

M&A NUGGET-PALOOZA

Mergers & Acquisitions Committee, Houston Bar Association
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Nugget Playlist

1. Who's your daddy, now?: Navigating the post-closing attorney-client relationship
2. Son, you're in Texas now and "best efforts" means a whole lotta *nada* (*Kevin M. Ehringer Enterprises, Inc. v. McData Services Corp.*)
3. The 10b-5 Flip
4. What's good for the goose is good for the gander – 10b-5 fair play
5. B-b-but, I didn't sign that stinking merger agreement...
6. Is it what you say, you don't say, or how you say it? – The fine art of sandbagging examined
7. RTM triggers an assignment: Say What? (*Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH*)
8. When the rubber hits the road – what's really happening in the world of post closing indemnity claims
9. A Heartwarming Tale of Gaseous Lawyers
10. The GAAP Trap – No Undisclosed Liabilities

Who's your daddy, now?

- Can target's counsel represent former owners, directors, and officers against target in a post-closing dispute?
- When control of a corporation passes to new management so goes the attorney-client relationship and the power to waive the attorney-client privilege
 - Also likely applies if buyer acquires substantially all assets and business as a going concern.
 - New owners/management has right to control attorney-client communications and may waive privilege on communications with former management
 - Increased likelihood that target counsel would be disqualified
- Parties may vary the general rule by agreement
 - Seller should retain the privilege for communications in connection with negotiations of the acquisition
 - Target's counsel should secure advance waivers from buyer to represent target's shareholders, directors, and officers

Who's your daddy, now?

SAMPLE PROVISIONS

[Stock Purchase Agreement]

Representation. The Buyer waives, and agrees to cause each of the Company and its Subsidiaries to waive, any conflicts that may arise in connection with (i) ***** LLP ("Prior Company Counsel") representing any one or more of the [Private Equity and Management] Sellers after the Closing Date or (ii) the communication by Prior Company Counsel to the Sellers, in any such representation or otherwise, of any fact known to such Prior Company Counsel, including in connection with any negotiation, arbitration, mediation, litigation or other proceeding in any way related to a dispute with either the Buyer or the Company or any of its Subsidiaries following the Closing Date, and the disclosure of any such fact in connection with any process undertaken for the resolution of such dispute.

Who's your daddy, now?

SAMPLE PROVISIONS (cont'd)

[Merger Agreement]

(a) Buyer and MergerCo waive and will not assert, and each agrees to cause the Surviving Corporation and each of its Subsidiaries to waive and to not assert, any conflict of interest arising out of or relating to the representation, after the Effective Time (the "Post-Closing Representation"), of the Stockholders' Representative, any Stockholder or other officer, employee or director of the Company or any Company Subsidiary (any such Person, a "Designated Person") in any matter involving any litigation, arbitration, mediation or other proceeding), by any legal counsel set forth on Schedule 11.06(a) that is currently representing the Company or any Company Subsidiary in connection with the Transaction Agreements or any other agreements or transactions contemplated hereby and thereby (the "Current Representation").

(b) Buyer and MergerCo will not assert, and each agrees to cause the Surviving Corporation and each of its Subsidiaries to not assert, any attorney-client privilege with respect to any communication between any legal counsel and any Designated Person occurring during the Current Representation in connection with any Post-Closing Representation in connection with a dispute with Buyer, and following the Closing, with the Surviving Corporation or any of its Subsidiaries, it being the intention of the parties hereto that all such rights to such attorney-client privilege and to control such attorney-client privilege shall be retained by such Designated Person; provided that the foregoing agreement of non-assertion and acknowledgement of retention shall not extend to any communication not involving the Transaction Agreements or any other agreements or transactions contemplated hereby and thereby, or to communications with any Person other than the Designated Persons and their advisers; provided, further that nothing in this Section 11.06 shall be construed as a waiver of any attorney-client privilege.

Son, you're in Texas now...

