Getting ahead

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When the world's largest brewer, Anheuser-Busch InBev, launched a bid to take full control of Mexico's largest brewer, Grupo Modelo, US and Mexican counsel found themselves playing a critical role closing groundbreaking deals on both sides of the border. Joe Rowley talks to the lawyers involved about the unique challenges involved and what the deals mean for the global beer industry

Whether it's socialising with friends, unwinding after work or watching sport, global brewers have spent countless millions carefully cultivating the impression that relaxation is best accompanied with a cold beer. Behind the scenes, however, it seems relaxing couldn't be further from the minds of the world's largest beer companies. With the global financial crisis squeezing household budgets and contributing to a falling demand in mature markets such as the US and Europe, recent years have seen a wave of consolidation in the sector as the market's dominant players have snapped up smaller companies in emerging markets in a bid to bolster falling sales. Asia, Latin America and Africa have been particular targets, thanks to burgeoning middle-classes driving up demand. Since holding 13 per cent of the global beer market in 2001, the "big four" of AB InBev, SABMiller, Heineken and Carlsberg had grown their share to almost half by the start of this year.

With the world's fifth-largest beer market by volume and easy access to the second-largest market just over the border in the US, Mexico finding itself at the centre of the global brewers' battle for dominance was of little surprise to many. In 2010, the market had already witnessed Heineken, the world's third-largest brewer, stake its claim in the country with a US$7.6 billion acquisition of local rival Fomento Económico Mexicano (FEMSA). Two years later it was AB InBev's turn, announcing in May it had launched a tender offer to acquire the 50 per cent it did not already own in the country's largest producer, Grupo Modelo – raising eyebrows around the world and underlining the importance of the Latin American country in the global battle for dominance between the world's largest brewers.

For the recently merged AB InBev (previously the US's Anheuser-Busch and Belgium's InBev), the attraction of getting the deal through was clear. With Modelo holding two-thirds of the local market, the deal would hand it full control in a fast-growing market and add Mexico's most iconic beer brand, Corona, to a portfolio that already included Budweiser, Stella Artois and Beck's. With the US$20.1 billion price tag making the deal the biggest to be struck in Mexico's history (and almost equalling the country's total foreign direct investment in 2011), Mexican counsel on both sides knew that the transaction would be one of the larger challenges they had faced.. "It was the largest public offering in the history of Mexico by far," remembers Von Wobeser y Sierra

SC managing partner Claus von Wobeser, who represented AB InBev on corporate and antitrust matters. “There were all sorts of challenges, involving Mexico’s securities law and the fact that the offer was going to be done in dollars, which was something that had rarely been done in the Mexican stock markets, so there were many, many technical problems... It’s not that we thought we wouldn’t get the permits, but it was complex work.”

A bittersweet history

Complicating matters further was a long and fraught history between the two companies that some feared would derail the transaction. While the companies had enjoyed a largely positive working relationship since Anheuser-Busch first purchased an 18 per cent stake in Modelo in 1993, recent years had seen the local company’s Mexican shareholders become more assertive in protecting their independence as Anheuser-Busch repeatedly exercised its option to increase its non-controlling stake in Modelo until it stood at over 50 per cent. Events came to a head in 2008 when the US company became the target of a US$50 billion hostile takeover attempt by Belgian brewer InBev. Anheuser-Busch approached Modelo with the idea of taking full control of it in order to deflect InBev’s advances, but at the last minute gave InBev a final chance to pay the US$70 billion the board felt comfortable with. InBev said yes, leaving Modelo high and dry. “In 2008, we had a fully negotiated deal to buy the remaining interest in Grupo Modelo, which could have made it more difficult for InBev to acquire Anheuser-Busch,” says Skadden, Arps, Slate, Meagher & Flom LLP partner Paul Schnell. “But, at the Anheuser-Busch board meeting to consider the Modelo acquisition, the board decided to give InBev one last opportunity to meet the purchase price at which the board was prepared to sell the company to InBev. To their credit, InBev went ahead and bought Anheuser-Busch despite challenging economic conditions and it pulled off a true deal of the century. Once an agreement was reached between InBev and Anheuser-Busch, the talks with Grupo Modelo ended and did not resume for several years.”

