

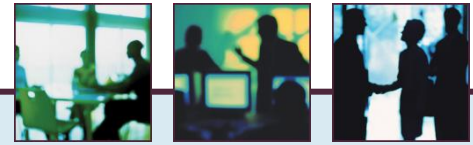


ACC AMERICA
Association of Corporate Counsel
Delaware Valley (DELVACCA) Chapter

DELVACCA 2008 * 2010 Chapter of the Year

DELVACCA presents: Avoiding Boilerplate Blunders
in Mergers and Acquisitions

AKIN GUMP
STRAUSS HAUER & FELD LLP

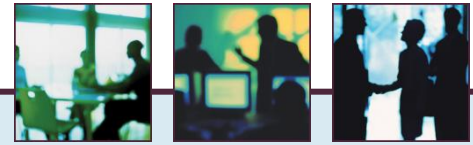






9 Provisions Likely to Cause Blunders

- Assignment
- Merger/Integration
- Forum Selection
- Governing Law
- Specific Performance
- Survival of Representations and Warranties
- Waiver of Jury Trial
- Severability
- Notice



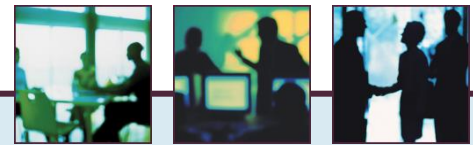
Assignment



Assignment

“No party may assign this Agreement or any of its rights hereunder without the prior written consent of the other party.”

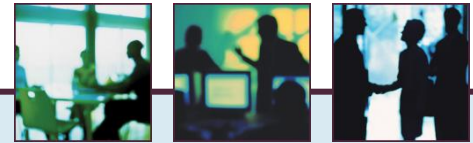
- Does this provision prohibit an assignment of rights?



Assignment

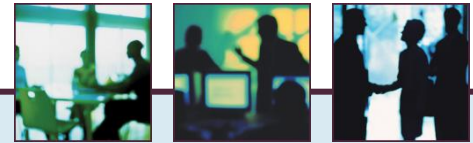
“No party may assign this Agreement or any of its rights hereunder without the prior written consent of the other party.”

- *Majority of courts construe this as merely taking away a party’s right to assign its rights, not the power to assign*
- *Consequently, if a party exercises its power to assign, it is in breach (because it violated the anti-assignment provision), but the assignment is still effective*
- *The assigning party may be liable for damages, but often there are no damages*



Assignment – Power to Assign

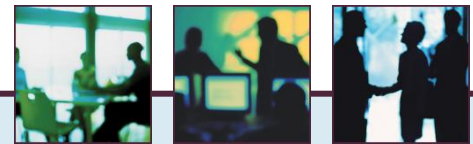
*To eliminate a party's power to assign, add magic words:
“and any purported assignment by a party without the
other party's consent will be null and void.”*



Assignment

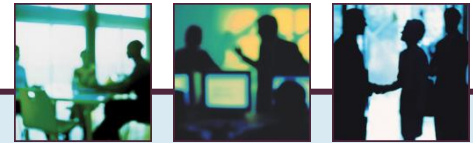
“No party may assign this Agreement or any of its rights hereunder without the prior written consent of the other party, and any assignment by a party without the prior written consent of the other party will be null and void.”

- Party A delegates its obligations to a third party
- Does the provision prohibit this?



Assignment

- Many courts will construe a general provision, such as *“no party may assign this Agreement,”* as prohibiting delegation, but
- *To avoid doubt, specifically refer to “obligations”*
- Even if a party is allowed to transfer obligations, the delegating party generally is not relieved of liability unless there is a novation



Assignment

“No party may assign this Agreement or any of its rights, interests or obligations hereunder without the prior written consent of the other party, and any assignment by a party without the prior written consent of the other party will be null and void.”

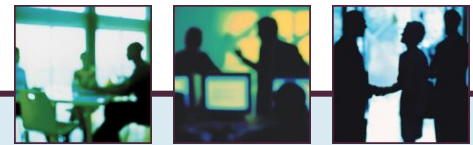
- Party A merges into another company
- Does the provision prohibit the merger?