10b-5 Flip

"10b-5"/Full Disclosure Representation

"10b-5" Formulation

No representation or warranty or other statement made by [Target] in this Agreement, the Disclosure Letter, any supplement to the Disclosure Letter, the certificates delivered pursuant to Section 2.7(a) or otherwise in connection with the Contemplated Transactions contains any untrue statement or omits to state a material fact necessary to make any of them, in light of the circumstances in which it was made, not misleading.

Full disclosure Formulation

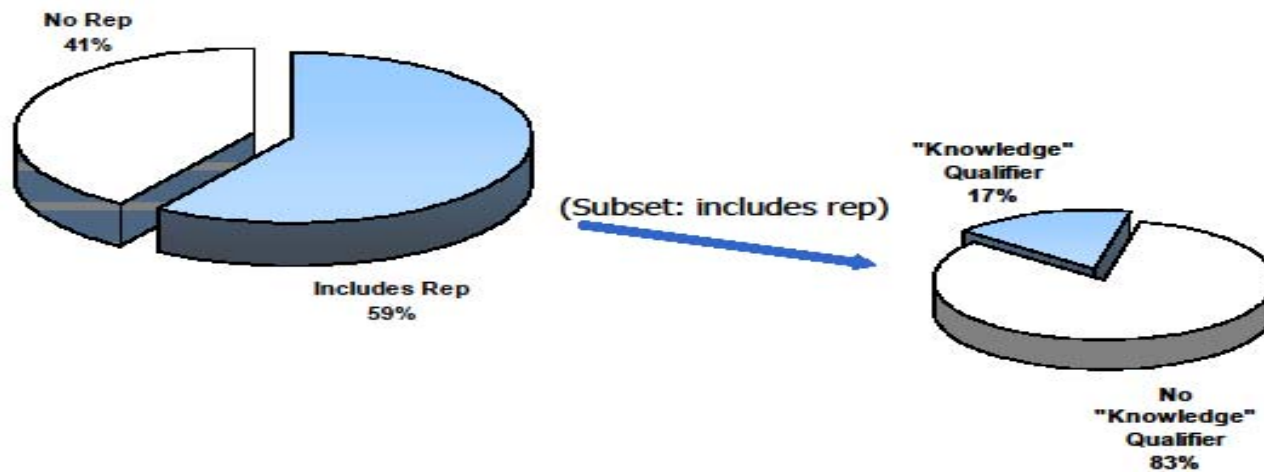
Seller does not have Knowledge of any fact that has specific application to Seller (other than general economic or industry conditions) and that may materially adversely affect the assets, business, prospects, financial condition or results of operations of Seller that has not been set forth in this Agreement or the Disclosure Letter.

(ABA Model Asset Purchase Agreement)

