Del. Dispatch: Lessons From Failed Albertsons-Kroger Merger

By **Gail Weinstein, Philip Richter and Steven Epstein** (January 30, 2025)

This article is part of a monthly column that delves into the most significant corporate law cases emerging from Delaware and offers practice points arising from recent court decisions. In this installment, we discuss the dispute over the fallout of Albertsons and Kroger's planned merger.



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On Dec. 10, two courts — the U.S. District Court for the District of Oregon and Washington state's King County Superior Court — enjoined the planned $24.6 billion merger pursuant to which Kroger was to acquire Albertsons on antitrust grounds. After the injunctions were issued, Albertsons terminated the parties' merger agreement and filed suit against Kroger in the Delaware Court of Chancery.

Albertsons alleges that, postsigning, Kroger had a case of buyer's remorse, and then, to derail the deal, willfully breached its obligations under the merger agreement to seek to obtain the antitrust approvals needed to close the deal.

Albertsons is seeking the $600 million reverse termination fee delineated in the merger agreement, as well as all legally available damages. Kroger, in turn, has asserted that Albertsons breached the merger agreement and is not entitled to the reverse termination fee.

While some or all of the allegations in the Kroger-Albertsons dispute may or may not be found to be true, they prompt consideration as to how a target company can best protect itself against the possibility that a buyer may not timely and effectively comply with its obligations to pursue the necessary regulatory approvals for a deal.

Key Point

The typical merger agreement provisions relating to obtaining regulatory approvals may not operate effectively in the case of a buyer that is not fully eager to close.

Usually, the typical efforts, cooperation and termination fee provisions relating to obtaining regulatory approvals are sufficient, as both parties have a unity of interest in obtaining the necessary regulatory approvals so that the deal can close.

However, where a buyer has a change of heart about the deal postsigning, or determines that the divestiture requirements necessary to obtain regulatory clearance are too steep, the typical provisions may not be sufficient to prevent the buyer from subtly sabotaging the regulatory approval process.

Thus, under certain circumstances, a target may wish to consider negotiating for additional, less usual agreement provisions to protect against such scenarios.

Background

In October 2022, Kroger agreed to acquire Albertsons in a merger, subject to antitrust clearance by the Federal Trade Commission. The parties understood from the outset that it could be challenging to obtain antitrust clearance, and that at a minimum, Kroger would have to make significant divestitures of stores to resolve antitrust issues.

According to Albertsons' complaint, Kroger proposed the divestiture of hundreds of stores, but the FTC found the divestiture package inadequate — stressing the "hodgepodge" nature of the list of stores to be divested, and the inexperience and other weaknesses of the proposed divestiture purchaser.

After a roughly two-year process, the FTC — joined by eight states — sued in federal court to enjoin the merger on Feb. 25, 2024, with two states filing separate suits to block the merger in those states. On Dec. 10, the District of Oregon granted the FTC a preliminary injunction blocking the merger, and the King County Superior Court issued an injunction blocking the merger in the state of Washington. Both courts found that the transaction raised antitrust issues, which the proposed divestiture package failed to resolve.

Albertsons then sent Kroger a notice terminating the merger agreement and sued, asserting that Kroger sought to derail the deal due to the strongly negative market and political reactions upon announcement, and decreased grocery store profits as people had shifted to more restaurant — rather than home — eating postpandemic. Specifically, Albertsons claimed that Kroger willfully breached its contractual efforts obligations to obtain the required regulatory approvals for the merger.

Kroger, in turn, sent a termination notice to Albertsons and publicly alleged that Albertsons breached the merger agreement, and that therefore its termination is invalid and it is not entitled to the reverse termination fee.

Discussion

The Merger Agreement

Efforts Obligations

The merger agreement set forth a variety of different efforts standards for Kroger, including (1) "reasonable best efforts" to satisfy closing conditions, (2) "best efforts" to eliminate all antitrust impediments; and (3) if a regulator threatened or instituted any proceeding[1] challenging the merger on antitrust grounds, to take "any and all actions" to contest the proceeding to avoid the entry of an injunction, and to "eliminate each and every impediment under any Antitrust Law" to closing the merger before the end date.

