

DEAL POINTS

The Newsletter of the Committee on Mergers and Acquisitions

FROM THE CHAIR

By Leigh Walton

I trust that many of you are planning to attend (in person or by phone) our Committee meetings to be held in conjunction with the ABA's Annual Meeting in San Francisco from Friday, August 6 through Sunday, August 8. Most of our meetings will be held at the Fairmont Hotel, located atop Nob Hill at 950 Mason Street. Note that Business Law Section members can pick up their ABA meeting materials at the Section's Satellite Registration Desk at the Fairmont in the Hunt Foyer on the Mezzanine Level.

The full Committee meeting will be held Sunday afternoon, beginning at 12:30 p.m., in the Grand Ballroom. Most of our meetings will be available by conference telephone. The dial-in information for the full Committee meeting and the Committee Forum is as follows:

Domestic Dial-In: (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 9210079161

Dial-in information for subcommittee and task force meetings is included in the schedule of meetings and other activities of our Committee starting on page 25 of this issue of *Deal Points*, and should also be available on the Business Law Section website at the following address:

<http://www.abanet.org/buslaw/meetings/2010/annual>.

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Leigh Walton – Chair
Wilson Chu – Vice Chair
Keith A. Flaum – Vice Chair
Mark A. Morton – Vice Chair
Michael K. Reilly – Editor

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Following our full Committee meeting, we will sponsor a Committee Forum entitled “M&A in the Alternative Entity Universe: How the Choice of Entity Affects Deal Negotiations, Fiduciary Standards, and the Rules of Contract Interpretation.” Moderated by Mark Morton, the program will feature as panelists Chief Justice Myron T. Steele, Delaware Supreme Court, Thomas P. Mason, General Counsel of Energy Transfer Partners, L.P., and Eric Feldman. Although corporations remain the dominant players in M&A, alternative entities play an important role in certain deal structures (for example, private equity) and in certain industries (for example, energy). The panel will discuss the guiding principles of alternative entities – when (and why) they should be used, the legal issues raised by the use of alternative entities, and the extent to which business planners, in practice, have been able to successfully eliminate corporate fiduciary concepts from alternative entity agreements.

Our Committee dinner is scheduled for Saturday evening at One Market Restaurant, 42nd Floor, 1 Market Street, San Francisco. With appreciation, I note that our dinner is sponsored by J.P. Morgan Escrow Services. Thanks to Ed Deibert for locating a terrific location with what I am told is a fantastic view of the Bay area.

At the Annual Meeting, our Committee will sponsor two very timely programs. First, on Friday, August 6, from 8:00 a.m. until 10:00 a.m., we will present a program entitled “What If International M&A Deals Go Sour: Lessons to be Learned for Drafting Dispute Resolution Clauses.” Then on Saturday, August 7, from 10:30 a.m. until 12:30 p.m., we sponsor a program to introduce our newest publication, “The Revised Model Stock Purchase Agreement: What’s New and Exciting and What Got Left on the Cutting Room Floor!” Throughout our meetings in San Francisco, we expect to celebrate the completion of this major

work. Copies will be available for purchase at the Annual Meeting while supplies last (and you will be able to order the publication at the meeting with a 15% discount and free shipping). Autographs from our editors can likely be arranged.

Our full Committee session is expected to be packed with useful and entertaining presentations. Since our meeting will be held at the heart of the world of technology, we will introduce Jack MacDonald, the Global Head of Technology for Bank of America – Merrill Lynch, who will address the status of the technology M&A marketplace. We will host Dan Burch, the Chief Executive Officer of MacKenzie Partners, Inc., who will discuss the approval process for public company deals. We also look forward to a presentation by John Gabbert, the CEO of PitchBook Data, Inc., that will highlight private equity deal activity by deal size and business sector, as well as insights into PE fundraising and exit activity.

To educate our members regarding recent federal legislative activity, Joel Greenberg will lead a discussion on the “Impact of the Financial Overhaul Package on M&A.” And, as is our tradition, we will welcome the Honorable Myron T. Steele, Chief Justice of the Delaware Supreme Court, for his perspectives on state law developments. We look forward to a successful meeting.

* * *

FOR A SCHEDULE
OF OUR MEETINGS
AND OTHER ACTIVITIES
IN SAN FRANCISCO
PLEASE SEE PAGE 25
OF THIS ISSUE OF *DEAL POINTS*

FEATURE ARTICLES

Closing Adjustment Provisions in M&A Transactions: Avoiding Common Disputes

By

Kevin R. Shannon and Michael K. Reilly¹

In most M&A transactions, there is a delay (sometimes significant) between the negotiation of the purchase price (the “Purchase Price”) and the closing of the transaction (the “Closing”). During that period, numerous events can occur that may affect the transaction and the reasonableness of the negotiated Purchase Price. Recognizing such possibilities, M&A practitioners may attempt, particularly in private company transactions, to protect their clients through the negotiation of provisions that address events which may occur prior to Closing. For example, in many private company transactions, the purchase or merger agreement (the “Agreement”) provides for an adjustment (the “Closing Adjustment”) to the Purchase Price to reflect the changes in certain of the target company’s assets and/or liabilities typically between a specified date prior to the execution of the Agreement and the date of Closing.

The purpose of the Closing Adjustment is obvious. In determining the Purchase Price, the buyer considers, *inter alia*, the target company’s assets and liabilities. As a

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consequence of the continuing operation of the target company (or certain conduct by the seller) those assets and liabilities will change prior to the Closing. The Closing Adjustment is intended to adjust the Purchase Price (either higher or lower) based on the changes in certain assets and liabilities, such as the components of working capital (“Working Capital”), prior to Closing.²

Although the determination of the Closing Adjustment would appear to be a rather straightforward exercise, it can have a significant impact on the Purchase Price. As a result, disputes often arise regarding the determination of the Closing Adjustment, which can result in litigation between the parties.³ Set forth below is a summary of certain disputes that may arise with respect to the determination of the Closing Adjustment, how the courts have resolved such disputes, and how the disputes may be avoided through careful drafting of the Agreement.⁴

² Although the Closing Adjustment may be based on the change in any assets or liabilities identified by the parties, it is common to use the components of working capital or some variation thereof. For the purposes of this article, it will be assumed that the Closing Adjustment is based on the change in Working Capital.

³ As subsequently addressed, many agreements provide that disputes relating to the Closing Adjustment must be presented to arbitration, and therefore, the disputes that result in litigation before courts likely represent only a small fraction of the total disputes relating to Closing Adjustments.

⁴ Along with the inclusion of closing adjustment provisions, purchase or merger agreements in private company transactions also typically include certain other provisions that raise unique issues under Delaware law. For example, it is common for private company merger agreements to include provisions purporting to withhold a portion of the merger consideration and to require the deposit of

The Closing Adjustment Provision

Although there is no uniform Closing Adjustment provision, the first step in the process typically is to determine the pre-closing Working Capital balance that will be used to calculate the Closing Adjustment (the “Reference Balance”). That amount is compared to the Working Capital balance as of the Closing Date (the “Final Balance”), and the Purchase Price is adjusted based on the difference between those two amounts.⁵ The preparation of the final statement of the target company’s assets and liabilities as of the Closing (the “Final Statement”) that is used to

such amounts into escrow accounts in order to facilitate certain post-closing adjustments and indemnification obligations, as well as provisions purporting to have the stockholders (including non-signatory stockholders) appoint a stockholder representative. Although beyond the scope of this article, we note that such provisions raise unique, and often overlooked, issues under Delaware law. Such provisions are fraught with enforceability concerns under Delaware law to the extent they are drafted as affirmative obligations of non-signatory stockholders, and not as neutral mechanics that provide both for the proper conversion of shares in accordance with Delaware law and for the proper implementation of “facts ascertainable” procedures as permitted by Delaware law. M&A practitioners negotiating merger agreements with such provisions should proceed with caution and consider engaging Delaware counsel.

⁵ Because it is not feasible to specifically determine and agree upon the Final Balance as of the Closing, it is common for the Agreement to require the seller to provide an estimated Working Capital balance as of the Closing Date (the “Estimated Balance”), which is used to make a preliminary adjustment to the Purchase Price. *See, e.g., OSI Systems, Inc. v. Instrumentarium Corp.*, 892 A.2d 1086, 1088 (Del. Ch. 2006) (noting that the seller was required to prepare “a Statement of Estimated Closing Modified Working Capital ... two days before the anticipated Closing Date”).

determine the Final Balance and the resulting Closing Adjustment is typically done during the period following the Closing.