Assignment - Mergers

- Many courts narrowly construe anti-assignment provisions as prohibiting only voluntary assignments
- *To prohibit other types of assignments, add “by operation of law, merger or otherwise”*
- May need to be even more explicit for some states (including TX and CA) that have statutes providing that mergers do not constitute assignments or transfers

* See, e.g. TEX. BUS. ORGS. CODE ANN. §10.008(a) and CAL. CORP. CODE §1107(a)



Assignment

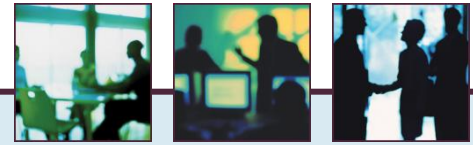
“No party may assign (by operation of law, merger or otherwise) this Agreement or any of its rights, interests or obligations hereunder without the prior written consent of the other party, and any assignment by a party without the prior written consent of the other party will be null and void.”

- Party A is a wholly-owned subsidiary of another company, which sells the stock of Party A to another entity
- Does the provision prohibit the transfer?

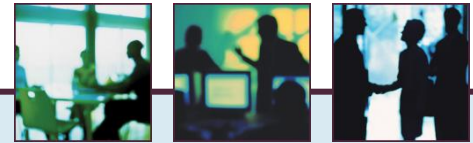


Assignment – Change in Control

Generally, to prohibit a change in control, must explicitly so provide and define events that constitute a change in control

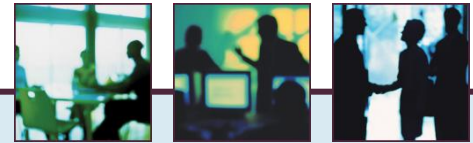


Merger/Integration



Merger/Integration

- **Entire Agreement Clause:** provides that the written agreement embodies the whole agreement between the parties and supersedes all prior agreements relating to its subject matter
- **Purpose:** to invoke protection of the parol evidence rule, which bars admission of extrinsic evidence to vary or *supplement the unambiguous terms of a “fully integrated”* contract, i.e., a writing that the parties intend to be the final and complete expression of their agreement



Merger/Integration

Issues to Consider

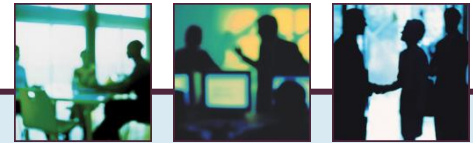
- Are there any other related agreements that are to remain in effect, e.g., confidentiality agreement?



Merger/Integration

Buyer and Seller enter into a Stock Purchase Agreement containing a standard merger provision, which provides that the agreement is the entire agreement between the parties. After entering into the agreement, Buyer alleges that Seller made false representations during the negotiation process.

Can Buyer introduce extrinsic evidence to show it was fraudulently induced to enter into the agreement?



Non-Reliance Provision

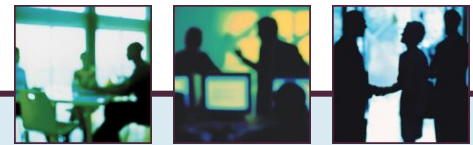
- Provides that in entering into the agreement, neither party has relied on any statement, representation or agreement of the other party except for those expressly contained in the agreement
- Purpose – *to preclude proof of the “reliance” element in a fraud or negligent misrepresentation claim*



Non-Reliance Provision

- Effectiveness of a non-reliance provision depends on law of the jurisdiction chosen to govern the agreement*
 - Factors that courts may consider
 - whether disclaimer is specific to alleged misrepresentation
 - sophistication of the parties
 - whether provision was negotiated
 - clarity of the language

*Also, if the transaction involves a sale of securities, courts vary on effectiveness of non-reliance provisions regarding securities fraud claims