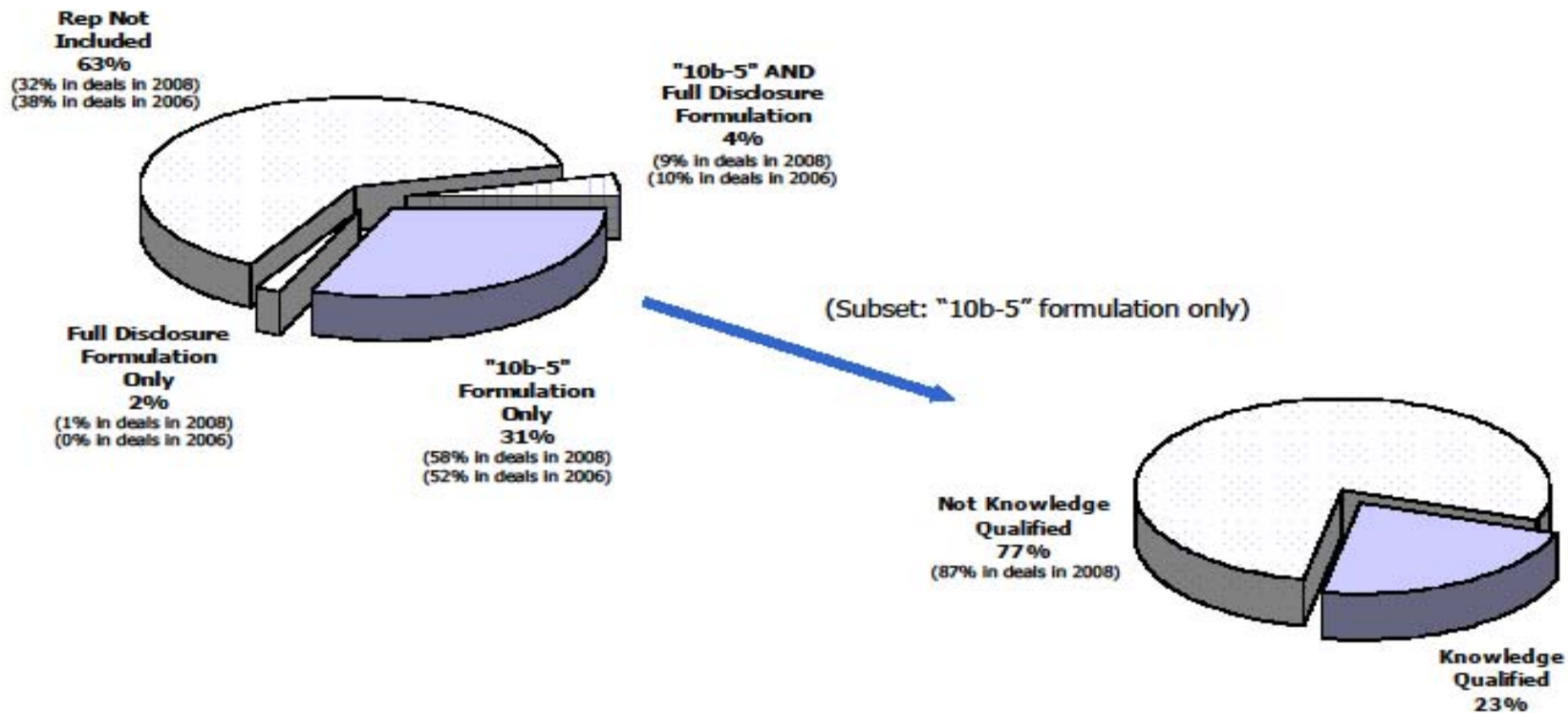
A Long, Long Time Ago...2005

Target's Representations and Warranties

"Full Disclosure" Representation



"10b-5"/Full Disclosure Representation



MSA Market Trends Subcommittee, Mergers & Acquisitions Committee, <http://apps.americanbar.org/idch/committee.cfm?com=CL560003>

2011 Private Target Study, slide 51
Release #2: 17Jan12

What's good for the goose is good for the gander

B-b-but, I didn't sign no stinking merger agreement...

- Insomnia Moment: Can stockholders who don't sign the deal documents or vote in favor of the deal really be bound by the actions of a stockholders' representative appointed in a merger agreement to handle disputes regarding earn-outs, other post-closing adjustments or indemnification claims?
- No Problemo... *Aveta Inc. v. Cavallieri*, C.A. No. 5074-VCL (Del. Ch. Sept. 20, 2010), non-signatory stockholders are bound as a matter of corporate law at least for...
 - appointment of a stockholder representative to resolve PPA disputes
 - clear and express contractual mechanism for determining merger consideration based on facts ascertainable outside of the agreement
- Limits to Delegatable Authority
 - can't be "impermissibly vague" or "constitute an improper abdication, or otherwise give rise to a breach of fiduciary duty" (*Aveta*)
 - could not broadly cede the determination of the merger price to the acquirer *Nagy v. Bistricher*, 770 A.2d 43 (Del. Ch. 2009)
 - could not delegate to an individual unfettered discretion to determine the merger consideration. *Jackson v. Turnbull*, 1994 WL 174668 (Del. Ch. Feb. 8, 1994)

The fine art of sandbagging examined...

