw antitrust scrutiny and anticipate relying on the failing firm defense should employ them only after pursuing all other reasonable sale alternatives.

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