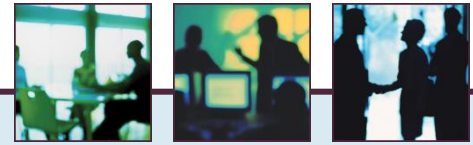


Non-Reliance Provision

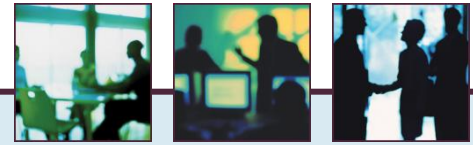
Why do lawyers argue over *non-reliance clauses*? *Can't a party still allege fraud?*

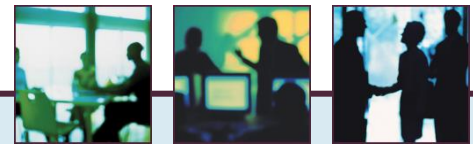
- Non-reliance clause can help foreclose a fraud claim based on a representation made outside the contract
 - e.g., in Delaware, a non-reliance clause can preclude a fraud or negligent misrepresentation claim for representations made outside the agreement – but will not shield a party from deliberate lies concerning reps and warranties set forth in the agreement.*

**ABRY Partners V, L.P. v. F&W Acquisition LLC, 891 A.2d 1032 (Del. Ch. 2006).*



Forum Selection and Governing Law





Forum Selection Clauses

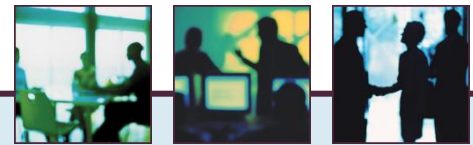
- Rap singer Pete Rock signs a recording contract with a music company.
- *The contract provides that “the validity, construction and effect of this agreement shall be governed by English law and any legal proceedings that may arise out of it are to be brought in England.”*
- *The music company releases an album containing Pete Rock’s songs without his permission.*
- Pete Rock sues music company in federal court in New York for breach of contract, copyright infringement, unjust competition and unjust enrichment.
- Should the case be dismissed due to the forum selection clause?



“any legal proceedings that may arise out of the contract are to be brought in England”

- *Court holding: The phrase “arise out of” means to originate from a specific source and does not encompass all claims that have some possible relationship to a contract, including claims that may only “relate to,” “be associated with” or “arise in connection with” the contract*
- *Only the breach of contract claim “arose out” of the contract*

Phillips v. Audio Active Ltd., 494 F.3d 378 (2d Cir. 2007).



Choice of Law

- Benchmark Electronics and J.M. Huber Corp. enter into *agreement that provides that “this agreement shall be governed by, and construed in accordance with, the internal laws of the State of New York.”*
- Benchmark, a Texas corporation located in Texas, then sues Huber in federal court in Texas, for breach of contract, fraud and negligent misrepresentation, based on representations in the contract.
 - *Which state’s law governs?*



Choice of Law

“this Agreement shall be governed by, and construed in accordance with, the internal laws of the State of New York”

- Court holding: The choice of New York law pertained only to the agreement. Therefore, only the breach of contract claim was subject to New York law; the tort claims were subject to Texas law.
- Did it matter? Yes.
 - Texas law permits fraud and negligent misrepresentation claims even if the representations on which the claims are premised are set forth in the contract. Thus, Benchmark could seek tort damages, including exemplary damages.
 - New York generally does not allow contracting parties to ground fraud or misrepresentation claims on contractual representations.

Benchmark Elecs., Inv. V. J.M. Huber Corp., 343 F.3d 719 (5th Cir. 2003).



Choice of Law and Forum Selection Clauses

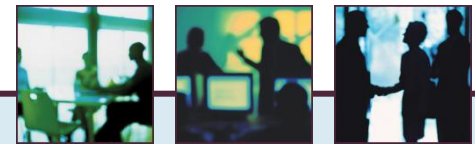
Lesson Learned: If you want forum selection and choice of law provisions to apply to extra-contractual claims, then use broader language.



