M&A Finance – Topics to be Covered

• Topics to be covered:
  – Evolution of deal protection provisions in acquisition agreements since the financial crisis and implications for debt financing
  – Overview of financing related provisions in the acquisition agreement
  – Selected terms of debt commitment papers
  – Case study: Apollo Tyre / Cooper Tire merger

• Scope:
  – Our presentation today covers terms typically found in mid- to large-cap acquisition transactions
  – We will address issues that arise in leveraged transactions involving private equity sponsors as well as debt financed transactions by strategic acquirors
Evolution of Deal Protection Provisions and Implications for Debt Financing

• Prior to the 2005-2007 leveraged buyout boom, most private equity transactions had financing conditions to closing, to protect buyer in the event its debt financing is not available at closing
• Competition among financial sponsors and with strategic buyers led to elimination of financing conditions
• The resulting potential exposure for financial sponsors led to two developments:
  – Increased pressure to conform conditions in debt commitment papers to those in the acquisition agreement
  – Introduction of a “reverse break fee” to cap buyer’s damages in the event buyer’s debt financing is not available at closing
Evolution of Deal Protection Provisions and Implications for Debt Financing

- What is a reverse break fee?
  - In contrast to the “break fee,” which is a fee agreed between buyer and seller to be paid by seller if seller does not close the transaction under certain circumstances, the “reverse break fee” is a fee paid by buyer if the transaction does not close under certain circumstances.
  - In early reverse break fee deals, reverse break fee was sole remedy for any breach by buyer.

- Creates “pure option” for the buyer to purchase the target.
  - There were a number of examples at the end of the LBO boom where buyers simply paid the reverse break fee to get out of the deal or used the threat of doing so to renegotiate the purchase price.
    - Examples include Cerberus/United Rentals and GSO/Reddy Ice.
Evolution of Deal Protection Provisions and Implications for Debt Financing

• Remedies provision in the acquisition agreement has evolved to include specific performance in situation where debt financing is available and all the other conditions are satisfied
  – This allows seller to force buyer to draw equity and debt financing (provided debt financing is available)
  – If debt financing is not available, sellers’s damages are capped by the reverse break fee

• In some deals, a two-tier fee is agreed, where the lower fee is payable for a financing failure and the higher fee is payable for other breaches by buyer

• Reverse break fees have become market standard for private equity buyers and are increasingly employed by strategic acquirors that require financing

• In some deals, reverse break fee does not apply to willful breaches by the buyer
What are Buyers’ and Sellers’ Primary Concerns in Negotiating Financing Provisions in Acquisition Agreements?

• Seller’s Concerns:
  – Buyer’s debt financing must be available at closing
  – Deal closes if financing is available, and if it is not, through no fault of seller, seller must have adequate remedies

• Buyer’s Concerns:
  – Must get target’s cooperation to complete debt financing and be assured there are no circumstances where buyer is obligated to close and debt financing is not available
  – Needs sufficient time to market its debt financing to potential investors
  – If debt financing is not available and buyer is nevertheless obligated to close, it wants to make sure its damages are limited to the reverse break fee
How are Seller’s Concerns Addressed?

• Limit circumstances in which buyer can claim seller has breached a covenant (entitling buyer to terminate without damages) by drafting the covenants as clearly and narrowly as possible

• Minimize conditions in buyer’s debt commitment papers or make sure they are consistent with the acquisition agreement

• Have a clear specific performance remedy if conditions to debt financing are met, so seller can sue buyer to require buyer to enforce the debt commitment against the banks

• Make reverse break fee large enough to deter buyer from colluding with the banks to make the financing unavailable
  – Reverse break fees average 3-5% though can go to 10% or more of deal value
How are Buyer’s Concerns Addressed?

• Conditions in the debt commitment papers should correspond to the conditions to its obligation to close the acquisition
• Appropriate covenant from seller to assist with its financing
• Flexibility to replace or amend debt financing
• Reverse break fee should be only remedy for financing failure
• Reduce reverse break fee and make clear it is only payable if seller is not in breach and closing would otherwise occur but for the financing failure
What are the Financing Related Provisions in the Acquisition Agreement?