But while Anheuser-Busch and InBev merged to form AB InBev, the relationship with Modelo deteriorated further when the Mexican company, with the help of Cravath, Swaine & Moore LLP, launched arbitration proceedings against its parent. Claiming that under Mexican law they should have been consulted on the Anheuser-Busch-InBev tie-up, Modelo’s shareholders lodged a US$2.4 billion claim for damages, which was eventually turned down by the tribunal hearing the claim, led by Freshfields Bruckhaus Deringer LLP partner Nigel Blackaby.

With the dust only just beginning to settle after an adversarial arbitration, relations between the two sides were on far from friendly terms.

Another round

AB InBev was determined to take full control of Modelo and made tentative steps to restart the conversation. Despite a far from smooth start to its merger, AB InBev took the unusual – and for Skadden, unexpected – step of bringing Anheuser-Busch’s original US and Mexican counsel on board. “We at Skadden had a long history working with Anheuser-Busch before its acquisition by InBev. But, after working across the table from InBev in what had started as a hostile takeover of Anheuser-Busch, we were of course concerned that we would not have an opportunity to work with them after the transaction. We were delighted that the AB InBev team gave us the chance to work with them – this time on their side.” For AB InBev’s general counsel Sabine Chalmers, the rationale behind retaining the same counsel was simple: “Anheuser-Busch, and then AB InBev, had a long history of working with Skadden and Von Wobeser in relation to its shareholding interest in Grupo Modelo,” she explains. “The two are leading law firms in their respective markets... The transaction raised both US and Mexican legal issues and we needed strong counsel to support us.”

AB InBev also turned to Mijares, Angoitia, Cortés y Fuentes SC, Sullivan & Cromwell LLP and Freshfields Bruckhaus Deringer LLP (for antitrust advice), while additional counsel was also drawn from Canadian firm Blake Cassels & Graydon LLP and the London office of Clifford Chance LLP, which advised on financing aspects. On Modelo’s side, the company also turned to Creel, García-Cuéllar, Aiza y Enriquez SC, Ritch, Mueller, Heather y Nicolau, SC and independent practitioner Alejandro Duclaud, while in the US Constellation relied on the Mexico and Chicago offices of Baker & McKenzie LLP, McDermott, Will & Emery LLP and Nixon Peabody LLP. Firms contacted on Modelo's side were either unavailable for comment or spoke on background for this article.

Possessing an in-depth knowledge of Modelo's shareholders after a decade sitting on the company's board of directors, Von Wobeser was the right man to begin the delicate task of reopening the discussions. AB InBev soon put him to work looking into the possibility of the newly merged company acquiring the outstanding stake in Modelo. "From early on, I started advising [AB InBev] on how a potential takeover could be done and we started a deep analysis of the Mexican legal framework, the contracts and the trust that was established," he says. "I started working with them on ideas, but very preliminarily."

"In both the 2008 negotiations and the most recent deal, there were repeated situations in which [Claus Von Wobeser] served as an intermediary between the parties to resolve issues," Schnell says, adding, "He's known all the players for many years".

For both sides, the task of convincing Modelo's shareholders to return to the negotiating table was daunting. With AB InBev's controlling stake in Modelo held in a management trust preventing shareholders from splitting their vote, any new offer would have to be agreed by more than 70 per cent of the trustees before a deal could go ahead.

To avoid the potential risk of a conflict of interest resulting from Von Wobeser's previous role on Modelo's board of directors, AB InBev turned to Mijares, Angoitia, Cortés y Fuentes SC for an extensive due diligence into Modelo and advice on the best tax structure. Stepping into the transaction at the end of 2011, Mijares partner Patricio Trad says it quickly became clear that price alone would not be the deciding factor in whether or not the deal would go through. "This was not like a private equity fund selling an asset because they need to exit or because they... had a change of mind about the industry," he says. "Some of the people who were selling [their shares] had owned this asset for generations, so they had to be sure they were selling under the right conditions, otherwise they wouldn't be selling."

Among the assurances sought by the selling shareholders was that Modelo's name, identity, heritage and headquarters in Mexico City would be maintained, and that the company would continue to have a local board.