Albertsons' complaint contends that the third point above amounted to a "hell or high water" commitment, subject only to the divestiture cap. The court, therefore, will have to determine whether it imposed an independent hell-or-high-water obligation on Kroger beyond the already high best-efforts obligation, or only obligated Kroger to contest any proceeding using best efforts.

Divestiture Cap

Kroger was not obligated to divest more than 650 stores.

Control, Cooperation

Kroger was obligated to cooperate with Albertsons in the process, including consulting with Albertsons and permitting it to participate in meetings with regulators. If the parties could not agree after working together in good faith, Kroger had the principal responsibility for devising and implementing the strategy to obtain antitrust approval.

Termination Fee, Damages

If the merger failed to close by the specified end date — and all of the nonantitrust closing conditions were satisfied, including that Albertsons had materially complied with its obligations under the merger agreement — Kroger was obligated to pay Albertsons a $600 million termination fee.

Further, if Kroger committed any "willful breach" of the merger agreement, Albertsons could seek, in addition to the termination fee, all legally available damages, including the lost merger premium.

Alleging Kroger Willfully Breached Its Efforts Obligations

Divestitures

The divestiture packages Kroger proposed to the FTC were facially inadequate to meet antitrust concerns — as Kroger had cherry-picked a "hodgepodge" of stores for divestiture, so that it could retain for itself the most valuable stores and offload the least valuable ones, rather than selecting stores that, based on objective and neutral economic analysis, would be likely to address antitrust concerns.

Further, Albertsons alleged that Kroger did not comply with its best-efforts/hell-or-high-water obligation under the merger agreement, including because the divestiture package did not include 650 stores.

Also, according to Albertsons, Kroger selected among the many interested bidders a company that Kroger knew the regulators were not likely to approve.[2]

Last, Albertsons said Kroger did not include in the divestiture package sufficient nonstore assets — such as store trade names, private label brands and technology — for the divested business to thrive as an effective competitor.

Unresponsiveness

According to Albertsons, Kroger dragged its feet when dealing with the regulators, including by not responding to their comments and concerns, or even their routine questions, and by doubling down on its proposed divestiture package even in the face of ongoing advice from Albertsons and repeated feedback from the FTC that the package was not sufficient to resolve antitrust concerns.

Noncooperation

Kroger failed to adequately inform and cooperate with Albertsons in the process, including by ignoring its advice, not including it in meetings, and ignoring its repeated pleas that Kroger be more responsive to the FTC's concerns, per the complaint.

The Anthem-Cigna Failed Merger

The Kroger-Albertsons situation is reminiscent of the failed $54 billion Anthem-Cigna merger in February 2017, following the U.S. District Court for the District of Columbia's injunction of that merger on antitrust grounds.

Anthem sued Cigna, claiming that Cigna — the target company — had a postsigning change of heart about the deal and then worked to sabotage Anthem's process seeking regulatory approvals.

The Court of Chancery agreed with Anthem in August 2020, but held that Cigna owed no damages to Anthem, because the merger likely would have been enjoined in any event. Further, the court held that, in light of Cigna's breaches, Cigna was not entitled to receive the reverse termination fee provided for in that transaction.

Practice Points

Under certain circumstances, a target may wish to consider negotiating for less usual provisions that could provide additional protection against a remorseful buyer derailing the regulatory approval process.

These circumstances might include, for example: a high level of antitrust risk; a buyer with a history of busted deals; a deal that is expected to provoke negative market, political or credit rating agency reaction; an environment in which significant postsigning economic or market changes are expected or possible; and/or a presigning divergence of views between the parties as to the regulatory approval strategy.

As indicated by the Anthem-Cigna failed merger, a buyer also may wish to seek greater protections against a target that may become reluctant postsigning and attempt to derail the regulatory approval process.

A more specific efforts provision may be more protective.

As efforts standards and limitations are often undefined, and materiality may be difficult to establish, a target may obtain added protection from provisions that set forth specific buyer obligations that are viewed as critical, with the parties agreeing in the merger agreement that a breach of any of them would be deemed to be material.