- Buyer’s representations about its debt financing
- Buyer’s covenant to obtain debt financing and pursue alternative financing if original financing becomes unavailable
- Seller’s covenant to assist with buyer’s financing
- Timing of closing and the “Marketing Period”
- Protections for buyer’s debt financing sources
Financing Related Provisions in the Acquisition Agreement

- **Buyer’s representations about its debt financing**
  - Typically will cover the following:
    - buyer has delivered complete and accurate copies of its debt commitment papers (including fee letter with economic terms redacted)
    - there are no conditions to funding of debt financing other than as set forth in the debt commitment letter
    - debt commitments, together with other available funding, will be sufficient to allow buyer to consummate all the transactions contemplated by the acquisition agreement
  - These representations are not usually controversial or highly negotiated, but are important because they provide seller with assurance that all terms and conditions of the debt financing were disclosed
Financing Related Provisions in the Acquisition Agreement

- *Buyer’s covenant to obtain debt financing and pursue alternative financing if original financing becomes unavailable*
  - This covenant prevents buyer from intentionally not consummating the debt financing to get out of the deal and pay the reverse break fee
  - In most deals seller can get a specific performance remedy to force buyer to consummate the debt financing provided banks are prepared to fund
Financing Related Provisions in the Acquisition Agreement

• **Buyer’s covenant to obtain debt financing and pursue alternative financing if original financing becomes unavailable (continued)**
  - This covenant also prevents the buyer from amending the debt commitment letter without seller’s consent
    • scope of these consent rights is negotiated
    • buyers will almost always be able to amend debt commitments to join additional lenders without seller consent, but sellers should be cautious about allowing in sponsor debt affiliates
    • buyers will try to get as much flexibility as possible (including to change the terms of, replace or restructure the debt financing) to be able to respond to changing market conditions
Financing Related Provisions in the Acquisition Agreement

• *Buyer’s covenant to obtain debt financing and pursue alternative financing if original financing becomes unavailable (continued)*
  
  – This covenant will also often, but not always, include language requiring the borrower to “enforce its rights under the Debt Commitment Letter” and further “including by bringing legal proceedings against the Debt Financing Sources”
  
  • this language gives teeth to the seller specific performance remedy and can be one of the most contentious financing related provisions
  
  • many private equity sponsors and strategics will object to this language on the basis that they do not want to damage their banking relationships by suing their banks
Financing Related Provisions in the Acquisition Agreement

• *Buyer’s covenant to obtain debt financing and pursue alternative financing if original financing becomes unavailable* (continued)
  – Covenant usually states that if original debt financing becomes unavailable, buyer is required to seek alternative financing
    • buyer wants to ensure that it cannot be compelled to obtain financing with worse economic terms
    • seller wants to ensure that any replacement financing will still provide enough funds to close and will not include additional conditions or otherwise delay the closing
Financing Related Provisions in the Acquisition Agreement

• **Seller’s covenant to assist with buyer’s financing**
  – In order to arrange the debt financing, buyer will need significant cooperation from seller
  – This covenant is either stated as a flat obligation or as a “reasonable best” or “commercially reasonable” efforts standard
  – Buyers are increasingly asking for extensive and detailed cooperation covenants and this creates risk for sellers – any material breach will give the buyer the right to walk away without paying the reverse break fee

• bond financed transactions present more risk for sellers as the level of financing assistance is greater
Financing Related Provisions in the Acquisition Agreement

• *Seller’s covenant to assist with buyer’s financing (continued)*
  
  – Items specifically required by the covenant include:
    
    • participating in lender meetings, rating agency presentations and bond offering road shows and assisting in the preparation of related documents (bank book, rating agency presentation and bond offering document)
    
    • furnishing the “Required Information” needed to start the “Marketing Period” (discussed below)
    
    • obtaining opinions and closing documents, including a solvency certificate from the target’s CFO and payoff letters and lien releases for the target’s debt
    
  – In addition, for a bond financed transaction, buyer will require additional information to meet SEC disclosure requirements as well as comfort letters from target’s auditors
Financing Related Provisions in the Acquisition Agreement