With Corona one of Mexico's best-known global brands, Schnell explains that throughout the negotiations the shareholders sought assurances that the brand's legacy would be allowed to continue: "Price, of course, was a critical issue, but the selling shareholders of Modelo also felt strongly about preserving the Mexican heritage of the company and finding an owner that would continue the company's legacy," he says. "It's an issue that you don't often see in M&A transactions."

Ironically, given Modelo's original opposition to Anheuser-Busch's takeover by InBev, the merger may have proved to be a helpful precedent in reaching a deal with the Mexican shareholders. "Since its acquisition of Anheuser-Busch in 2008, AB InBev has had tremendous success in building Budweiser into a leading global brand outside the US", explains Schnell. "This was an attractive selling point for Modelo's shareholders because of the prospect that AB InBev could similarly use its global platform to expand Corona as a leading global brand."

While a record-breaker by Mexican standards, Mijares' Trad notes that much of the deal was relatively straightforward and a "redo" of the original agreements drafted during Anheuser-Busch's initial attempt to buy the stake four years earlier. But he adds that a number of factors, notably the "passage of time" since the first attempt and subsequent shifts in the regulatory environment in Mexico, did require that certain amendments be made.

"A gun against our head"

On 29 June last year, AB InBev announced that it had reached an agreement to acquire the remaining stake in Modelo for US$9.15 per share, equating to a total purchase price of US$20.1 billion.

But there was still uncertainty surrounding the transaction thanks to a separate and long-running case brought by SABMiller, which holds just 1 per cent of the Mexico market, alleging exclusivity agreements struck with bars and restaurants by Modelo and Heineken constituted anti-competitive conduct that prevented new companies from entering the market. “We didn’t know if the Mexican antitrust authorities would try to link the approval process for the transaction with the investigation,” explains Von Wobeser, adding that if they had decided to push for a settlement it “could have been like holding a gun against our head”.

In the end these concerns proved to be unfounded, with Mexico’s antitrust commission, the CFC, deciding against tying the two approvals together and handing down its ruling on exclusivity agreements a month after AB InBev successfully closed its tender offer for the remaining shares in Modelo. Drawing short of imposing an outright ban on the practice, the CFC’s agreement with Modelo and Heineken’s Cuauhtémoc Moctezuma would see them limit exclusivity contracts with most retailers to a maximum of 25 per cent of all its sales terminals and imposed a penalty equal to 8 per cent of annual Mexican turnover for failure to meet the conditions.

“The SAB Miller investigation was ongoing pre-merger,” explains Skadden partner Steve Sunshine, who advised AB InBev on antitrust matters. “The Mexican competition authority reviewed the AB InBev/Modelo transaction and cleared it, and subsequently the Mexican authority made its decision with respect to that investigation. It didn’t change the trajectory of the merger process.”

The bigger battle

Gaining regulatory approval in Mexico may have caused a few sleepless nights, but legal counsel knew the bigger battle lay north of the border in the US. With Corona the US’s number one imported beer, prosecutors from the Department of Justice (DoJ) sued to block the deal, claiming that the loss of Modelo’s independence would remove a major player in the US market and could negatively affect consumers by leading to higher prices for AB InBev’s brands.

Anticipating the DoJ would seek to block the transaction, Modelo offered to sell its 50 per cent stake in Crown, which imports and markets Modelo’s brands in the US, to Constellation, the world’s largest wine company and Modelo’s joint venture partner. Constellation agreed to pay US$1.85 billion for the stake in Crown, in return for an exclusive licensing agreement to supply Modelo brands in the US for 10 years.

The DoJ blocked the deal at the start of this year, claiming it was aimed at “creating a facade of competition” between AB InBev and Constellation under which the latter “would acquire no Modelo brands or brewing facilities” and remain dependent on AB InBev. “In the original deal, the DoJ didn’t like the ability of AB InBev to terminate the licence after 10 years, and it wanted Constellation to have its own manufacturing facility,” explains Skadden’s Sunshine. “In the scope of the whole set of transactions those were the DoJ’s two concerns, so the revised transactions were really just modifications to the basic structure that AB InBev put forward.”