“Sandbagging” (pro-sandbagging)

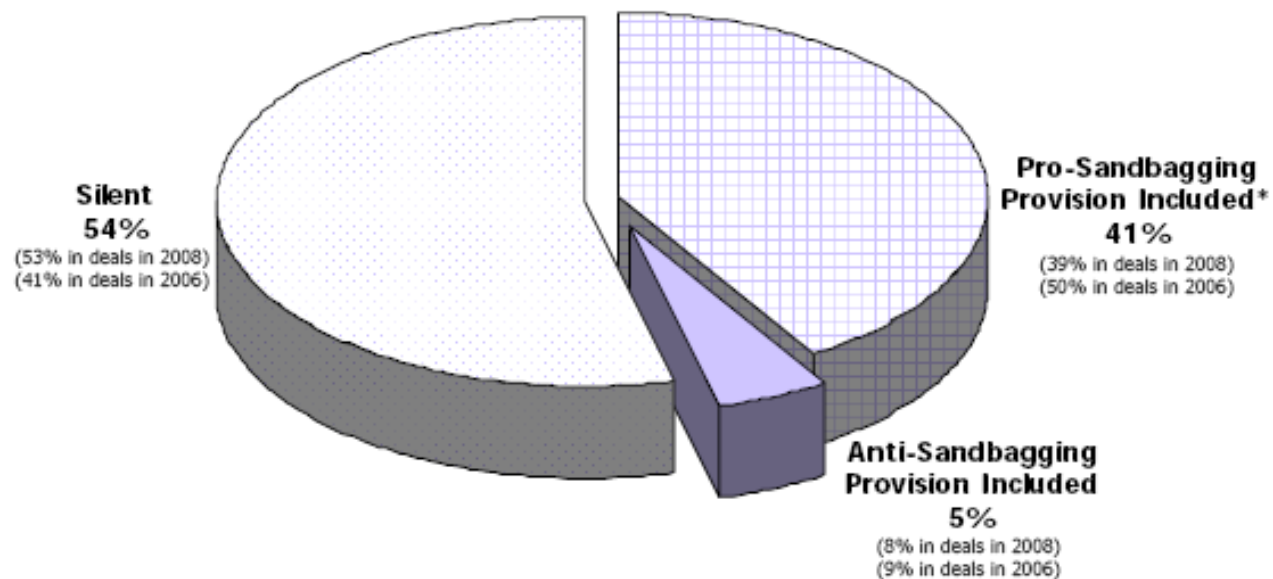
The right to indemnification, payment, reimbursement, or other remedy based upon any such representation, warrant, covenant, or obligation **will not be affected by... any investigation conducted or any Knowledge acquired at any time**, whether before or after the execution and delivery of this Agreement or the Closing Date, with respect to the accuracy or inaccuracy of, or compliance with, such representation, warranty, covenant, or obligation.

(ABA Model Stock Purchase Agreement, Second Edition)

"Sandbagging"
(anti-sandbagging provision)

No party shall be liable under this Article for any Losses resulting from or relating to any inaccuracy in or breach of any representation or warranty in this Agreement **if the party seeking indemnification for such Losses had Knowledge of such Breach before Closing.**

"Sandbagging"



* Includes one deal with a hybrid provision that prohibits sandbagging only with respect to certain information prepared at the request of Buyer, but that otherwise allows for sandbagging. For purposes of this Study "pro-sandbagging" is defined by excluding clauses that merely state, for example, that Target's representations and warranties "survive Buyer's investigation" unless they include an express statement on the impact of Buyer's knowledge on Buyer's post-closing indemnification rights.

