

State of the Art: Critical Developments and Trends in M&A

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Agenda

Issue 1 – Letters of Intent: Disclaiming a Partnership or Joint Venture

Issue 2 – Delaware Statutory Changes

Issue 3 – Representation and Warranty Insurance

Issue 4 – Purchase Price Adjustment Issues

Issue 5 – Fraud Exceptions

Issue 6 – Litigation Closing Conditions

Issue 7 – Damage Waiver Provisions

Issue 8 – Drafting Indemnification Provisions for Third Party Claims



ISSUE 1

Letters of Intent

Challenges in disclaiming a partnership or joint venture in light of
Energy Transfer Partners v. Enterprise Products



Energy Transfer Partners v. Enterprise Products

- Parties entered into non-binding LOI for a joint venture
- After execution of LOI, parties publicly announced the JV, formed joint working teams, jointly met with potential customers and jointly solicited bids with respect to the proposed project
- One party subsequently withdrew from the project and later announced it would pursue a similar project with a new counterparty
- Jilted party sued, claiming a partnership had been formed and breach of fiduciary duty
- Typical disclaimer language in LOI was not controlling on whether a partnership had been formed
- Partnership law question v. contractual interpretation question
- Formation of a general partnership depends on facts and circumstances



ETP v. Enterprise Products Litigation Key Takeaways

- Closely monitor external communications related to the proposed deal to ensure that they do not create the impression that there is a partnership
- In the binding portion of the LOI, include language that:
 - explicitly disclaims the existence of a partnership or joint venture
 - explicitly waives fiduciary duties
 - mutually waives the right to sue for breach of fiduciary duties or to claim the existence of a partnership
 - mutually waives the right to a jury trial



ETP v. Enterprise Products Litigation

Key Takeaways

- Do not state in the LOI that the parties have agreed to some terms, subject to further documentation, or that the parties have reached “an agreement in principle”
- All post-LOI written communications should reiterate the non-binding, non-partnership nature of the relationship
- Do not contribute assets to a joint account prior to execution of a definitive agreement



ISSUE 2

Delaware Statutory Changes

Recent amendments to Delaware General Corporation Law § 251(h)



Background

- Since its enactment, Section 251(h) has been popular in the deal community, used in most Delaware-governed tender offers
- Questions as to the statute's scope led to the enactment of clarifying amendments, which took effect on August 1, 2014

Clarifying Amendments

- Permissive: Merger agreements may “permit” or “require” the merger to occur under Section 251(h), allowing the parties flexibility to abandon the merger and pursue a merger using a different statutory provision
- Removal of “Interested Stockholder” Prohibition: Intended to eliminate uncertainty regarding the use of tender and support, voting and rollover agreements with stockholders owning 15% or more of target’s stock
- Counting of Shares Otherwise Owned or Irrevocably Accepted: Stock counted towards the threshold required for completion of the second-step merger includes stock already owned by the acquiring corporation and stock irrevocably accepted for purchase
- Tender Offer Can Exclude Certain Target and Acquiror-Owned Stock: Offer can exclude stock owned by target, the acquiror, any parent of the acquiror (if wholly owned) and any subsidiaries of the foregoing



ISSUE 3

Representation and Warranty Insurance

The Current Transaction Risk Market

State of the Market

- Increased popularity
 - significant growth in North America during last 4 years
- Insurance market well-developed
- Target transactions
 - transactions between \$25M and \$2B
 - individual insurers generally cap at \$50M; however, limits available up to \$350M+ per deal by stacking policies
 - generally, no restrictions on industry sector
- Advantages
 - Addresses road-blocks to deal completion
 - Eases collection concerns
 - Bankruptcy of sellers
 - Jurisdictional concerns (i.e., cross-border)
 - Disbursed seller group
 - Enhances bid in a competitive auction situation
 - Attracts best offer by maximizing indemnification
 - Expedites distribution of sale proceeds (“clean exit”)
 - Protects key relationships by collecting against policy rather than sellers



Basics

- Can cover all representations and warranties or only specified representations and warranties
- Pricing generally 2% to 4% of the limit of liability
 - Nonrefundable underwriting fee
- Retention generally 1% to 3% of transaction value
- Policy period typically matches survival period in acquisition agreement or can extend survival period up to 6 years
- Common structure is to cap indemnification at a reduced escrow equal to 1% - 2% of purchase price for 12 months and supplement indemnity with insurance