With the tender offer hinging on gaining antitrust approval for Modelo’s US divestment, the lawyers had to move fast. Two weeks later, AB InBev submitted a revised offer under which it would divest all of Modelo’s US business and agree to sell its Compañía Cervecera de Coahuila brewery in Piedras Negras, in northern Mexico, to Constellation. Under the new deal, Constellation would also receive perpetual licences for Modelo’s brands in the US, boosting the total value of that deal to US$4.75 billion. It is thought to be the second-largest divestment in US history.

The DoJ’s ruling also contained a first in US antitrust history by requiring that Constellation commit to double the capacity at Piedra Negras in order to replace the lost supply created through the removal of an independent competitor. “It’s the first time the assets that were meant to replace the lost competition do not yet exist, so the acquirer of the assets actually has to add new assets in order to replace the lost competition,” says McDermott, Will & Emery LLP partner Warren Rosborough, who provided antitrust advice to Constellation. “It was really novel in that respect. I think this deal is a flag to the antitrust community of continued, increased merger enforcement led by the DoJ.”

Without an available precedent to draw upon, Rosborough says that it was critical to win the trust of the DoJ and convince it that Constellation had the capacity and motivation to undertake the expansion, estimated to cost between US$500 million and US$600 million.

The DoJ approved the revised conditions in early April, meaning the path was now clear for AB InBev to complete its merger with Modelo. AB InBev merged Modelo with two of its subsidiaries, Diblo and Dirección de Fábricas, that month, and in May undertook the tender offer for the Series C shares it did not already own in the company. Combined with AB InBev’s existing stake, the company held 95 per cent of Modelo. On 4 June, the same day as the settlement of the tender offer, AB InBev launched a trust to acquire any further tenders of shares from Modelo’s shareholders at the same price of US$9.15 per share over the next 25 months. Three days later, the closing of Modelo’s divestment of its US business to Constellation finally brought matters to a close – half a decade after Anheuser-Busch had made its first play to acquire the stake in Modelo in 2008.

Transforming the beer industry

Observers following the deal say its success has led to a significant restructuring of the beer industries on both sides of the US-Mexico border. In the US, Rosborough notes that the acquisition of Modelo’s US business has proved to be “really transformational” for Constellation, shifting the company from being a “very large and well-known wine producer with a beer business on the side”, to deriving half its revenues from beer sales and being the third-largest company in the market.

In Mexico the impact has been no less dramatic, with AB InBev’s assimilation of Modelo handing it control of 55 per cent of the local beer market and putting it in direct competition with second place brewer Heineken, which holds 43 per cent through Cuauhtémoc Moctezuma and brands such as Dos Equis and Tecate. “Mexico has become the new battleground for AB InBev and Heineken,” said Creel, García-Cuéllar, Aiza y Enriquez SC partner Jean Michel Enriquez, who gave antitrust advice to Modelo on the transaction.

While 98 per cent of the market being in the hands of the country’s two largest producers is making other high-profile mergers unlikely in the short term, Von Wobeser speculates that the presence of a large brewery in Piedras Negras, albeit one currently devoted to serving the US market, could potentially lead to the emergence of a new player: “Maybe in the future they will start selling in the Mexican market; not with Corona and not with the Modelo brands, because they can only sell those in the US, but they could set up a new brand and try to start competing in the Mexican market,” he ponders.

For Mijares’ Trad, the response to SABMiller’s long-running complaint holds broader implications for competition in the market: “You’re going to have competition between two major brewing groups in Mexico,” he predicts. “The antitrust rulings with respect to exclusivity agreements will somewhat lessen the concerns independents and microbreweries have about their ability to tap the market. It is going to be an interesting landscape.”

If SABMiller has its way, heightened competition in the Mexican market could happen far sooner. With the CFC’s previous ruling falling short of imposing an outright ban on exclusivity agreements, on 7 August the company announced that a federal court had accepted its case and was considering overruling the July settlement. For the world’s largest beer companies, relaxing looks unlikely – meaning that cold beer, at least in the short term, may need to be kept on ice.

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Comments

There are currently no comments.