Depending on the facts and circumstances, such obligations could include, for example, that the buyer must:

- Select assets for divestiture based on their value in resolving antitrust issues, rather than any other objectives the buyer may have;

- Identify up front specific assets that must be part of a divestiture package — unless the target or the regulator agrees otherwise — where it is relatively clear from the outset that certain specific assets will have to be divested to meet antitrust rules or concerns;

- Include in the package of divested assets specified ancillary assets that would help the divested business operate as a strong competitor — such as, in the Kroger-Albertsons case, the divested stores' trade names, private label brands and technology;

- Divest assets at the divestiture cap if, by a certain date, the regulator has not accepted a lesser divestiture package;

- Select as the proposed divestiture purchaser a party that meets specified criteria;

- Select a specified investment banker to be responsible for running the divestiture process, and provide that both parties must be allowed to participate in substantive meetings with the banker;

- Agree to have disputes between the parties over compliance with efforts obligations relating to the divestiture package refereed and resolved by independent, experienced antitrust counsel and/or an economist; and/or

- Perform certain tasks within specified time frames — such as deadlines for the buyer and the target to certify substantial compliance with any second request; and for the buyer to propose a divestiture package to regulators, commence the process for locating a divestiture buyer, enter into a divestiture agreement, enter into consent decree, and so on.

The agreement could set forth specific consequences for a breach of any of these specific obligations.

Such consequences could include, for example: shifting to the target some, or primary, control over the regulatory approval process; and/or a right of the target to terminate the deal, which it might want to do if it has lost all hope that the buyer will do what is necessary to obtain the approvals.

Also, the agreement could provide that, if certain deadlines during the process are missed, or if the regulatory process drags out beyond certain points, that failure would not constitute a breach. The buyer would have to make specified payments to the target or make such payments into an escrow with the escrowed funds released to the target if regulatory approvals ultimately are not obtained — essentially a "pay-for-delay" construct.[3]

In addition, as a reverse termination fee typically is not payable if the target breached its

obligations under the merger agreement, a target may seek to negotiate, for this purpose, a higher standard of breach than usual or a breach only of specific obligations.

A target should seek maximum flexibility in the interim operating covenants.

A merger agreement often provides that, between signing and closing, the target must act in the ordinary course of business and cannot take certain specified actions without the buyer's consent.

Many agreements provide that the buyer cannot withhold its consent unreasonably. Although the buyer and the target have a unity of interest in ensuring that the target operates effectively pending closing, their views may well diverge with respect to what constitutes effective operation.

Also, particularly in the case of a remorseful buyer, the buyer's incentives may be skewed. Thus, the consent provision, even if consent cannot be withheld unreasonably, may not offer the target sufficient flexibility.[4]

A target should consider seeking to obtain the highest possible reverse termination fee.

Albertsons alleged that, in negotiating with Kroger, it traded a lower-than-usual reverse termination fee in exchange for the highest possible standard of buyer efforts.

Given the potential for a buyer's breach of its efforts obligations, however, and the possible difficulty of proving willful breach, a target may not always be advantaged by prioritizing the efforts obligation over the termination fee. The decision may depend on the level of antitrust risk, as well as the level of the target's trust in the buyer and its commitment to the deal.[5]

Merger agreement parties should seek to ensure clarity with respect to efforts obligations.

First, drafters must pay special attention to the interaction of the various sections of a merger agreement, so that the parties' intentions are properly and clearly reflected. The interaction of multiple efforts standards is a common trouble spot in merger agreements.

Second, in some decisions in recent years, the Court of Chancery has indicated that, without further definition, all efforts standards could, in practice, impose a similar obligation — that is, to take all reasonable steps to solve problems and consummate the transaction. Accordingly, where parties agree on a best-efforts standard, they should consider whether they intend this standard to require even actions that are not commercially reasonable — and, if so, they should expressly so provide.

Where parties agree on a hell-or-high-water commitment, the agreement language should be clear that the parties intend that the buyer is obligated to take any and all actions to resolve antitrust issues, including making any divestitures and agreeing to any conduct restrictions — that is, that they intend to require the highest possible level of efforts that is judicially sustainable.