The Court of Chancery’s decision in *OSI Systems* provides the following summary of a typical Closing Adjustment:

To arrive at a final purchase price, that provision begins by stating a nominal purchase price of \$57.384 million, which then is adjusted primarily through the so-called “Closing Adjustment” The “Closing Adjustment Formula” is driven by a comparison of [the target company’s] Modified Working Capital as of June 30, 2003 and a Final Modified Working Capital Statement as of the Closing Date, March 19, 2004.⁶

As explained below, each step in the process of determining the Closing Adjustment raises issues that may result in disputes.

The Reference Statement

A critical component of the Closing Adjustment is the Reference Balance, which is typically based on the balance of certain assets and liabilities (*e.g.*, the components of Working Capital) as set forth on a financial statement prepared prior to the execution of the Agreement (the “Reference Statement”). Essentially, the Reference Statement sets forth the target company’s assets and liabilities that the buyer considered when determining the Purchase Price, and the Closing Adjustment is intended to reflect the changes in those assets and liabilities during the intervening period prior to the Closing. In negotiating the Reference Balance, it is important to understand and clearly state in the Agreement what assets and liabilities are included.

⁶ 892 A.2d at 1087.

Another important consideration, which is sometimes overlooked, is whether any of the assets or liabilities included in the Reference Balance (or the Final Balance) are separately addressed in the Purchase Agreement. If such assets and liabilities are separately addressed, unintended consequences may result.

For example, in *Brim Holding Company, Inc. v. Province Healthcare Company*,⁷ the Court of Appeals of Tennessee enforced the express terms of a purchase agreement, which resulted in what appeared to be an unintended double recovery for one of the contracting parties. At issue in the case was a purchase agreement pursuant to which Brim Holding Company, Inc. (“Brim”) acquired Brim Healthcare, Inc. (“Healthcare”) from Province Healthcare Company (“Province”). Pursuant to the agreement, Province agreed to indemnify Brim for losses related to certain specified litigation. Brim paid \$50,000 to settle the litigation and then made a demand upon Province for indemnification. Province, however, rejected the demand on the ground that Brim had already recovered the payment through a working capital adjustment. Specifically, Province asserted that the closing balance sheet already included a \$50,000 reserve for the litigation, which had the effect of reducing working capital (and the amount paid by Brim at closing) by \$50,000. As such, Province asserted that requiring it to indemnify Brim for the \$50,000 settlement would result in a double recovery for Brim. Although that argument had some logical force, in granting Brim’s motion for summary judgment, the Court held that “the parties anticipated the loss now at issue and made express and unequivocal provisions to assure that the loss, if any, would be paid by [Province].”⁸ Therefore, the Court

refused to “nullify the indemnity provision” based on Province’s assertion that requiring such payment was unfair in light of the working capital adjustment and inconsistent with the intentions of the parties.⁹ Simply put, the Court enforced the express terms of the contract as written.

The import of the decision in *Brim* is clear. To avoid a potential double recovery, if the parties have agreed to indemnify with regard to specific losses, any reserve with respect to such losses should be excluded from the Working Capital used to determine the Closing Adjustment. Such a provision would not prejudice the buyer because it should be protected with regard to such losses pursuant to indemnification provisions.

Another important consideration when determining the Reference Balance is the fact that the Final Balance typically will be required to be prepared in the same manner as the Reference Balance. For example, as noted by the Court in *OSI Systems*, the balances used to determine the Working Capital at Closing were to be:

prepared in accordance with the Transaction Accounting Principles applied consistently with their application in connection with the preparation of the Reference Statement of Working Capital ... and shall otherwise contain at least the same line items as the Reference Statement of Working Capital....¹⁰

Accordingly, the parties likely will be required to consistently apply the same accounting principles used in the Reference Statement – even if the buyer contends that the accounting

⁷ 2008 WL 2220683 (Tenn. Ct. App. May 28, 2008).

⁸ *Id.* at *5.

⁹ *Id.*

¹⁰ *OSI Systems*, 892 A.2d at 1088 (emphasis added).

principles did not comply with GAAP or the applicable contractual standard. For example, if the Reference Balance is overstated by \$10 million because the Reference Statement was not prepared in accordance with GAAP, that error most likely cannot be fixed in connection with determining the Final Balance, which must be prepared consistently with the Reference Balance. Moreover, if the overstatement of Working Capital increased to \$25 million as of the Closing (as a result of consistently applying the alleged erroneous accounting principles used in preparing the Reference Balance), that \$25 million overstatement would be included in the Final Balance, which (all other things being equal) would result in a \$15 million increase in the Purchase Price – notwithstanding the fact that the Final Balance was not calculated in accordance with GAAP.

Of course, the buyer is not necessarily left without a remedy for the overstatement of Working Capital. Rather, any challenge to the application of the accounting principles used in preparing the Reference Statement (as carried through to the Final Statement) most likely could be pursued through a breach of representation claim relating to the Reference Statement.¹¹ As such, it is necessary to ensure that the Agreement contains a representation with regard to the Reference Statement (*e.g.*, that it was prepared in accordance with GAAP) that survives Closing.¹² It is important to note, however, that establishing a claim for breach of a financial statement representation is different than resolving a dispute regarding the amount of the Closing Adjustment. For example, unlike the calculation of a Closing Adjustment,

whether a financial statement is prepared in accordance with GAAP may implicate materiality considerations – *i.e.*, a financial statement may contain immaterial errors or misstatements and still comply with GAAP. Moreover, in contrast to a Closing Adjustment, any purported damages arising from a breach claim may be subject to contractual minimums and caps.¹³ In addition, as noted by the Court in *OSI Systems* (and as further addressed below), the Purchase Agreement may set forth different processes to resolve a breach claim (*e.g.*, legal arbitration) than is applicable to a dispute relating to a Closing Adjustment, which may be required to be submitted to an accountant.

The Final Statement

The Final Statement is generally prepared post-Closing following the buyer's receipt and review of the target company's financial information. Typically, in connection with preparing the Final Statement, the buyer will carefully scrutinize the target's financial information in an attempt to find any basis to lower the amount of the Final Balance and thereby reduce the Purchase Price. Although the Agreement may require that the Final Balance be prepared in accordance with the same accounting principles used to determine the Reference Balance (consistently applied), it is important to note that, as a result of intervening events and/or business developments, the classification of an asset or liability may change under the applicable accounting principles, which could have a significant impact on the Closing Adjustment. An example of such a situation is illustrated by the Delaware Superior

¹¹ *OSI Systems* 892 A.2d at 1091-92 (stating that the “assertion that the Reference Statement did not comply with U.S. GAAP is also necessarily an assertion that [the seller] breached a representation and warranty”).

¹² *Id.* at 1092.

¹³ *See, e.g., id.* at 1094-95. It should also be noted that, in connection with a breach claim, a buyer would be required to establish the damages resulting from the alleged breach, which may be different than the amount that could be recovered if the dispute was resolved as part of the Closing Adjustment process.

Court's decision in *Mehiel v. Solo Cup Company*.¹⁴

In *Mehiel*, the merger agreement provided for a post-closing adjustment based on changes to Working Capital between the time the parties entered into the agreement and the closing, and further provided that any disagreements regarding the closing adjustment must be presented to an arbitrator. One of the parties' disputes related to a facility located in St. Thomas, Maryland with a value of \$5.6 million, which had been treated as an asset held for sale and included in working capital by the seller. The buyer, however, asserted that the facility should be treated as a long-term asset and excluded from working capital when determining the Closing Adjustment. The arbitrator accepted the buyer's position, which resulted in a \$5.6 million decrease in the purchase price. The seller filed litigation challenging the arbitrator's ruling asserting as follows:

Count V alleges that [the buyer] was unjustly enriched by persuading the Neutral Auditor to treat St. Thomas as a long-term asset and remove it from working capital. In reference to St. Thomas, *Mehiel* stated in a letter to the Neutral Auditor that "[the buyer's] proposed adjustment is inequitable, and if accepted, would result in [the buyer] receiving monetary benefit (to *Mehiel's* detriment) for its post-closing decision to not complete the sale of the St. Thomas facility. Further, "[i]f this asset held for sale is removed from Final Working Capital, [the buyer] will enjoy the following windfall: it will have

reduced the purchase price of the merger (through this adjustment) and at the same time retained the benefit of keeping the St. Thomas facility – at no cost to itself – which it could then sell for cash.¹⁵

Without addressing the merits of the argument, the Court concluded that the seller's argument had been presented to and resolved by the arbitrator, and therefore, the seller was barred from attempting to litigate that issue in Court.

Thus, in *Mehiel*, as in *Brim*, the application of the Closing Adjustment resulted in an unintended windfall for the buyer. Such a situation, however, potentially could be avoided by specifically identifying the assets and liabilities to be included in determining the Reference Balance and the Final Balance, and further providing that the accounting treatment of the assets or liabilities must be consistent in calculating both the Reference Balance and the Final Balance.