Choice of Law and Forum Selection – Additional Pointers

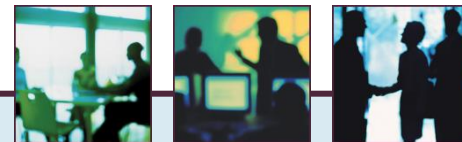
Choice of Law

- Choice of law provisions are generally enforceable so long as:
 - there is a reasonable relationship between the transaction and the chosen state and
 - the chosen law would not violate a fundamental public policy of the forum state
- Usually best to choose same state for governing law and forum (do not want court in forum state rejecting chosen governing law due to public policy difference)



Choice of Law and Forum Selection – Additional Pointers

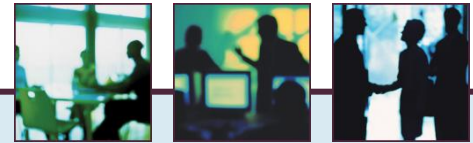
- Some states have statutes governing choice of law provisions:
 - New York – parties can choose New York law where transaction covers at least \$250,000, subject to certain exceptions
 - CA – parties can choose CA law where transaction involves at least \$250,000, subject to certain exceptions
 - Del. – parties can choose Delaware law where contract involves at least \$100,000, and parties are, by law or such agreement, subject to jurisdiction of Delaware courts and can be served with legal process
 - TX – *parties can choose any jurisdiction's law for a transaction involving at least \$1 million that bears reasonable relation to chosen jurisdiction, subject to certain exceptions*



Choice of Law and Forum Selection – A Few Pointers

Forum Selection

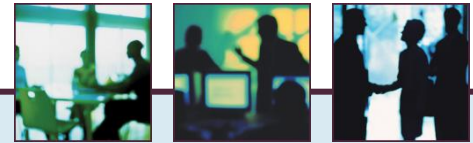
- *Note difference between permissive (“may be brought”) vs. mandatory (“must be brought and determined exclusively”)*
- Forum selection clause cannot confer federal jurisdiction
- Forum selection clauses are generally enforceable, subject to limited exceptions (including public policy in some jurisdictions)
 - Some states have specific statutes



Choice of Law and Forum Selection – Additional Pointers

Forum Selection

- Even if court finds forum selection clause enforceable, a court may dismiss or transfer case on the grounds of *forum non conveniens* unless there is also a waiver of this defense
- Therefore, forum selection clause should always be coupled with waiver of right to contest jurisdiction



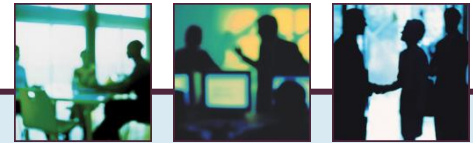
Specific Performance



Specific Performance

“Each party agrees that the other party would be irreparably damaged and would not have an adequate remedy at law if any provision of this Agreement were breached. Accordingly, the parties will be entitled to specific performance of the terms hereof, in addition to any other remedy at law or in equity.”

- Party A breaches agreement and Party B brings suit seeking specific performance.
- Will court order specific performance?



Specific Performance

- Specific performance is an equitable remedy that is within the discretion of the court to award
- Nevertheless, very helpful to have specific performance provision as it may be persuasive to the court

Gildor v. Optical Solutions, Inc. (Del. Ch. 2006); Kansas City Southern v. Grupo TMM, S.A. (Del. Ch. 2003)

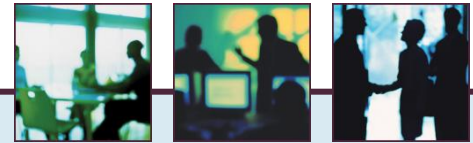


Specific Performance

United Rentals Case

- United Rentals, Inc. enters into a merger agreement to be acquired by Ram Holdings, Inc.
- The merger agreement provides:
 - Section VI.1 – *“The parties acknowledge that a breach of any provision of this agreement that would prevent consummation of the transactions contemplated herein will cause irreparable harm. Accordingly, seller is entitled to specific performance if buyer breaches this agreement.”*
 - Section VII.3 – *“Notwithstanding any provision of this agreement, seller’s remedy for any breach of buyer’s obligations is limited to the termination fee set forth in Section 9.6.”*