Targets should consider early on what a rejection by regulators would mean for the company.

A target should consider carefully what impact nonapproval by regulators would have on the company; merger parties should carefully consider the level and type of divestitures likely to be required by regulators; and a buyer should consider whether, realistically, it will find such divestitures to be acceptable.

Also, in connection with the regulatory approval process, a buyer should not ignore the target's input if there is a cooperation obligation.[6]

Antitrust law and policy are in flux.

Notably, the federal court enjoining the Kroger-Albertsons merger endorsed the FTC's embrace of important new components of the 2023 Merger Guidelines that have been controversial — including a narrower definition of "relevant markets," consideration of labor markets as a relevant antitrust market, and low levels of concentration (as low as 30%) as establishing a presumption that a transaction is anticompetitive.

We expect that the antitrust agencies, under new leadership in the Trump administration, are likely to revert to a more traditional approach to mergers than was the case under the Biden administration, with less focus on novel theories of harm such as the impact on labor, and possibly the revision or withdrawal of the 2023 Merger Guidelines.

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[1] The term "Proceeding" was defined to include "any investigation" — which, we note, potentially could include even just a second request from the FTC.

[2] The proposed divestitures purchaser was a grocery wholesaler, with little experience operating retail supermarkets, a history of selling retail locations soon after acquiring them, and a need for significant new financing to acquire the stores to be divested.

[3] Under this type of arrangement, if a buyer thought it could obtain a better outcome by continuing to negotiate with regulators, it could do so, but at a predetermined price; the buyer would effectively be prepaying the reverse termination fee, with the benefit to the target that it would not have to litigate after the deal breaks to obtain the reverse termination fee.

[4] With respect to the buyers' skewed incentives relating to providing consent, see our article, "A Postpandemic Framework for Ordinary Course and MAE Provisions in Merger Agreements: Reviewing Recent Market Practice Changes and Addressing Skewed Incentives," published online in The Yale Law Journal. https://www.yalelawjournal.org/forum/a-proposed-postpandemic-framework-for-ordinary-course-and-mae-provisions-in-merger-agreements-reviewing-recent-market-practice-changes-and-addressing.

[5] The parties should keep in mind that reverse termination fees payable by a buyer are not subject to the same type of fiduciary duty issues as deal protection breakup fees payable by the target. Accordingly, the size of a reverse termination fee can exceed the typical 3-4% range for deal protection termination fees. A Practical Law study of 2023 deals with antitrust-related reverse termination fees reflects that, in 72% of the 39 public and private transactions in this dataset (with a value over $100 million), the reverse termination fee was 6% or more of the total merger consideration, with the average for all the deals being 4.8%. For deals valued over $5 billion in this dataset, most had reverse termination fees above the 2.5% fee in the Kroger-Albertsons deal.

[6] A buyer also could consider the following, although not usual:

(1) Spinoff. Effecting a spinoff instead of divestitures—in which case a third party purchaser would not have to be located, the spinoff would be self-executing, and the value delivered to the spinco would be captured by the merger party's stockholders rather than by a third party in what is often the equivalent of a "fire sale" due to the pressure to divest to obtain the approvals.

(2) Presale of overlapping assets. Signing an agreement to sell the overlapping assets prior to the Hart-Scott-Rodino filing, and then submitting the HSR filing only for the acquisition of assets that would remain after the divestiture—in which case the antitrust agencies, and potentially a court, may focus on the as-fixed transaction upfront, rather than focusing on the divestitures as a potential remedy to an otherwise anticompetitive transaction, with it only being at the rebuttal stage that the defendants have an opportunity to show how the proposed divestitures would mitigate the anticompetitive harms.

(3) Pre-packaged divestiture proposal. Presenting to the antitrust regulators at the outset a divestiture package with a divestiture purchaser and appropriate support agreements already lined up; and/or, to address a divestiture purchaser's needs for support, providing upfront cash support instead of support agreements that would entail a lengthy period of co-dependence on a competitor.