The Process for Resolving Closing Adjustment Disputes

It is common for the Agreement to set forth a post-Closing process to determine the Closing Adjustment and also to resolve any disagreements between the parties relating to the Closing Adjustment. For example, the Purchase Agreement may provide that the buyer has sixty days to prepare and provide the Final Statement and supporting documentation to the seller. The seller then will have a period of time to review the proposed Final Balance, and provide the buyer with a list of any disagreements (the "Notice of Disagreement").¹⁶ The parties typically are

¹⁵ *Id.* at *4 (emphasis omitted).

¹⁶ See, e.g., *HDS Investment Holding, Inc. v. Home Depot, Inc.*, 2008 WL 4606262, at *2 (Del. Ch. Oct. 17, 2008) (describing contractual process for determining the Closing Adjustment).

¹⁴ 2007 WL 901637 (Del. Super. Ct. May 26, 2007).

required to work in good faith for a period of time to attempt to resolve the disagreements. If such efforts are not successful, the disagreements typically are required to be submitted to a third party (*i.e.*, the court or an arbitrator) for resolution. As noted below, disputes often arise regarding the process for resolving disagreements regarding the Closing Adjustment, which must be addressed before the actual merits of such disagreements can be resolved.

One issue that may arise in this context relates to the buyer's failure to deliver the Final Statement within the period set forth in the Agreement (*e.g.*, 60 days). The Agreement is often silent with respect to this issue, including the consequences that flow from the failure to timely deliver the Closing Statement. To avoid any uncertainty, the Agreement could expressly provide that the buyer loses his right to seek an adjustment to the Purchase Price if it fails to timely submit the Final Statement. In this respect, it is important to note that the Closing Adjustment as determined by reference to the Final Statement may result in either an increase or a decrease in the Purchase Price. Thus, the buyer would have little reason to submit the Final Statement within the contractual period if it resulted in an increase in the Purchase Price.

In that case, however, it would be in the seller's interest to prepare the Final Statement and obtain the resulting increase in the Purchase Price. As such, the seller may want to have the Agreement expressly provide that the seller has the right to prepare the Final Statement if the buyer fails to timely do so.¹⁷ In order to prepare the Final Statement, however, the seller

¹⁷ Alternatively, the seller could assert that the buyer breached the Agreement by failing to timely submit the Final Statement, and seek to recover damages equal to the amount of the Closing Adjustment that would otherwise have been due under the Agreement.

typically will need access to the target company's financial records, which usually are in the possession of the buyer after the Closing. Accordingly, the Agreement also should provide that the seller shall have sufficient access to the target's financial information so as to prepare the Final Statement if it so elects.¹⁸

Finally, as previously noted, the Agreement typically will set forth a time period (*e.g.*, 60 days) for preparation of the Final Statement, and a process to resolve disputes relating the Final Balance. It is not unusual, however, for the parties to identify "additional" adjustments to the proposed Final Balance after the submission of the Final Statement.¹⁹ The Agreement, however, usually does not expressly address whether a party may pursue such additional adjustments as part of the Closing Adjustment process. Thus, to the extent that the parties intend that the Closing Adjustment process shall be limited solely to the items/adjustments raised in the Final Statement (as originally submitted by the buyer to the seller), the Agreement should expressly so provide. Otherwise, the Court or the

¹⁸ The Agreement typically provides the seller with access to such financial information, which it can use to review the Final Statement prepared by the buyer. *See, e.g., HDS Investment Holding*, 2008 WL 4606262, at *2 (noting that the buyer was required to provide the seller with the closing statement and "related schedules and work papers"); *Aveta Inc. v. Bengoa*, 2008 WL 5255818 (Del. Ch. Dec. 11, 2008) (considering dispute regarding whether the buyer delivered sufficient financial information to the seller such that the seller could evaluate the proposed closing adjustment).

¹⁹ *See, e.g., HDS Investment Holding*, 2008 WL 4606262, at *7; *Nash v. Dayton Superior Corp.*, 728 A.2d 59, 61 (Del. Ch. 1998) (noting that a party attempted to raise in the arbitration "New Items" that "had not been raised or even indicated in either the Closing Balance Sheet or the Notice of Disagreement").

arbitrator will be required to determine whether the parties intended to allow such additional items/adjustments to be raised as part of the determination of the Closing Adjustment.²⁰

Submission of the Dispute to Arbitration

The Agreement will often provide that disagreements regarding the Closing Adjustment must be presented to arbitration before an accountant, and may even identify the accounting firm. Such provisions are intended to provide for a quick and less expensive resolution of the disagreements by an individual with expertise in the accounting issues that may be implicated in the determination of the Closing Adjustment. Disputes, however, often arise regarding the determination of which specific disagreements/adjustments are required to be submitted to the accounting arbitration (often called substantive arbitrability) and whether a party has properly or timely commenced the arbitration under the Agreement (often called procedural arbitrability).²¹ These issues usually must be decided by the court before the arbitrator can begin to address the merits of the actual

disagreements regarding the Closing Adjustment.

Significantly, the threshold issue is often simply whether the Court – or the arbitrator – is required to resolve the issue of substantive or procedural arbitrability. For example, in *Nash v. Dayton Superior Corporation*,²² the agreement of sale provided that the buyer had 60 days to submit a closing balance sheet to the selling stockholders. The stockholders then had 45 days to deliver a notice of disagreement laying out any disputes they had with the closing balance sheet. If the parties could not come to an agreement, the dispute would be submitted to an independent accounting firm for resolution. After following the process provided for in the Agreement, the buyer attempted to submit certain “new items” to the accounting firm that were not included in the closing balance sheet.²³ The selling stockholders of the target corporation filed a complaint seeking to enjoin the buyer from submitting the new items to the accounting arbitrator, and the buyer moved to dismiss the complaint on the ground that the issue was required to be resolved by the arbitrator and not the Court. The Court of Chancery held that the dispute over whether the acquirer could submit the “new items” to the accounting firm was a question of substantive arbitrability, and because the “new items” did not “on [their] face, fall [] within the arbitration clause of the contract,” it was a factual question for the Court to decide whether the parties agreed to submit such items to the accounting firm.²⁴ Therefore, the Court denied the motion to dismiss as to the closing balance sheet claim.

²⁰ See, e.g., *HDS Investment Holding*, 2008 WL 4606262, at *8; *Nash*, 728 A.2d at 63.

²¹ Substantive arbitrability involves questions regarding the scope of the arbitration provision at issue. *RBC Capital Mkts. Corp. v. Thomas Weisel Partners, LLC*, 2010 WL 681669, at *7 (Del. Ch. Feb. 25, 2010) (“The question of whether parties have agreed to arbitrate a particular dispute, *i.e.* the ‘question of arbitrability,’ is ‘an issue for judicial determination [u]nless the parties clearly and unmistakably provide otherwise.’”). In contrast, procedural arbitrability involves questions of “whether prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met,” as well as “allegation[s] of waiver, delay, or a like defense to arbitrability.” *RBC Capital*, 2010 WL 681669, at *7.

²² 728 A.2d 59 (Del. Ch. 1998).

²³ *Id.* at 61.

²⁴ *Id.* at 63 (citation omitted).

Similarly, the contracts at issue in *Matria Healthcare, Inc. v. Coral SR LLC*²⁵ and *OSI Systems*²⁶ both provided for two different arbitration procedures, pursuant to which post-closing adjustments relating to Working Capital were to be submitted to accounting arbitration, and other claims (such as claims for breach of warranty or misrepresentation) were to be submitted to legal arbitration. In each case, the court was required to determine whether the disputes at issue were required to be submitted to accounting or legal arbitration. And, in each case, the Court adopted a narrow view of the disputes that were required to be submitted to the accounting arbitration, and determined that the claims at issue involved potential misrepresentations – as opposed to pure accounting disputes relating to the calculation of working capital – and were required to be submitted to legal arbitration.

Ultimately, the goal would be to avoid separate litigation regarding the scope of the arbitration provision and/or procedural issues regarding whether the arbitration was properly or timely commenced, which necessarily delays and increases the expense associated with resolving the real disagreements regarding the Closing Adjustment. To avoid the uncertainty as illustrated by *Nash*,²⁷ the Agreement should expressly state who (*i.e.*, the accounting arbitrator, the legal arbitrator, or the court) is empowered to decide issues such as whether the arbitration was timely commenced or whether the parties could raise “new items” in arbitration. Similarly, if the Agreement

provides for both legal and accounting arbitrations, so as to avoid litigation in court, the Agreement could make clear that any dispute as to whether a claim falls within the accounting or legal arbitration shall be resolved by the legal arbitrator, who is likely better able to resolve such issues of contract interpretation.²⁸

Conclusion

The Closing Adjustment is an important part of the Agreement, and can have a material impact on the Purchase Price. Therefore, it is not surprising that disputes often arise as to both the amount of, and the contractual process to determine, the Closing Adjustment. As explained above, however, it may be possible to avoid (or at least more quickly resolve) some of the potential disputes through careful drafting of the sections of the Agreement relating to the Closing Adjustment.