• *Timing of Closing and the “Marketing Period”*
  – Buyer is not obligated to close the transaction until the “Marketing Period” has run
  – Buyer and its lenders need time following the completion of customary marketing documents (bank book, bond offering memo) to market the loans and/or bonds to potential investors
  – The Marketing Period construct began in bond-financed deals, but has now migrated to bank-financed deals as well
  – Because the marketing period ties directly to whether or not the buyer is required to close, it is often the most heavily negotiated financing provision in the acquisition agreement
Financing Related Provisions in the Acquisition Agreement

• **Timing of Closing and the “Marketing Period” (continued)**
  – What is needed to start the Marketing Period?
    • delivery of “Required Information” (discussed in detail below)
    • satisfaction of some or all conditions to closing, including a bringdown of the target reps (including no “material adverse effect”), and no illegality or injunction blocking the transaction
    • in public deals will usually include stockholder vote although marketing in practice often starts well before the vote
    • buyers will seek to include additional conditions; e.g., compliance with covenants, obtaining HSR and other government or third party consents, etc.
    • Marketing Period in commitment papers often ends earlier than Marketing Period in acquisition agreement
Financing Related Provisions in the Acquisition Agreement

- **Timing of Closing and the “Marketing Period” (continued)**
  - “Required Information”
    - will include historical financial statements of the target (typically 3 years of audited financials and quarterly financials which in a bond deal, must be subjected to a SAS 100 review by the auditors)
    - for bond deals, buyers will also insist on getting all other information necessary to satisfy the requirements of Reg S-X and S-K for registered securities offerings; in addition, will require drafts of auditor’s “comfort letters” on the target’s financial statements
    - pro forma financial statements are also often included, but this is controversial since pro formas depend on information from both buyer and seller
    - buyer will insist on including other, non-financial information needed to complete the bank book or offering memo
Financing Related Provisions in the Acquisition Agreement

• **Timing of Closing and the “Marketing Period” (continued)**
  – The Marketing Period will run from 10 to 20 business days following the satisfaction of specified conditions, throughout which time:
    • auditors shall not have withdrawn any audit opinion covering financial statements included in the “Required Information” and target has not announced a restatement
    • at least for bond deals, buyers will usually insist in addition that “Required Information” must be “Compliant” throughout the Marketing Period
    • conditions required to start the Marketing Period remain satisfied
Financing Related Provisions in the Acquisition Agreement

- **Timing of Closing and the “Marketing Period” (continued)**
  - “Compliant” requirement typically includes the following:
    - the Required Information is sufficiently current to allow a registration statement containing such information to be declared effective on the last day of the Marketing Period and a comfort letter to be delivered
    - in addition, buyers often ask that the Required Information comply with Reg S-X and S-K and/or be true and correct in all material respects
      - this is often strongly resisted by sellers; it means that any adverse development that renders the target’s disclosure non-compliant with Reg. S-K or S-X or inaccurate or incomplete can stop the Marketing Period
      - sellers should argue that there is no analogous condition in the buyer’s debt commitment
      - buyers will argue that they cannot sell the debt and should not be required to pay reverse break fee in this situation.
Financing Related Provisions in the Acquisition Agreement

• *Protections for buyer’s debt financing sources*
  – In the aftermath of broken deal litigation following the financial crisis, banks became more focused on the risk of getting sued by sellers and started asking for certain protective provisions to be included in the purchase agreement to address two concerns:
    • claims by sellers that failure to fund amounted to tortious interference with the acquisition, giving the seller a direct claim against the financing sources
    • being sued by sellers in their home state in front of juries with the risk of significant damages awards
Financing Related Provisions in the Acquisition Agreement

- **Protections for buyer’s debt financing sources (continued)**
  - These protections are known as the “Xerox” provisions as they were first employed in the Xerox/ACS merger and typically include the following:
    - banks have no liability to seller/target, or the reverse termination fee is sole remedy against the banks for a failure of the financing
    - New York is the exclusive jurisdiction for any dispute and agreement by buyer and seller that they and their affiliates will not bring suit in any other jurisdiction
    - waiver of jury trial
    - banks are express third party beneficiaries of these provisions and they cannot be amended without banks’ consent
Selected Terms of Debt Commitment Papers