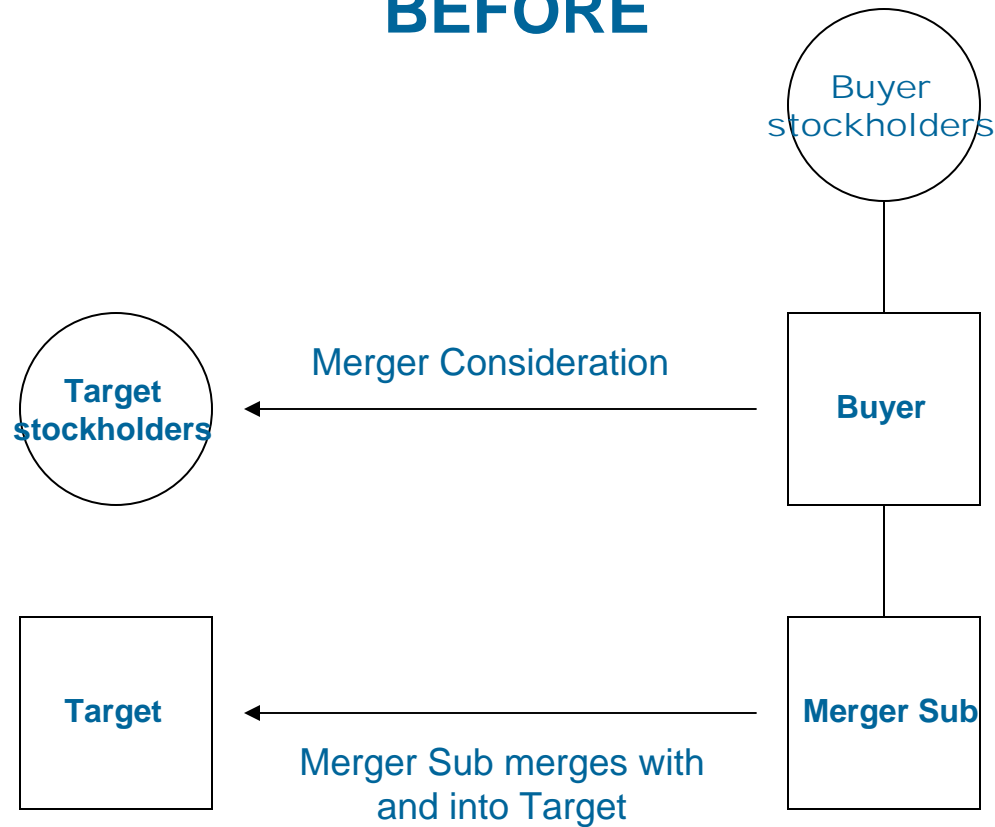
One Way to Get Out of the Sandtrap?

The Buyer, on its own behalf and on behalf of the Buyer Indemnified Parties, acknowledges that the Sellers have preserved any rights they may have at law or equity to prove and establish that, in connection with any claim by the Buyer or the Buyer Indemnified Parties for a breach of a representation, warranty or covenant of the Company or the Sellers, that the Buyer had Knowledge of such breach (or the facts giving rise to such breach) at or prior to the date hereof and, as such, indemnification should not be available or would be inequitable, notwithstanding the fact that there is no specific provision in this Agreement expressly setting forth such rights.

The Sellers, on their own behalf and on behalf of the Seller Indemnified Parties, acknowledge, that the Buyer has preserved any rights it may have at law or equity to prove and establish that, in connection with any claim by the Buyer or Buyer Indemnified Parties for a breach of a representation, warranty or covenant of the Company or the Sellers, the Buyer or the Buyer Indemnified Parties had the right to rely on such provisions as made and that no Knowledge of the Buyer of such breach (or the facts giving rise to such breach), whether before or after the date hereof, should make such indemnification unavailable or inequitable, notwithstanding the fact that there is no specific provision in this Agreement expressly setting forth such rights.