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²⁵ 2008 WL 401125 (Del. Ch. Feb. 14, 2008).

²⁶ 892 A.2d 1086 (Del. Ch. 2006).

²⁷ 728 A.2d at 63 (noting that there was a “factual question as to whether the parties intended the arbitration to permit [the buyer] to revise the Closing Balance Sheet in response to objection raised by the Notice of Disagreement”).

²⁸ *OSI Systems* 892 A.2d at 1095 (noting that the “Legal Arbitration process should be completed first and the parties can work with the Legal Arbitrator, who has broad interpretative powers regarding the Purchase Agreement, to determine the issues that would then remain for determination in the Closing Adjustment Arbitration”).

UK Bribery Act: A New Issue in Cross-Border M&A Transactions

By
Steve Wilson¹

As more M&A transactions are becoming global, the myriad of legislation which applies to targets (or even indirectly to businesses which are part of the target group) can become a material liability for an acquirer and, to the unwary, such material liability may not be caught by standard form representations and warranties. In the Spring Issue of *Deal Points*, an article described the implications of the US Foreign Corrupt Practices Act (the “FCPA”). Following on that article, we consider the impact of the UK’s new Bribery Act 2010 (the “Bribery Act”), which will come into force in April 2011. The following provides an overview of the new legislation, but in particular examines the areas in which it differs from the FCPA and would therefore require special attention during the diligence process.

What Does the Act Cover?

The UK’s existing anti-bribery provisions are anything but coherent, with legislation spanning over three centuries. The Bribery Act will abolish and repeal the existing common law and antiquated statutory bribery offenses and replace them with a number of more straightforward offenses.

The Bribery Act contains two general offenses, the first making it *illegal to offer a*

bribe and the second making it *illegal to accept a bribe*. There is also a third offense of *bribery of a foreign public official*. If any of these three offenses are proved to have been committed with the consent or connivance of a senior officer of a body corporate, then that person (as well as the body corporate) is guilty of an offense.

The key development under the Bribery Act, however, is the new offense under which commercial organizations will be liable if they *fail to prevent bribery* from being committed in connection with their business. The intention behind this offense is to make it much easier for the UK’s Serious Fraud Office to prosecute companies for bribery.

To Whom Does the Bribery Act Apply?

The Bribery Act has very wide territorial scope. The general bribery offenses apply to acts of bribery committed anywhere in the world by *companies* incorporated in the UK as well as *individuals* who are British citizens or ordinarily resident in the UK.

The offense for a commercial organization of failing to prevent bribery applies not only to bodies incorporated and partnerships formed under the laws of any part of the UK but also to any other body corporate or partnership that carries on business in the UK. Therefore, any company with a footprint in the UK needs to ensure that it is compliant with the provisions of the Bribery Act.

This can have extensive reach where a business operates in the UK, but such bribe occurs elsewhere in the world and not necessarily connected with the British operations or by its employees. Clearly this can have significant implications for a multi-national business with a significant number of employees and therefore it is vital to prevent the bribery being committed by properly drafting and adopting sufficient global policies.

¹ Steve Wilson is a partner with European law firm, Osborne Clarke (Palo Alto, California), and an English Solicitor and Registered Foreign Legal Consultant of the State Bar of California. The views expressed are those of the author and may not be representative of those of his firm or its clients.

Anti-Corruption Policies

Whilst most large US corporations (and subsidiaries of US businesses) will have anti-corruption policies in place to comply with the FCPA, they are less common in domestic British businesses. Even where such a policy has been adopted, however, the Bribery Act is wider than the FCPA in certain respects and therefore, pre-existing anti-corruption policies need to be extended to comply with the Bribery Act.

Where no anti-corruption policies and procedures are in place, these should be adopted to ensure that “adequate procedures” are in place ahead of the entry into force of the Bribery Act.

Where target businesses are located or operating in the UK, specific review should be made of the anti-corruption policy and, where necessary, protection sought for actions which could lead to liability under the Bribery Act where lack of “adequate procedures” results in no defense being available.

The UK’s Ministry of Justice will publish guidance on the procedures that commercial organizations should put in place to prevent bribery from being committed in connection with their businesses, which will allow better interpretation of “adequate procedures.” Such guidance is anticipated to be published in early 2011 following a short period of consultation commencing in September 2010.

“Adequate Procedures” Defense

As indicated, no specific guidance has yet been provided and, since the Bribery Act is yet to become law, no judicial interpretation is available. The following issues are therefore expected to support such defense:

- Evidence of completion of a full internal risk assessment;

- A statement of values and code of conduct;
- Public support of code of conduct by management;
- Clear guidance provided to employees setting out the company’s policies on hospitality, gifts, expenses, charitable and political donations, facilitation payments, the use of intermediaries and agents, and conflicts of interests. The guidance should also set out to whom employees should address questions in relation to such policies;
- Evidence that employees have been trained to ensure that they are fully aware of the adopted anti-corruption policy;
- Evidence of systems in place to supervise and monitor compliance with company policies (often through a compliance function) and, in addition, the implementation of appropriate disciplinary processes;
- Adoption of a whistle blowing system that enables employees and third parties to report any instances of bribery or corruption; and
- Public statements that the anti-corruption policy applies to business partners.

What are the Differences Between the Bribery Act and the FCPA?

There are four main areas where the two laws differ and therefore should be addressed specifically in existing anti-corruption policies:

Strict liability for the entity. The company itself is liable for criminal liability if it does not provide “adequate procedures” to prevent its employees from breaching the terms of the Bribery Act. Lack of knowledge on management’s part is irrelevant to exposure to such liability.

TASK FORCE REPORTS

Task Force on Distressed M&A

The Task Force held a successful meeting at the Spring Meeting in Denver. We featured Peter Fishman of Houlihan Lokey who provided an update on the state of the distressed M&A market. In addition, John Clifford of McMillan presented a case study on the Canwest bankruptcy. The group discussed *In re Philadelphia Newspapers*, *In re DBSD North America, Inc.*, and other recent cases. Eric Johnson also presented his “Top 10” distressed M&A developments. Finally, we discussed, and enlisted members in, our new deal point analysis of 363 asset purchase agreements and sale orders.

We plan to have a robust discussion on distressed dealmaking at our meeting on Saturday, August 7, from 9:00 a.m. until 10:30 a.m., in San Francisco. (dial-in will be available, please contact my assistant at laura.vanerp@hro.com for the specifics). Jennifer Muller will lead the meeting and our discussion of the 363 Study. In addition, Peter Fishman of Houlihan Lokey will provide an update on the state of the distressed M&A market.

Hendrik Jordaan
Chair

Task Force on the Model Stock Purchase Agreement

The Model Stock Purchase Agreement (Second Edition) will be published in time for the San Francisco meeting. Pre-sales have already begun. The Second Edition consists of two volumes. Volume 1 contains the Agreement itself together with Commentary and Seller’s Response. Volume 2 contains the Exhibits, Ancillary Documents, and Appendices. With the publication of the Second

Facilitation payments. Facilitation payments (e.g., small payments made to overseas public officials for carrying out their routine function in such role) are included within the Bribery Act. In contrast, the terms of the FCPA provide an exception for such payments.

Commercial bribery. Whilst much publicity around bribery is often focused on public sector workers or government officials, the Bribery Act extends to private individuals and commercial operations. In contrast, commercial bribery is not directly prohibited by the FCPA.

Penalties. The maximum prison term for individuals found guilty of an offense under the Bribery Act is 10 years. Under the FCPA, the maximum term for an offense is 5 years.

Summary of M&A implications

As indicated above, whenever a cross-border transaction is contemplated that involves a British company (and note that the Bribery Act extends to companies incorporated in England, Wales, Scotland, and Northern Ireland), special attention should be given to the scope of anti-corruption policies adopted and inquiries made in respect of any actions which could be considered to breach the terms of the Bribery Act, irrespective of which jurisdictions such actions took place.

As the law is adopted and starts to be implemented, businesses and advisors will become more aware of expected levels of *adequate procedures* and M&A counsel’s approach to transactional based protection will become more standard form.

* * *

Edition, the work of the Task Force is now complete.

Several programs have been planned to introduce the Second Edition, including a panel presentation in San Francisco on Saturday, August 7, from 10:30 a.m. until 12:30 p.m., on “The Revised Model Stock Purchase Agreement: What’s New and Exciting and What Got Left on the Cutting Room Floor!”

Our Editorial Committee will celebrate the completion of our work at a celebratory dinner in San Francisco.

We look forward to seeing everyone at the Annual Meeting.