• Debt commitment papers consist of the following:
  – Commitment Letter and Term Sheet: sets forth the terms of the debt financing and *all of* the conditions precedent to the lenders’ obligation to fund the financing
  – Fee Letter: sets forth the fees to be paid to the banks and also the “market flex terms”; i.e., the terms of the deal the lenders have the right to change in order to syndicate the financing. In bond financed deals, the Fee Letter will also include the “Securities Demand” provision
  – Engagement Letter: only used in bond financed deals, provides for the engagement of the lead underwriters/arrangers for the bond financing
Selected Terms of Debt Commitment Papers

• Key focus of both buyers and sellers is to make sure the conditions to the debt financing line up as closely as possible to the conditions to the buyer’s obligation to close the acquisition

  • Standard Conditions to Debt Financing:
    – Execution of definitive financing and collateral documentation consistent with the term sheet(s) and filing to perfect liens
    – No “Material Adverse Change” (definition will usually match the acquisition agreement)
    – Accuracy of other reps in the acquisition agreement
    – Accuracy of “Specified Representations” in the credit agreement (cover basic corporate matters, enforceability, solvency and compliance with law (including OFAC and FCPA))
Selected Terms of Debt Commitment Papers

– Funding of equity commitment and consummation of acquisition in accordance with acquisition agreement
  • this condition gives lenders a veto over any changes to the acquisition agreement that are adverse to the lenders
– Delivery of historical financial statements of target and pro formas
– Delivery of bank/bond offering memorandum and passing of 10 – 20 business day Marketing Period following such delivery
– Delivery of customary closing documents, including a CFO’s solvency certificate, and opinions and payment of fees and expenses
Selected Terms of Debt Commitment Papers

- Areas of “daylight” between debt commitment conditions and acquisition agreement conditions:
  - Solvency condition and CFO certificate
  - Material adverse effect (“MAE”) condition
    - if there are any carveouts for actions taken at the direction of the buyer, lenders will often want to have approved such actions in order for them to be carved out of the MAE in the commitment letter
    - commitment letter should state that the MAE will be interpreted in accordance with the governing law of the acquisition agreement
  - Truth of “specified representations” including compliance with OFAC and FCPA
  - Closing documents
  - Buyers will want to cover these by cooperation covenant to the extent possible
Case Study – Apollo Tyre / Cooper Tire Acquisition

• Apollo Tyre entered into a merger agreement with Cooper Tire on June 12, 2013.

• Apollo planned to finance the purchase with a bond offering
  – Upon announcement of the transaction, Cooper’s Chinese JV partner objected and among other things blocked Cooper appointed managers from accessing the JV facility and obtaining financial information that was necessary for Cooper to comply with its SEC reporting requirements
  – Apollo and Cooper were aware of the likely negative reaction of the Chinese JV partner and had specifically carved this out of the “material adverse effect” condition

• Poor market reception to the deal, as reflected in drop in its stock price, led Apollo to consider its options for getting out and also trying to avoid paying the $112.5 million reverse break fee
Case Study – Apollo Tyre / Cooper Tire Acquisition

- The financing assistance covenant gave Apollo a path to get out of the deal without paying the reverse break fee (which allowed them to renegotiate price)
  - Cooper believed it had delivered all the “Required Information” based on its second quarter financial statements
  - Apollo knew that Cooper would be unable to deliver the third quarter financial statements due to lack of access to its Chinese JV
  - The merger agreement required Cooper to deliver its third quarter financial statements to Apollo by November 14, 2013 (if the transaction had not yet closed)
  - Then arbitrator of the union dispute ruled that Apollo and Cooper must enter into a new collective bargaining agreement with the union before the transaction closed; this allowed Apollo to delay the closing beyond November 14th
Case Study – Apollo Tyre / Cooper Tire Acquisition

• Apollo claimed that Cooper’s “Required Information” could not be “Compliant” until the union negotiations were complete