United Rentals v. RAM Holdings, Inc., 937 A.2d 810 (Del. Ch. 2007)

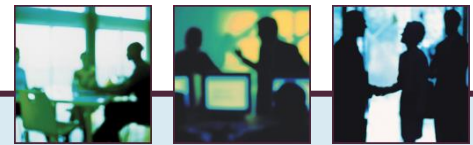


Specific Performance

United Rentals (con't):

Buyer terminates merger agreement and seller sues for specific performance

- At trial, testimony shows that during contract negotiations:
 - *buyer's lawyer told seller's lawyer that buyer did not think specific performance was available, but*
 - *seller's lawyer did not say anything in response or respond to emails*



Specific Performance

United Rentals (con't):

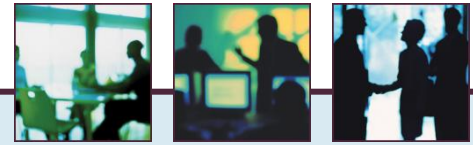
- Court decision:
 - admonishes attorneys for sloppy drafting
 - *under “forthright negotiator” principle, buyer wins and there is no right to specific performance*
- United Rentals loses billions in market value and at most can get relatively small termination fee as liquidated damages
- United Rentals hit with a slew of lawsuits from its own shareholders



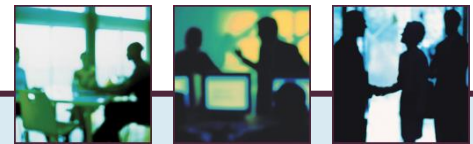
Specific Performance

Lesson Learned:

- If you have provisions for specific performance, liquidated damages, indemnification and/or election of remedies, make sure they are internally consistent

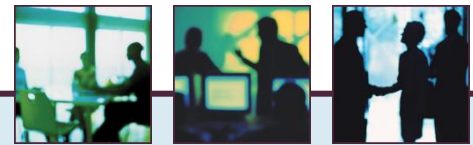


Survival



Survival Clauses

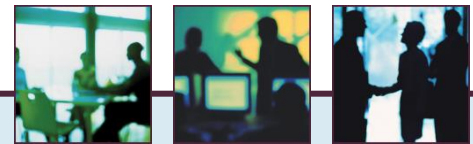
- Argan, Inc. agreed to sell all of the stock of one of its subsidiaries to Western Filter Corp
- The stock purchase agreement contained a survival *clause that said “the representations and warranties of the parties shall survive the Closing for a period of one year”*
- 11 months after the Closing, Western Filter notified Argan of alleged breaches of representations relating to the subsidiary
- 17 months after the Closing, Western Filter sued Argan for the alleged breach
 - Should the suit be dismissed?



Survival Clauses

“The representation and warranties in this Agreement will survive the Closing for a period of one year.”

- Most attorneys probably think that this means that a suit for breach of a representation or warranty must be brought within one year after the Closing or it is barred



Survival Clauses

Court holding: such a clause merely establishes the period during which a party could *discover* a breach, but does not limit the time during which a party could *file suit* for the breach

- Reasoning: The law disfavors provisions to shorten the statute of limitations and therefore requires such a provision to be strictly construed against the party invoking it

Western Filter Corp. v. Argan, Inc. 540F.3d.947 (9th Cir. 2008) (construing California law); see *Hurlbut v. Christiano*, 63 A.D.2d 1116 (NY. Sup. Ct. 1978) (construing New York law)

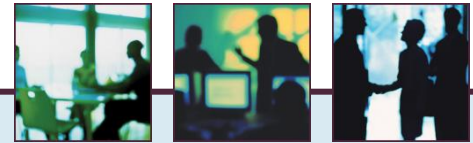


Survival Clauses:

Lesson Learned:

If you want a limited survival period, provide that

- *actions must be brought (or noticed, depending on parties' intent) before the end of the survival period or they are forever barred, and*
- the survival period may be shorter than otherwise provided by law

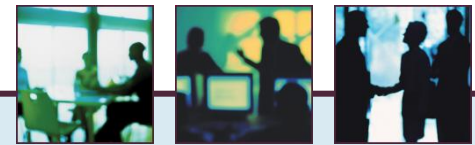


Survival Clauses

Section 8.5 Survival of Representations and Warranties. Each representation and warranty in this Agreement will survive the Closing and remain in full force and effect until the close of business of the *one-year anniversary of the Closing Date (the “Expiration Date”)*. *Notwithstanding any longer period that may be permitted by any applicable statute of limitations or other applicable law, the parties agree that any action or proceeding arising out of a breach of any representation or warranty in this Agreement must be brought on or before the Expiration Date or be forever barred.*

Section 8.6 Governing Law. This Agreement will be governed by, and construed in accordance with, the laws of the State of Texas, without giving effect to any conflict of law principles that would result in the application of the laws of any other jurisdiction.

- Any problems?



Survival Clauses

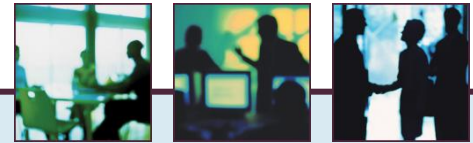
Under Texas law:

- Any contract that purports to limit the time in which to bring suit on the contract to a period shorter than 2 years is void.
- Any contract provision that requires a claimant to give notice of a claim for damages as a condition precedent to bringing suit is not valid unless it is reasonable. Requiring notification within less than 90 days is void. Tex. Civ. Practice & Procedures Code §§16.07 and 16.071.
- There are exceptions to both statutes for contracts relating to the sale or purchase of a business entity involving consideration of at least \$500,000.



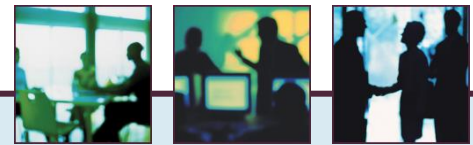
Survival Clauses

Each representation and warranty in this Agreement will survive the Closing and remain in full force and effect, *regardless of any investigation or disclosure made by or on behalf of any party to this Agreement.*



Survival Clauses

- Sandbagging language in M&A deals allows a buyer that is aware of a breach to proceed with the closing of the acquisition and then sue the seller for the breach
- Buyer argues this preserves the benefit of the bargain
- Seller argues it should not be subject to the risk of an *“ambush” after buyer closes*



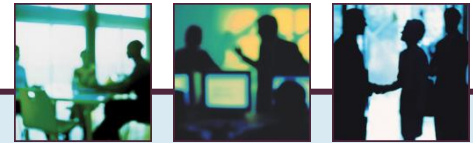
Survival Clauses

Sandbagging:

- Make sure provisions addressing survival, sandbagging, indemnification and remedies are internally consistent
 - Best practice is to include them all in same section
- Make sure client understands the issue
- Even if sandbagging provision is included, case law is not clear. Many courts require a party to establish reliance.



Waiver of Jury Trial



Waiver of Jury Trial

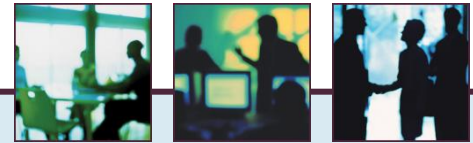
Should you include a waiver of jury trial?