Robert T. Harper
Murray J. Perelman
Co-Chairs

SUBCOMMITTEE REPORTS

Acquisitions of Public Companies Subcommittee

Our Subcommittee will be meeting in San Francisco on Saturday, August 7, from 2:30 p.m. until 4:30 p.m., at the Fairmont Hotel, Gold Room, Lobby Level. As we discussed at our inaugural Subcommittee meeting in Denver, we will have a panel discussion by experienced litigators to offer advice on “what deal lawyers should know about deal litigation: privilege, process, and disclosure landmines.” I am pleased to report that Greg Varallo and Erik Olson will be our panelists for what promises to be a very interesting program. Thanks to Steve Bigler and Michael O’Byryan for their suggestions for our panelists.

We are also pleased that Dan Burch, CEO of MacKenzie Partners, will be with us to talk about recent trends in proxy contests, the

approval process for M&A deals (and recent ISS trends), and other issues relating to the stockholders meeting process. Finally, Mark Morton will be leading a discussion on the legality of top-up options in tender offers in light of new Delaware developments.

My intrepid Vice Chairs, Jim Griffin and Lorna Telfer, will be with me to update you on our substantial progress on the Model Agreement, and we will continue our preliminary discussions about our two-step agreement task force, with a goal to get that project up and running after we get the Model Agreement out to the ABA editors. It should be a great meeting and we look forward to seeing many of you in San Francisco.

Ed Deibert and David Lipkin have also arranged a wonderful evening for us on Friday, August 6. We will have cocktails from 6:30 p.m. until 8:00 p.m. at David Lipkin’s apartment, address 568-A Greenwich Street (between Stockton and Grant), which is in North Beach, a wonderful Italian neighborhood (just a cab ride from our hotels on Nob Hill), followed by dinner starting at 8:00 p.m. at a local North Beach restaurant, Vicoletto. Vicoletto’s is within walking distance from the apartment. We estimate \$125 for this evening, which will include the cocktail party and the dinner (as the restaurant is providing catering for the cocktail party). We have a limit of 50 for this event, and we are bumping up on that limit, so let me, Vicky DeRossett, and Ed Deibert know if you are planning to attend the cocktail party and dinner. Thanks to David and Ed for making these arrangements; for those of you who don’t live here, North Beach is always a real treat and we look forward to showing off a great San Francisco experience!

Diane H. Frankle
Chair

Jim Griffin
Lorna Telfer
Vice Chairs

International M&A Subcommittee

The International M&A Subcommittee met on Friday, April 23, in connection with the Spring Meeting in Denver.

Current M&A Developments in China

Audrey Chen gave a presentation on current M&A developments in China, which included summaries of the regulation of M&A and foreign direct investment in China. She covered:

- Central government policies and directions;
- Key issues in foreign direct investment and M&A, including restrictions, business structures, the process of setting up a co-operative joint venture (CJV), and other issues, including dealing with state-owned assets;
- Recent legislation affecting foreign direct investment and M&A, including changes in the taxation of representative offices, SAIC rules on foreign investment partnerships, and merger control law and MOFCOM practice; and
- Practical approaches to foreign direct investment and M&A in China.

Survey on Post-Closing Dispute Resolution in International M&A Deals

Cynthia Kalathas reported on the status of the Subcommittee's survey project on post-closing dispute resolution in international M&A transactions. Cynthia reported that 30 different countries have now completed surveys, and that a progress report is available on our website. There are several countries outstanding including Korea, the UAE, and China. The survey in its completed form may be posted on the ABA website or, possibly, become an ABA publication.

Supranational Business Entities and Merger Structures in Europe

Christiaan de Brauw and Reid Feldman gave a presentation on supranational business entities and merger structures in Europe. The presentation included an outline of the EU legal environment, cross-border merger structures without a statutory merger, cross-border statutory mergers, and the use of Societas Europa entities.

Public Company Acquisition Issues Questionnaire

Stan Freedman gave an update on the Subcommittee's Public Company Acquisition Issues Questionnaire project. He indicated that it is proposed to create an international appendix to the model public company acquisition agreement that will be completed later this year by the Acquisitions of Public Companies Subcommittee.

International Joint Venture Project

Mireille Fontaine provided an update on the Subcommittee's International Joint Venture Project. Mireille reported that lawyers in 43 countries have contributed, and contributions will be updated over the next three months by a ten member editorial committee, which will consult with each contributing country to ensure the contributions remain accurate. She reported that the aim was to publish early next year.

Foreign Direct Investment Survey

Frank Picciola reported on the status of the Subcommittee's Foreign Direct Investment Survey. Frank reported that firms from ten countries had responded to date, and that it was intended that answers to the questionnaire would be available on our website. Ultimately, consideration would be given to the possibility of publishing the results. Leigh Walton commented that the Committee supports production of content on the website in this way, so that the output is more immediately available.

IP Issues in International M&A

Peter Haver gave a presentation on IP Issues in international M&A transactions. He summarized key points from a recent paper, including techniques for dealing with IP ownership issues in M&A transactions, targets' transfer of IP rights to buyers, third party rights and sellers' IP, and possible infringement of third party IP rights.

Open Discussion

Daniel Rosenberg (attending by telephone) thanked Stan Freedman for chairing. Daniel mentioned a number of recent developments in the UK including the following:

- Issues relating to the new UK Bribery Act 2010, which potentially attaches to acts by foreign entities and has broader application than US law. Daniel mentioned that the new Act includes the crime of failing to prevent bribery, applies to corruption in the private sector as well as the public sector, contains no carve-out for facilitation payments (payments to a foreign public official of such a nature are prohibited), and applies to both the giving and the receiving of a bribe;
- Changes to the Takeover Code which focus more on the interests of the acquirer; and
- Issues relating to the recoverability of VAT on deal costs.

Website

The Subcommittee's website can be found at the following address:

www.abanet.org/dch/committee.cfm?com=CL560016.

The website contains the following information:

- The slides from the presentation by Audrey Chen on Current M&A Developments in China.

- The slides from the presentation by Christiaan de Brauw and Reid Feldman on Supranational Business Entities and Merger Structures in Europe.
- The handout from the presentation by Peter Haver on IP Issues in International M&A.
- The questionnaire relating to the Subcommittee's Foreign Direct Investment project.
- The questionnaire and draft general report relating to the Subcommittee's Post-Closing Dispute Resolution in International M&A Deals project.
- A memorandum by Daniel Rosenberg expanding on his comments at the meeting on the recoverability of VAT on deal costs.
- Details of the Subcommittee's publications, future meetings, work-in-progress, and past program materials.

We look forward to seeing you in San Francisco.

Daniel P. Rosenberg
James R. Walther
Co-Chairs

Membership Subcommittee

The Membership Subcommittee welcomes your participation and your ideas! We want our membership to continue to grow as it has in the past year.

Indeed, the total membership of our Committee is at 3,828 compared to a 3,682 membership as of July 15, 2009. Although a 3% increase, we can do better! The Membership Subcommittee has recently assisted the Business Law Section in a formal expansion of ties with the Association for Corporate Growth (ACG), including efforts to create synergies and cross-sell our knowledge, contacts, and meeting opportunities. This effort

is ongoing and should hopefully create membership momentum. We encourage you to join your local ACG Chapter and also to spread the word of our Committee in that forum. Our ACG outreach should also enrich our membership with people with different backgrounds and experiences.

Since our April 2010 report, our membership is still throughout 49 states but went up from 45 to 47 countries. Our in-house counsel members have also grown from 366 to 377, while our “associate” members (non-lawyers) are back up at 305 from 296. A slight increase of 2% but it demonstrates we have been keeping our energy focused on those “associate” members.

As mentioned, we are working with the Business Law Section to renew relationships and expand and seek opportunities with other networking or trade groups. We are looking at the implementation of a user-friendly system to address the members’ needs in accessing information and contacts to add value to membership in the Committee. We are also exploring a partnership with the ABA’s Business Law Today relating to their new content-based website that will go live at the Annual Meeting in San Francisco – in particular looking for ways for our Committee to provide M&A related content.

The M&A Market Trends Subcommittee is still our largest group with 1,401 members. Here is a list of our other larger subcommittee and task force membership numbers:

Private Equity M&A	1,194
Acquisitions of Public Cos.	754
International M&A	779
Model SPA	682
M&A Jurisprudence	628

All of these subcommittees and task forces have seen their membership grow since

our April 2010 report. The continued systematic growth of approximately 3% - 4% for each clearly demonstrates the interest that they are able to raise with new trends, projects, and continued updates in the various fields. Furthermore, the Task Force on Distressed M&A continues to grow and is now comprised of 301 members.

Women continue to represent 17% of the total membership of the Committee. This is good news but there needs to be growth. Our Committee is dedicated to seeing this number increase and values your opinions and suggestions on how this could be achieved in the short term. We are also looking at working with the members of the Diversity Initiative to achieve this goal.