• Apollo simply needed to “slow walk” the union negotiations until the November 14 deadline passed – after that date, Cooper would not be able to comply with the “Required Information” and “Marketing Period” provisions of the merger agreement and therefore Apollo would not be required to close and would not owe the reverse break fee
  – Apollo had to walk a fine line; it would not be excused from its obligation to close if its own conduct caused a condition to fail to be satisfied

• Apollo believed it would not be required to close the deal and asked Cooper to reduce the purchase price by $2.50/share

• Cooper sued for specific performance to force Apollo to resolve the union contract prior to the November 14th deadline

• Delaware judge found that Apollo was not in breach, as ample time remained prior to the December 31st drop dead date to resolve the union issue

• Dispute continues on whether Cooper is entitled to the reverse break fee
Case Study – Apollo Tyre / Cooper Tire Acquisition

• Lessons:
  – Both parties to the agreement were aware of the potential issues with the union in the US and with the Chinese JV partner and specifically carved them out of the MAE clause, placing these risks on Apollo
  – Financing provisions in the merger agreement shifted this risk back to Cooper in a way that neither of the parties could have anticipated but which may allow Apollo to get out of the deal without paying a reverse break fee
  – Apollo repeatedly used the “Required Information” provision to delay the start of the Marketing Period by making requests for additional information
  – While Cooper’s lack of access to its own financial information is an extremely unusual circumstance, sellers need to be aware of risks of more common financial statement issues, such as restatements, can have for deal certainty
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Aaron F. Adams

Aaron F. Adams is a partner in the New York office of Gibson, Dunn & Crutcher. He is a member of the Firm’s Global Finance Practice Group. He represents borrowers and lenders in connection with senior credit facilities, note offerings, mezzanine financings, asset-based financings and other banking and credit matters.

Mr. Adams earned his Juris Doctor in 2000 from the Boston University School of Law, where he was a member of the *Boston University Law Review*. He received a Master of Arts degree from The University of Chicago in 1996 and a Bachelor of Arts degree in Philosophy with honors from Swarthmore College in 1994. Prior to joining Gibson, Dunn & Crutcher, Mr. Adams was an associate in the New York office of Cravath, Swaine & Moore from 2000 to 2006.

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Joerg H. Esdorn

Joerg Esdorn, a partner in Gibson, Dunn & Crutcher’s New York office and a Co-Chair of the Firm’s Global Finance Practice Group, received the equivalent of a master’s degree in process engineering from the Technical University of Munich, Germany, in 1981 and his J.D. from The University of Chicago Law School in 1985. He focuses on the representation of providers of capital and issuers/borrowers in leveraged finance transactions, convertible debt offerings and restructurings. His experience includes leveraged loans, high yield notes, mezzanine debt, convertible debt as well as exchange offers and consent solicitations, DIP loans and exit financings. He has extensive experience with financings in the TMT, healthcare, industrial, energy and other sectors.


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Darius J. Mehraban

Darius Mehraban is a partner in the New York office of Gibson, Dunn & Crutcher. He is a member of the Firm’s Global Finance Practice Group, focusing on loan and other debt financing transactions, as well as swaps and other derivative transactions. Mr. Mehraban’s debt finance experience includes syndicated credit facilities for leveraged and investment grade borrowers, project financings and equipment financings, and acquisition credit facilities, as well as high-yield and convertible notes and leasing and structured finance transactions. Mr. Mehraban has represented borrowers, issuers, arrangers and lenders in many types of secured and unsecured financing structures in a wide range of industries, with particular concentrations in the energy, natural resources and aerospace sectors. Mr. Mehraban’s derivative transaction representations for a range of international and domestic clients cover many types of equity derivative structures, as well as commodity, currency and interest hedging and total return and synthetic debt products.

Mr. Mehraban earned his Juris Doctor cum laude from the University of Michigan Law School in December of 1996, where he was an editor of the Michigan Law Review. He received his Bachelor of Arts degree in English Literature and Philosophy with high honors from the University of Michigan in 1994. Prior to joining Gibson, Dunn & Crutcher, Mr. Mehraban was an associate in the New York office of Simpson Thacher & Bartlett from 1999–2005 and in the New York office of Dewey Ballantine from 1997–1999.
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