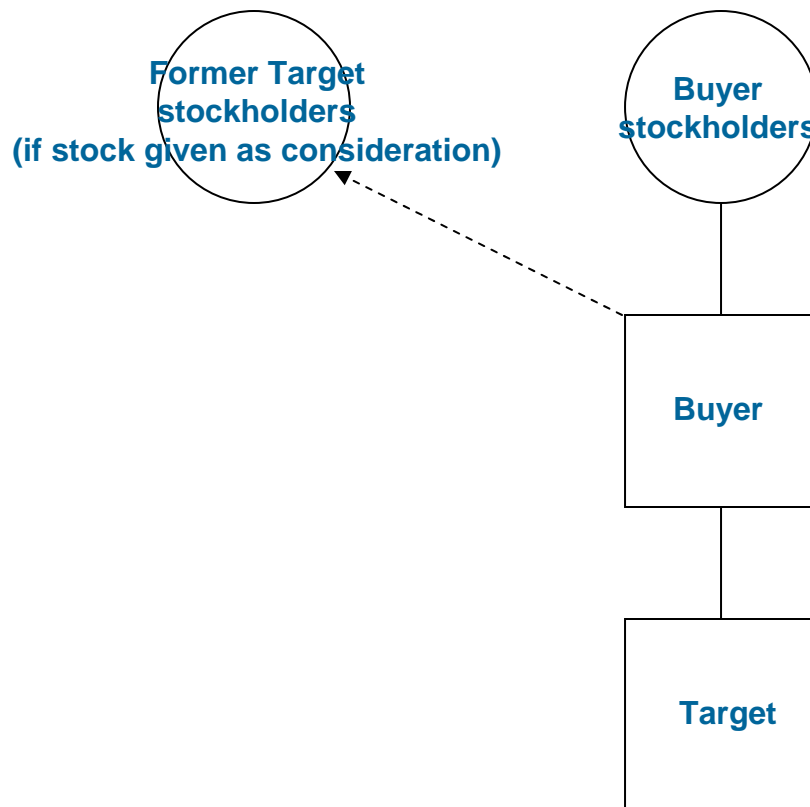
RTM triggers an assignment: Say What?

BEFORE



RTM triggers an assignment: Say What?

AFTER



Key Points

- Unanimous vote of target stockholders not required
- Third party consents to anti-assignment provisions not required except...

RTM triggers an assignment: Say What?

- *Meso Scale Diagnostics, LLC v. Roche Diagnostics GMBH*, C.A. No. 5589-VCP (Del. Ch. April 8, 2011)

- Facts:

- Roche and BioVeris were parties to a series of agreements providing for the license of certain patents owned by BioVeris

- License in question:

“Neither this Agreement nor any of the rights, interests or obligations under this Agreement shall be assigned, in whole or in part, **by operation of law** or otherwise by any of the parties without the prior written consent of the other parties...”

- In 2007, Roche acquired BioVeris through an RTM without first seeking consent from Meso Scale.

- Post-closing, Roche shot down BioVeris (laid off all BioVeris employees, vacated company’s facilities, and told customers that product lines being discontinued)

RTM triggers an assignment: Say What?

- Decision:
 - An RTM alone does not constitute an assignment
 - But RTM may constitute an assignment by operation of law where the plaintiff presents evidence that more than a mere change of ownership occurred, e.g., where buyer converted the target into a shell company immediately following the merger
- Nuggets
 - Forward mergers (where target disappears) are assignments by operation of law
 - No Delaware case has squarely addressed the issue of whether a RTM could be viewed as an assignment by operation of law under any circumstances
 - Deal structuring and diligence should include diligence buyer's post-closing plans
 - Plundering and pillaging are bad facts
 - But court didn't rule on the merits (motion to dismiss case)
 - For buyer: When in doubt, get the consent
 - For contracting parties: use express COC provision

Rubber Hits the Road...

Gaseous Lawyers

Gaseous Lawyers..

Allen v. Devon Energy Holdings, L.L.C., 2011 WL 3208234 (Tex.App.–Hous. [1 Dist.] July 28, 2011)

Facts:

- , Allen (Plaintiff) and Rees-Jones (Defendant) were law partners.
- Rees-Jones left law to go into the “awl bidness.”
- In 1994, Allen invested \$700 and pledged at \$34,000 CD for an 8% interest in Chief Holdings to explore the Barnett Shale
- In 2004, Allen sold his interest back to Chief for \$8.2M
- In 2006, Rees-Jones sold Chief for \$2.2B.
- Allen alleges fraudulent inducement (including reliance on extra-contractual statements by Rees-Jones) seeking \$100M more than what Chief paid in redemption

Gaseous Lawyers..