Also, to be noted, our Canadian members now represent 5% of all our members. This clearly shows that their committed involvement continues to grow and this is excellent news namely for cross-border deal flow.

We strongly encourage you to invite new people to join our Committee. We would also appreciate your involvement in our recruitment efforts and your ideas to enhance membership. If you see a need or have an idea, please contact any of us. As we become more and more diversified, let’s work together to bring new and interesting developments forward to energize our Committee!

Mireille Fontaine
Ryan Thomas
Tracy Washburn
Co-Chairs

M&A Jurisprudence Subcommittee

The M&A Jurisprudence Subcommittee has two working groups. The Annual Survey Working Group identifies and reports to the Committee on recent decisions of importance in the M&A area, and prepares the Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions, which is published annually in *The Business Lawyer*. The Judicial Interpretations Working Group examines and reports to the Committee on judicial interpretations of specific provisions of acquisition agreements and ancillary documents, looking not only for recent M&A cases of special interest, but also examining the entire body of case law on the specified type of provision. The work product of the Judicial Interpretations Working Group consists of memoranda summarizing our findings regarding those acquisition agreement provisions and M&A issues. The memoranda are posted in an extranet library, to which only M&A Jurisprudence Subcommittee members have access currently, but which we are preparing to make available to all members of the Committee.

The Annual Survey Working Group will meet in San Francisco on Saturday, August 7, from 8:30 a.m. until 9:30 a.m., in the Crown Room at the Fairmont Hotel, 24th floor. The Judicial Interpretations Working Group will meet immediately thereafter, from 9:30 a.m. until 11:00 a.m., in the same room. Dial-in information for the meetings will be sent to members of the Subcommittee.

Annual Survey Working Group

The seventh Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions was published in the February 2010 issue of *The Business Lawyer*. We thank all Committee members who have suggested cases. At the Committee meeting in San

Francisco, we will discuss the *Turner Broadcasting* case, which is summarized below. At the Working Group meeting, we will continue our efforts, begun at the Denver meeting, to select cases for inclusion in the 2010 annual survey.

We are asking all members of the Committee to send us significant judicial decisions for possible inclusion in the survey. Submissions can be sent by email either to Jon Hirschhoff at jhirschhoff@fdh.com or to Michael O'Bryan at mobryan@mofo.com. You may fax cases to Jon at (203) 325-5001 or to Michael at (415) 268-7522. Please state in your email or on the fax cover sheet why you believe the case merits inclusion in the survey.

The first criterion for inclusion is that the decision must involve a merger, an equity sale of a controlling interest, a sale of all or substantially all assets, a sale of a subsidiary or division, or a recapitalization resulting in a change of control. The second criterion is that the decision must (a) interpret or apply the provisions of an acquisition agreement or an agreement preliminary to an acquisition agreement (*e.g.*, a letter of intent, confidentiality agreement, or standstill agreement), (b) interpret or apply a state statute that governs one of the constituent entities (*e.g.*, the Delaware General Corporation Law or the Louisiana Limited Liability Company Law), (c) pertain to a successor liability issue, or (d) decide a breach of fiduciary duty claim. We are currently excluding cases dealing with federal law, securities law, tax law, and antitrust law. But if you feel a case dealing with an M&A transaction is particularly significant please send it, even if it does not meet the foregoing criteria.

To join our working group, please email either Jon Hirschhoff (jhirschhoff@fdh.com) or Michael O'Bryan (mobryan@mofo.com), or simply attend the working group meeting in Denver.

**Decision to be Discussed
at the Full Committee Meeting**

Turner Broadcasting System, Inc. v. McDavid, 2010 WL 1136274 (Ga. Ct. App. Mar. 26, 2010).

In *Turner Broadcasting System, Inc. v. McDavid*, a Georgia appellate court affirmed the trial court’s denial of defendant’s motion for judgment notwithstanding the verdict or, alternatively, a new trial, after a jury entered a \$281 million verdict for breach by Turner Broadcasting System, Inc. (“Turner”) of an oral agreement to sell certain assets to David McDavid (“McDavid”).

Background

In November 2002, Turner and McDavid began negotiating the sale of the Atlanta Hawks and Atlanta Thrashers sports teams. On April 30, 2003, the parties signed a letter of intent (“LOI”), which outlined the proposed terms and provided for a 45-day exclusive negotiating period. The LOI stated, among other things, that “neither party . . . [would] be bound . . . unless and until such party . . . has executed the Definitive Agreements.” The LOI expired at the end of the exclusivity period, with only the confidentiality provisions stated to survive.¹

The parties continued to negotiate. McDavid asked Turner about extending the LOI, but was told there was no need because they were “very, very close to a deal.”² Throughout June and July, the parties engaged in negotiations to address remaining outstanding issues. On a July 30 conference call, McDavid agreed to Turner’s proposed resolution of an outstanding tax issue on the condition that it would finalize the deal, to

which Turner’s CEO responded, “we have a deal.”³

In August, the parties worked to draft the purchase agreement and exhibits and identified “open issues.” During this time, Turner drafted a memo to its employees and prepared for a press conference to announce the deal. Turner also consulted with McDavid on management decisions for the Hawks. In mid-August, Turner proposed a simplified structure for the transaction, to which McDavid agreed, based on assurances that it would not change the deal and that Turner was “ready to close on the deal . . . made on July 30th.”⁴ On August 19, the board of directors of Turner’s parent company approved the McDavid deal.

On August 20, another bidder, Atlanta Spirit, LLC, expressed an interest in purchasing the assets from Turner, and Turner entered negotiations with Atlanta Spirit.

On September 12, Turner and McDavid “verbally reached a final agreement” on the remaining open items and Turner’s principal negotiator announced that “[t]he deal is done. Let’s get documents we can sign....”⁵ That same day, however, Turner signed an agreement with Atlanta Spirit. Three days later, Turner informed McDavid that Turner had sold the assets to another buyer. McDavid subsequently filed suit for breach of an oral contract and promissory estoppel.⁶

¹ *Id.* at 1, 4.

² *Id.* at 1.

³ *Id.* at 1, 2.

⁴ *Id.* at 2.

⁵ *Id.* at 2.

⁶ *Id.* at 2, 3. Although the jury found in favor of McDavid on both claims, the \$281 million judgment was entered on the breach of an oral contract claim and no judgment was entered on the promissory estoppel claim. The promissory estoppel claim was not discussed in the appellate court’s opinion.

Breach of Oral Contract

After an 8-week trial, the jury found for McDavid on the breach of oral contract claim, rejecting Turner's argument that the parties had not executed a final purchase agreement or agreed to all essential terms. On appeal, the Court noted that the determination as to whether an oral contract existed presented issues of fact for the jury, and held that there was sufficient evidence to support the verdict.

1. Parties' Intent to be Bound.

The Court noted that whether there was mutual assent to a contract was determined pursuant to an "objective theory," with a party's intent deemed to be "that meaning a reasonable man in the position of the other contracting party would ascribe to the first party's manifestation of assent, or that meaning which the other contracting party knew the first party ascribed to his manifestations of assent."⁷

Expressions and Conduct. The Court held that evidence of the parties' expressions and conduct supported a conclusion that each intended to be bound to the deal. Among such evidence were statements made by Turner representatives, such as "we have a deal" and "the deal is done." In addition, Turner's internal memo to employees, preparations for a press conference to announce the deal, and consultation with McDavid on management decisions supported a finding that Turner intended to be bound.

Letter of Intent. The Court acknowledged the LOI's express disclaimer to the effect that the parties would not be bound absent a written, signed definitive agreement. However, the LOI also provided for expiration on June 14 of all terms other than the confidentiality terms. The Court noted that if Turner had intended for the written agreement

requirement to have effect after the expiration of the LOI it could have provided for such survival in the same manner as it provided for the survival of the confidentiality provisions, and that Turner's failure to do so served as "some evidence contradicting Turner's claim that it maintained an objective manifestation to be bound only by a written agreement."⁸ Further, after expiration of the LOI, Turner had not communicated its intent to be bound only by written agreement. Given that fact, Turner's failure to renew the LOI upon McDavid's request suggested that an oral agreement was "not precluded."⁹

Contemplation of Written Instrument and Draft Integration Clause. Although it was clear that the parties intended to sign written agreements documenting the terms of their oral agreement, the Court held that the failure to sign such written agreements did not affect the validity of the oral agreement itself. While the contemplation of a subsequent written contract served as "strong evidence that [the parties] did not intend to be bound by a preliminary agreement," the jury was authorized to find the existence of a binding oral contract based on conflicting evidence of the parties' intent.¹⁰ In addition to the evidence discussed above relating to the parties' expressions and conduct and the LOI, such conflicting evidence included the merger clause contained in the draft agreements circulated among the parties and their legal counsel, which provided that the written agreement would "supersede all prior agreements, understandings and negotiations, both written and oral."¹¹ The Court stated that such language could be viewed as an acknowledgment of the possibility of a previous oral agreement.