Key Negotiated Terms

- Definition of “Losses”
 - should mimic definition in purchase agreement
 - insured should seek to have defense costs, fees and expenses incurred included
- Exclusions
 - known losses will always be excluded but should limit “knowledge” to “actual knowledge” of a narrowly defined group of individuals
 - will not cover purchase price adjustments or breaches of covenants
 - deal specific exclusions
- Subrogation
 - insurers will generally request a right to be subrogated to any rights of recovery in respect of a loss that the insured may have
 - the insured will want to focus on exclusions and what actions the insured may be required to take to secure rights/remedies of insurer
 - in a buy-side policy, should require the insurer to waive subrogation rights against seller and the target company absent fraud



ISSUE 4

Purchase Price Adjustment Issues

Tips for drafting dispute resolution provisions in purchase price adjustment clauses

Providing Clarity

- Arbitration or Appraisal?
 - No general rule about how a PPA determination will be reviewed
 - Make clear whether a PPA determination will be binding or reviewable
- Contract Has Both PPA and General Arbitration Clause
 - If the PPA is intended to stand alone, parties should expressly carve it out of the general arbitration clause
 - If PPA disputes are intended to be arbitrated under the general arbitration clause, the contract should say so explicitly



Accountants

- Nature of Potential Disputes: If the PPA entails non-accounting determinations, consider appointing an arbitrator
- Specify the grounds upon which the accountant may opine
- Mandatory or Discretionary Engagement: PPAs often provide that either party “may engage” an accounting firm to resolve a dispute. This leaves unclear whether the other party can refuse to join the engagement



ISSUE 5

Fraud Exceptions

Fraud exceptions to exclusive remedies provisions and
indemnification limitations

Indemnification and Exclusive Remedy Provisions

- Provisions intended to limit liability for breaches of representations and warranties
- Standard carve-out for fraud may take several forms
 - fraud
 - intentional fraud
 - willful misconduct
 - willful misrepresentation
 - gross negligence
- Tort concepts introduce uncertainty and can allow uncapped, extra-contractual claims to proceed against the seller despite the specifically negotiated limits on recourse for breach of contractual representations and warranties
- Fraud is not necessarily limited to deliberate lying
 - can encompass making a representation with insufficient knowledge of its accuracy or recklessness
 - impact on allocation of risk
- Governing law matters
- Instead of using a vague term like “fraud,” spell out exactly what is intended



ISSUE 6

Litigation Closing Conditions

Traps to avoid when drafting litigation closing conditions



Clause Limited to Litigation in Which a Restraining Order or Injunction Has Been Issued

There shall be no effective Law, injunction, writ or preliminary restraining order or any order of any nature issued by a Governmental Entity of competent jurisdiction to the effect that the transactions contemplated by this Agreement may not be consummated as provided herein



Clause Covering Threatened or Pending Litigation Challenging the Deal

No proceeding or lawsuit shall have been commenced or overtly and directly threatened by any third party which presents a reasonable likelihood of enjoining or obtaining material damages in respect of the transactions contemplated by this Agreement



Clause Limited to Litigation Pending by a Governmental Authority

No proceeding or lawsuit shall have been commenced or overtly and directly threatened by any Governmental Entity which presents a reasonable likelihood of obtaining an injunction, writ or preliminary restraining order



ISSUE 7

Damage Waiver Provisions

Unintended consequences of waiving consequential damages

Possible Elimination of All Damages Caused by a Particular Breach

- Consequential damages can be interpreted to include direct damages in some situations
- Consider a buyer who purchases a company expecting an above-market profit on certain of the selling company's contracts based on representations in the purchase agreement regarding such contracts' validity and enforceability
 - If the representations turn out to be untrue, the resulting losses could be labeled consequential "lost profits"
 - A boilerplate waiver of consequential damages could deny the buyer recovery for the breach



Solutions to Using the Poorly Understood Term of “Consequential Damages”

- Contract law generally limits damages to those that were reasonably foreseeable by the parties
- If the concern is the extent of exposure to damages, set a cap on the amount of damages, rather than including a waiver of certain types of damages
- Buyers should resist waivers of “incidental” damages
- Buyers should resist waivers of “lost profits” damages
- List the types of damages permitted, rather than damages waived



ISSUE 8

Drafting Indemnification Provisions for Third Party Claims

The definition of third party claims and its impact on the survival of a claim

- Agreements should clearly identify what constitutes an indemnifiable third party claim
 - When legal action is threatened or commenced by a third party, or
 - When the indemnified party becomes aware of a potential third party claim
- Agreements should set forth when an indemnified party is allowed to preserve a claim beyond the claim survival period
 - This may also impact when it is appropriate to release funds from escrow
- It is good practice for the purchase agreement to specify exactly what a notice must contain in order to preserve an indemnification claim
- Parties should not rely on “placeholder language” in a notice in order to preserve their indemnification claim



QUESTIONS?