***The Defense:** Disclaimers and release provisions in the redemption agreement barred Allen's fraud claims by negating reliance or materiality as a matter of law*

- Redemption Agreement's Holy Trinity: (1) independent investigation; (2) general mutual release; and (3) merger clause

- The "independent investigation" paragraph provided that: (1) Allen based his decision to sell on his independent due diligence, expertise, and the advice of his own engineering and economic consultants; (2) the provided appraisal and the reserve analysis were estimates and other professionals might provide different estimates; (3) events subsequent to the reports might "have a positive or negative impact on the value" of Chief; (4) Allen was given the opportunity to discuss the reports and obtain any additional information from Chief's employees as well as the valuation firm and the reserve engineer; and (5) the redemption price was based on the reports regardless of whether those reports reflected the actual value and regardless of any subsequent change in value since the reports. The independent investigation paragraph also included mutual releases "from any claims that might arise as a result of any determination that the value of [Chief]...was more or less than" the agreed redemption price at the time of the closing.

Gaseous Lawyers..

Court's Decision:

- The disclaimer did not clearly and unequivocally disclaim Allen's reliance on representations of Chief and Rees-Jones.
- The redemption agreement failed to state that the only representations that had been made were those set forth in the agreement.
- It did not contain a broad disclaimer that no extra-contractual representations had been made and that no duty existed to make any disclosures
- The broad language releasing "all claims, demands, rights, liabilities, and causes of action of any kind or nature" did not specifically release fraudulent inducement claims.
- The merger clause stated that the contract is the "final integration of the undertakings of the parties hereto and supersedes all prior agreements and undertakings," but did not include clear and unequivocal disclaimer of reliance on prior representations.
- Finally, it did not include a specific "no liability" clause stating that the party providing certain information will not be liable for any other person's use of the information

Gaseous Lawyers..

Drafting Tips

- Don't bum rush; back-and-forth process helps
- Don't use provisions that appear to be boilerplate, and tailor the limitation of liability provision for each transaction in a way that shows that it has been specifically negotiated.
- Expressly disclaim reliance on (i) any representations that are not embodied in the four corners of the agreement; (ii) any statements by any representative of any of the parties whose liability is limited; or (iii) information in the dataroom (if such is the case).
- Expressly state that no reliance has been placed on any prior representations.
- Expressly state that fraud in the inducement claims are being released.