⁷ *Id.* at 3.

⁸ *Id.* at 4.

⁹ *Id.* at 5.

¹⁰ *Id.* at 6.

¹¹ *Id.* at 5.

2. Agreement Upon All Material Terms.

To establish the existence of a binding contract, evidence must show that the parties had reached agreement on all essential terms. The Court held that the evidence presented on this issue by both parties was conflicting and presented a genuine issue of fact for the jury. The evidence supported the jury's determination that the parties had reached agreement on all material terms and that a binding oral agreement existed by September 12, when Turner's principal negotiator stated, "the deal is done."¹²

3. Statute of Frauds.

Turner argued that contracts pertaining to "complex, expensive business matters" should be enforceable only if in writing. However, the Court noted that the statute of frauds explicitly sets forth which contracts fall within its purview and that the contract at issue is not included therein. Thus, the statute of frauds claim was rejected.¹³

Damages

Turner further argued that the judgment should be reversed because there was no evidence that the condition for league approvals would have been met and, as such, McDavid should have been awarded only nominal damages. The Court rejected this claim, noting that the requirement for league approvals was a condition subsequent that each party had, by entering into the agreement, "impliedly promised to use ... best efforts" to fulfill.¹⁴ Turner's refusal to execute written agreements, which was a necessary first step in each party's ability to meet this condition, constituted a breach. Thus, McDavid's nonperformance of the league approvals requirement was caused

by Turner's breach and, as such, Turner's defense failed.¹⁵

Turner also argued that the judgment should be reversed because the \$281 million award was excessive and speculative. The Court held that the jury was properly instructed that the measure of damages should be the difference between the contract price and the fair market value of the assets at the time of breach. Each party presented conflicting evidence as to the valuation of the assets. Because the damages award fell within the range presented at trial, the Court found no basis for reversal of the judgment.¹⁶

Practical Implications

The outcome in this case is significant, as it held that Turner was bound by an oral agreement with McDavid, despite the language in the earlier LOI and Turner's assertion of its continued intent not to be bound except by written agreement. The opinion makes it clear that ultimately the question of whether the parties have mutually assented to an agreement is a question of fact.

- The outcome makes clear the importance of properly memorializing or expressing the intent to be bound only by written agreement. The fact that the LOI explicitly provided for survival of the confidentiality provisions, but not the writing requirement, following its expiration undermined Turner's position that the written agreement requirement was meant to continue in effect throughout negotiations. Thus, parties should be mindful of drafting LOI terms in such a way as to avoid the expiration of any conditions, such as a writing requirement, that affect whether the parties will be legally bound.

¹² *Id.* at 8.

¹³ *Id.* at 9.

¹⁴ *Id.* at 6, 10.

¹⁵ *Id.* at 10.

¹⁶ *Id.* at 12.

Alternatively, the party (or parties) not intending to be bound except by written agreement should manifest more objectively that intent.

- Also notable was the Court's statement that the merger clause in the draft agreements could be construed as recognition that an oral contract may exist prior to the execution of a definitive agreement. While a merger clause is helpful in establishing that the final written agreement takes precedence over any previous agreements, in the event that such an agreement is drafted but never executed, it can have the unwanted effect of supporting the validity of any such prior agreement, whether written or oral.
- The Court's imposition of a "best efforts" obligation to fulfill the conditions to closing also is significant.

Judicial Interpretations Working Group

The Judicial Interpretations Working Group has thus far completed memoranda summarizing our findings regarding the judicial interpretation of the following: (i) financial statement representations; (ii) no undisclosed liabilities representations; (iii) full disclosure ("10b-5") representations; (iv) material adverse change clauses; (v) survival clauses and contractual statutes of limitations; (vi) tortious interference claims in M&A transactions; and (vii) attorney-client privilege and conflicts issues in M&A transactions. Currently we have working drafts of memoranda on the following: (i) best efforts/reasonable efforts clauses; (ii) earn-out provisions; (iii) exclusivity and standstill provisions/agreements; (iv) choice of law provisions; (v) bring-down conditions; (vi) no third-party beneficiaries provisions; (vii) non-reliance provisions; and (viii) rescission claims based on fraud when indemnification is stated to be the sole remedy. We also have working group teams in various stages of

preparation of five memoranda regarding additional acquisition agreement provisions and M&A issues. The completed memoranda and working drafts are posted in an extranet library, to which only M&A Jurisprudence Subcommittee members have access at this time.

Our primary project is to create for members of the Committee an online research library of memos on acquisition agreement provisions and M&A issues. Our goal is to launch the library in 2011.

We welcome all interested Committee members to join our Working Group. We have a virtually unlimited pool of topics to work on, so the Judicial Interpretations Working Group is a good way to become involved in the Committee. Extensive transactional experience is not necessary, so this Working Group is perfect for younger Committee members.

The Judicial Interpretations Working Group met during the ABA Spring Meeting in Denver. During the meeting we had a spirited discussion of the memo on exclusivity agreements prepared by John Houston, and the memos on best efforts clauses and earnout provisions, which were prepared by Arthur Wright. We also discussed the architecture of and functionality issues concerning the internet library.

As indicated above, the San Francisco meeting of the Judicial Interpretations Working Group will be held on Saturday, August 7, from 9:30 a.m. until 11:00 a.m., in the Crown Room at the Fairmont Hotel, 24th Floor. We plan to discuss the papers on (i) non-reliance provisions, being authored by Pat Leddy and Joe Kubarek; (ii) no third-party beneficiary provisions, being authored by Frederic Smith; and (iii) bring-down conditions, being authored by Brian North. We will also discuss a revision of Arthur Wright's paper on earnouts that we reviewed in Denver. In addition, we will discuss some of the other memoranda in

progress, and our plans for rolling out our online library.

To join our working group, please send an email to either Scott Whittaker (swhittaker@stonepigman.com) or Jim Melville (jcm@kskpa.com), or simply attend the working group meeting in San Francisco.

Jon T. Hirschhoff
Subcommittee Chair

Michael G. O'Bryan
Chair, Annual Survey Working Group

Scott T. Whittaker
James C. Melville

Co-Chairs, Judicial Interpretations
Working Group

M&A Market Trends Subcommittee

Thank you to everyone who attended our meeting in Denver in April. At that meeting, Mark Danzi provided an overview of how the statistics in the 2009 Private Target M&A Deal Points Study change when you compare sellers with financial (or other dominant) backing to those without such backing. We also heard from Stephen Kotran, who discussed a report prepared by Practical Law Company entitled "Reverse Break-up Fees and Specific Performance: Remedies for Buyer Breach." In addition, Rick Lacher and Jennifer Muller of Houlihan Lokey updated the Subcommittee on the state of the M&A market.

The members of the M&A Market Trends Subcommittee continue to be busy on our various deal point studies. Hal Leibowitz has launched the preparations for the 2010 Strategic Buyer/Public Company Target M&A Deal Point Study, and Mark Danzi, John Clifford, Reid Feldman, and Freek Jonkhart are in the process of finalizing the 2010 Financial Seller Supplement, 2010 Canadian Deal Points Study, and 2010 European Deal Points Study, respectively.

Our next meeting will be held in San Francisco on Sunday, August 8, from 9:00 a.m. until 10:30 a.m. At that meeting, we will hear from the following:

- Jennifer Muller will discuss updated data on the state of the M&A market.
- Reid Feldman and Freek Jonkhart will discuss certain data points from the 2010 European Private Target M&A Deal Points Study.
- John Clifford will discuss certain data points from the 2010 Canadian Private Target M&A Deal Points Study.
- Hal Leibowitz will discuss certain data points related to two-step transactions from the upcoming 2010 Strategic Buyer/Public Company Target Deal Point Study.
- Mark Morton will discuss recent trends in Delaware litigation involving two-step deals.

The dial-in number and passcode for the meeting for those of you who cannot attend in person is as follows:

Domestic: (866) 646-6488
International: (707) 287-9583
Passcode: 1183276306

We look forward to seeing you in San Francisco.

Jim Griffin
Jessica Pearlman
Co-Chairs

Private Equity M&A Subcommittee

The Private Equity M&A Subcommittee met in Denver on Friday, April 23. At the gathering, the Subcommittee received materials and discussed events and developments related to the Private Equity and M&A markets generally during the past 6 - 12 months. The

Subcommittee was joined by a number of guest speakers, and there was a panel discussion on “The Current State of the Private Equity Market” that reviewed the latest market trends, data, and developments. Panelists included the following: Rick Lacher, Managing Director, Houlihan Lokey; Shawn G. Hessing, National Managing Partner – Private Equity, KPMG; Jerry Sturgill, Senior Advisor, Headwaters|MB; and Jay Marshall, Managing Director, AlixPartners. The Subcommittee meeting was well-attended, and the Subcommittee thanks all attendees and participants for contributing to the session.