Professional Profile



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Robert B. Little is a partner in Gibson, Dunn & Crutcher's Dallas office. He is a member of the firm's Mergers and Acquisitions, Capital Markets, Energy and Infrastructure, Private Equity, Securities Regulation and Corporate Governance, Global Finance, and Corporate Transactions practice groups. Mr. Little serves on the Gibson Dunn Hiring Committee and Partnership Evaluation Committee and is the hiring partner for the Dallas office.

Consistently recognized as a "Rising Star" by *Texas Monthly* and as one of *The Best Lawyers in America*®, Mr. Little's practice focuses on corporate transactions, including mergers and acquisitions, securities offerings, joint ventures, investments in public and private entities, and commercial transactions. He also advises business organizations regarding matters such as securities law disclosure, corporate governance, and fiduciary obligations. In addition, he represents investment funds and their sponsors along with investors in such funds. Mr. Little has represented clients in a variety of industries, including energy, retail, technology, transportation, manufacturing, and financial services.

In 2013, Mr. Little was the youngest corporate M&A lawyer in Texas to receive a ranking by *Chambers USA: America's Leading Lawyers for Business*. *Chambers* noted that Mr. Little "attracted a raft of glowing comments, with one interviewee noting: 'He is very personable and one of the best lawyers in negotiations at keeping the relationship with the other side good. He is a fantastic lawyer with great commercial and interpersonal skills.'" *Chambers* 2014 observed that he has a "remarkable grasp of legal issues" and "provides outstanding legal work." *Texas Lawyer* named Mr. Little to its 2013 list of "Legal Leaders on the Rise" recognizing Texas lawyers under age 40 whose accomplishments distinguish them from their peers. In addition, *Dallas Business Journal* named Mr. Little to its list of Who's Who in Energy 2013, featuring "the movers and shakers of the energy industry."

Mr. Little previously served as a law clerk to The Honorable Patrick Higginbotham of the U.S. Court of Appeals for the Fifth Circuit. He received his law degree in 1998 with highest honors from The University of Texas School of Law, where he was named a Chancellor and a member of Order of the Coif and served as Articles Editor of the *Texas Law Review*. He also holds a B.A. from Baylor University, where he graduated *summa cum laude* in 1995.

Professional Profile



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Melissa Persons is an associate in the Dallas office of Gibson, Dunn & Crutcher LLP. She is a member of the firm's Corporate Department and practices in the Capital Markets, Mergers and Acquisitions, and Energy and Infrastructure Practice Groups.

Ms. Persons' practice focuses on corporate and securities transactions, including mergers and acquisitions, private equity investments, and public and private capital markets transactions.

Ms. Persons' representative transactions include: counsel to Woodbine Holdings (an E&P company) in its sale to a Chinese buyer for approximately \$560 million; Provista in its acquisition of Horizon Resource Group; TEAK Midstream in its sale of Eagle Ford Shale assets for \$1 billion; Chief E&D Holdings in its sale of Marcellus Shale assets to PVR Partners for \$1 billion; Saddle Butte Pipeline in its sale of Bakken Shale assets to Targa Resources \$950 million; GAIL India in its joint venture with Carrizo Oil & Gas; Meritage Midstream Services in its sale of Eagle Ford Shale assets; and Cardinal Midstream in its acquisition of Woodford Shale Assets for \$268 million (includes matters handled prior to joining Gibson, Dunn & Crutcher LLP).

Ms. Persons received her law degree in 2009 from the SMU Dedman School of Law, where she was a member of the Dean's List. While in law school, she served as Articles Editor of the *SMU Law Review*. She earned her Bachelor of Science in chemistry, with a concentration in biochemistry, from Duke University in 2005.

A member of the Dallas Bar Association, Ms. Persons is admitted to practice in Texas and before the U.S. District Court for the Northern District of Texas.