The GAAP Trap

"No Undisclosed Liabilities" Representation

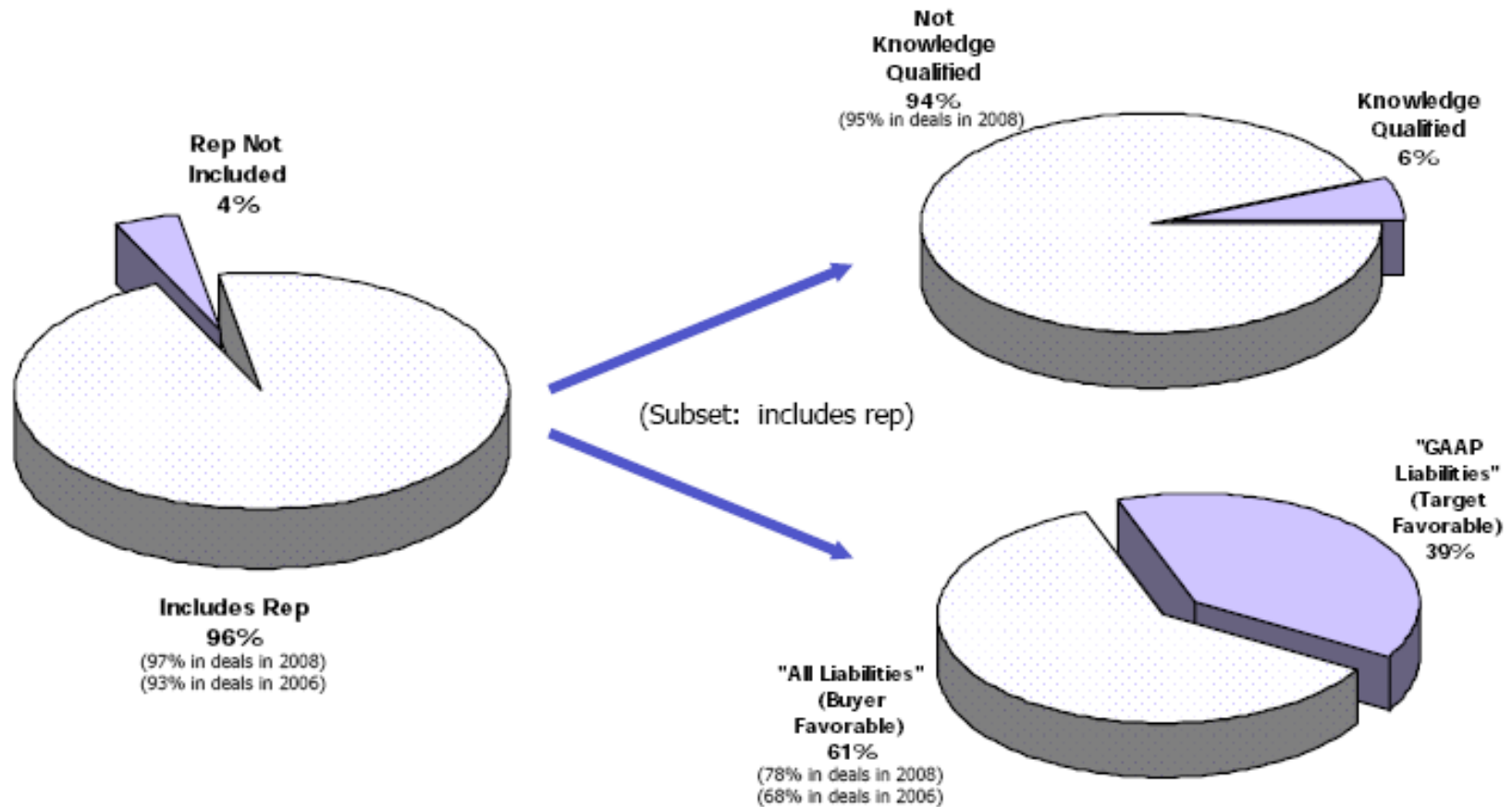
Buyer-Favorable Formulation

Target has no liability except for liabilities reflected or reserved against in the Balance Sheet or the Interim Balance Sheet and current liabilities incurred in Target's ordinary course of business since the date of the Interim Balance Sheet.

Target-Favorable Formulation

Target has no liability of the nature required to be disclosed in a balance sheet prepared in accordance with GAAP except for...

"No Undisclosed Liabilities" Representation



Disclaimers

This presentation is intended merely to provide a general introductory overview of certain trends and developments affecting M&A transactions. This presentation is not intended to provide a complete analysis of the matters covered, but rather is intended to be used and referred to in conjunction with a more comprehensive oral presentation regarding those matters. Accordingly, there are potentially important exceptions and qualifications that are not reflected in this presentation. This presentation does not necessarily reflect the personal views of the speakers or their firms.

The sample provisions included in these materials are intended only to serve as examples of hypothetical provisions. All provisions must be carefully tailored to reflect the specific terms of the transactions to which they relate; accordingly, it may be necessary to make substantial modifications to these sample provisions before they can be used in the context of any proposed transactions.

The reader should not attempt to operate motor vehicles while reading this presentation or pondering any implications therefrom.