John K. Hughes
Chair

Programs Subcommittee

The Committee is sponsoring two programs and a Committee Forum at the ABA Annual Meeting in San Francisco. The Committee is also co-sponsoring a program with the Cyberspace Law Committee. We hope you will join us.

What if International M&A Deals Go Sour? Lessons to be Learned for Drafting Dispute Resolution Clauses

Friday, August 6
8:00 a.m. - 10:00 a.m.

This program will focus on the issues to consider when drafting a dispute resolution clause for a share purchase or asset purchase agreement in international M&A deals. Based on the results from a survey conducted of over thirty countries on data regarding dispute resolution, the panelists will begin by examining the kinds of disputes which are the most likely to arise in international M&A transactions. The program will then focus on the best methods to deal with such disputes, drawing on the diversity and expertise of the panelists. Finally, the panelists will illustrate a practical approach on how to draft an arbitration clause. The program will be

moderated by Katrien Vorlat. Additional panelists will be Jean-Pierre Fierens, Vladimir V. Khvalei, William H. Knull, Guy Harles, and Alfredo L. Rovira.

The Revised Model Stock Purchase Agreement: What’s New and Exciting and What Got Left on the Cutting Room Floor!

Saturday, August 7
10:30 a.m. - 12:30 p.m.

The second edition of the Model Stock Purchase Agreement (first published in 1995) will be published this summer. This session will be led by members of the Task Force that revised the agreement and will highlight changes from the first edition, including the introduction of seller responses. Robert Harper and Murray Perelman will co-chair this program. Additional speakers will be Martha Anderson, Bruce Cheatham, Thomas Thompson, and Dennis White.

Committee Forum – M&A in the Alternative Entity Universe: How the Choice of Entity Affects Deal Negotiations, Fiduciary Standards, and the Rules of Contract Interpretation

Sunday, August 8
3:00 p.m. - 4:00 p.m.

Immediately following the full Committee meeting, Mark Morton will moderate a presentation on alternative entities and M&A. Although corporations remain the dominant players in M&A, alternative entities play an important role in certain deal structures (for example, private equity) and in certain industries (for example, energy). The panel will discuss the guiding principles of alternative entities – when (and why) they should be used, the legal issues raised by the use of alternative entities and the extent to which business planners, in practice, have been able to successfully eliminate corporate fiduciary concepts from alternative entity agreements – and how those principles are likely to impact

your M&A practice in the coming years. The panelists will discuss how the choice of form of entity can impact the negotiations, price, and risks of M&A transactions. We are fortunate to have the participation of the Honorable Chief Justice Myron T. Steele in this program. The panel will also include Thomas Mason, Vice President and General Counsel of Energy Transfer Partners, L.P., a publicly-traded MLP, and Eric Feldman.

**Deciphering Due Diligence:
Tackling the IT Issues That Can
Cripple a Business Transaction**

Friday, August 6
2:30 p.m. - 4:30 p.m.

The Committee will also join the Cyberspace Law Committee in co-sponsoring a program on IT issues in due diligence. Operational efficiency is a driving factor in any merger or acquisition. That cannot be achieved without fully anticipating, understanding, and addressing the information technology on which the companies depend. A mere due diligence checklist will not adequately identify and address complex issues such as cloud computing practices and heightened concerns of data privacy and security. This program will enable practitioners on both sides of a transaction to identify and address the lurking IT issues that could seriously cripple the deal or ultimately undermine the expected operational efficiency gains. This program will be co-chaired by William Denny and Thomas Laudise (both of the Cyberspace Law Committee). Participating as a panelist from our Committee will be Edward Deibert.

The Programs Subcommittee has begun developing programs for the 2011 stand-alone meeting in Miami. The Subcommittee is also undertaking the development of “webinars” to improve the accessibility of Committee content and programs. Additional updates on this effort will be available at the Miami meeting.

The Programs Subcommittee is interested in receiving suggestions for programs, Committee Forums, and the new webinars. We encourage you to forward suggestions for topics to any of the members of our Subcommittee: Yvette Austin Smith at yaustinsmith@crai.com, David Albin at dalbin@fdh.com, or Bob Copeland at rcopeland@sheppardmullin.com.

David I. Albin
Robert G. Copeland
Yvette Austin Smith
Co-Chairs

**COMMITTEE MEETING
MATERIALS**

**ABA ANNUAL MEETING
FAIRMONT / INTERCONTINENTAL
SAN FRANCISCO, CA
AUGUST 6 - 8, 2010**

**SCHEDULE OF MEETINGS AND OTHER
ACTIVITIES**

Friday, August 6, 2010

Program – What if International M&A Deals Go Sour? Lessons to be Learned for Drafting Dispute Resolution Clauses

8:00 a.m. – 10:00 a.m.
Fairmont Hotel
Pavillion Room, Lobby Level

Program – Deciphering Due Diligence: Tackling the IT Issues That Can Cripple a Business Transaction

2:30 p.m. – 4:30 p.m.
Fairmont Hotel
French Room, Lobby Level

Houlihan Lokey Cocktail Reception for Women in M&A

5:00 p.m. – 7:00 p.m.
Fairmont Hotel
Pavillion Room, Lobby Level

Saturday, August 7, 2010

Annual Survey Working Group of the M&A Jurisprudence Subcommittee

8:30 a.m. – 9:30 a.m.
Fairmont Hotel
Crown Room, 24th Floor
Domestic Dial-In: (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 9881146337

Task Force on Distressed M&A

9:00 a.m. – 10:30 a.m.
Fairmont Hotel
California Room, Mezzanine Level
Domestic Dial-In: (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 1183276306

Judicial Interpretations Working Group of the M&A Jurisprudence Subcommittee

9:30 a.m. – 11:00 a.m.
Fairmont Hotel
Crown Room, 24th Floor
Domestic Dial-In: (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 9881146337

Program – The Revised Model Stock Purchase Agreement: What’s New and Exciting and What Got Left on the Cutting Room Floor!

10:30 a.m. – 12:30 p.m.
Fairmont Hotel
Pavillion Level, Lobby Level

Private Equity M&A Subcommittee

12:30 p.m. – 2:30 p.m.
Fairmont Hotel
Gold Room, Lobby Level
Domestic Dial-In: (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 1473302150

Acquisitions of Public Companies Subcommittee

2:30 p.m. – 4:30 p.m.
Fairmont Hotel
Gold Room, Lobby Level
Domestic Dial-In: (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 1473302150

Meeting of the Subcommittee and Task Force Chairs and Vice Chairs

4:30 p.m. – 5:30 p.m.
Pavilion Room, Lobby Level

Committee Reception and Dinner

Reception: 7:00 p.m.
Dinner: 8:00 p.m.
One Market Restaurant
1 Market Street
42nd Floor (Spectacular View)
San Francisco, CA 94105

Sunday, August 8, 2010

M&A Market Trends Subcommittee

9:00 a.m. – 10:30 a.m.
Fairmont Hotel
California Room, Mezzanine Level
Domestic Dial-In: (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 1183276306

International M&A Subcommittee

10:30 a.m. – 12:30 p.m.
Fairmont Hotel
California Room, Mezzanine Level

Domestic Dial-In: (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 1183276306

Task Force on Dictionary of M&A Terms

10:30 a.m. – 12:00 p.m.
Fairmont Hotel
Crystal Room, Lobby Level

Domestic Dial-In: (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 4329591052

Full Committee Meeting

12:30 p.m. – 3:00 p.m.
Fairmont Hotel
Grand Ballroom, Grand Ballroom Level

Domestic Dial-In: (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 9210079161

Committee Forum – M&A in the Alternative Entity Universe: How the Choice of Entity Affects Deal Negotiations, Fiduciary Standards, and the Rules of Contract Interpretation

3:00 p.m. – 4:00 p.m.
Fairmont Hotel
Grand Ballroom, Grand Ballroom Level

Domestic Dial-In: (866) 646-6488
International Dial-In: (707) 287-9583
Conference Code: 9210079161

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American Bar Association, Section of Business Law, Committee on Mergers and Acquisitions. The views expressed in the Committee on Mergers and Acquisitions Newsletter are the authors' only and not necessarily those of the American Bar Association, the Section of Business Law or the Committee on Mergers and Acquisitions. If you wish to comment on the contents, please write to the Committee on Mergers and Acquisitions, Section of Business Law, American Bar Association, 321 N. Clark Street, Chicago, Illinois, 60610.



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