- Generally desirable in commercial transactions, but *consider client's specific interests*
- If Delaware Chancery Court is chosen as the exclusive forum, you do not need waiver
- Pre-dispute contractual waivers of jury trial are not valid under California law



Waiver of Jury Trial

- Generally enforceable, but the presumption is **against** jury trial waivers, i.e., the party attempting to enforce the clause has the burden of proof
- Waiver must be
 - knowing
 - voluntary
 - intentional



Waiver of Jury Trial

Factors courts consider:

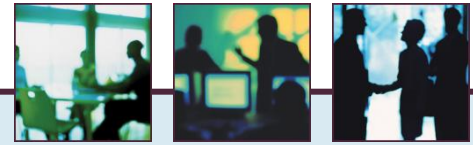
- *parties' sophistication*
- *parties' bargaining power*
- review by counsel
- negotiations regarding the waiver
- conspicuousness of the language



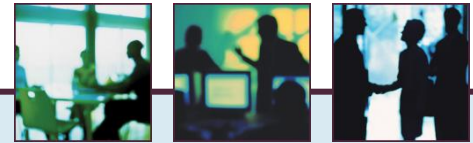
Waiver of Jury Trial

Best Practices:

- Clause should be conspicuous: **ALL CAPS, bold, or underlined** (or combination)
- Clause should include acknowledgement by each party supporting a knowing, voluntary and intentional waiver



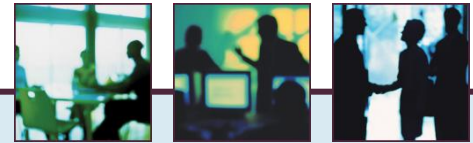
Severability



Severability

“If any provision of this Agreement is determined to be invalid, illegal or unenforceable, all other provisions of this Agreement will nevertheless remain in full force and effect.”

- Is this enforceable?



Severability

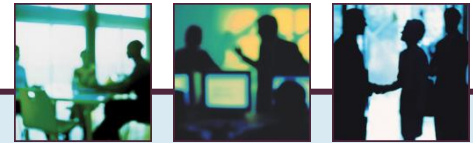
- A court will not preserve a contract when severed portion is an essential part of the agreement
- Helpful to have severability provision as it encourages a court to sever unenforceable provisions rather than find the entire agreement unenforceable



Severability

Factors courts look at include:

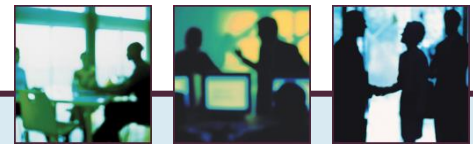
- intent of the parties
- whether unenforceable provision is independent and divisible
- whether unenforceable provision is an integral part of the agreement



Severability

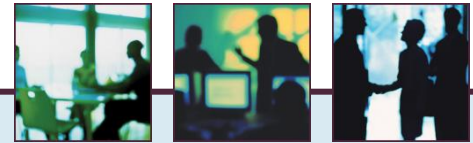
Do you want a severability provision?

- Generally recommended – provisions are persuasive to courts in determining severability
- Even without one, courts have power to modify or reform an unenforceable provision if it is not an essential part of contract
 - If important, you can specify essential parts of contract in the severability provision
 - But remember, it is difficult to predict your position on issues that may arise in the future



Three Types of Severability Clauses

- **True Severance Clauses**
 - completely sever the provision - provision is taken out of the contract and party loses the benefit of the bargain of that provision
- **Severance Unless MAE Clauses**
 - sever the provision unless the severance would have a material *adverse effect on one side or the other's bargain*, in which case the contract is terminated
- **Reformation Clauses**
 - allow judge to reform the provision so it is enforceable, or
 - require parties to negotiate in good faith to replace an unenforceable provision with an enforceable provision



Severability

- **Prevailing market practice**
 - Overwhelming majority of recent agreements include reformation clause requiring parties to negotiate in good faith to replace unenforceable provision with an enforceable provision



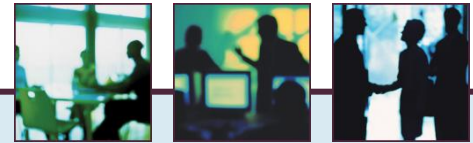
Notice



Notice

All notices, requests and other communications provided for or permitted to be given under this Agreement must be in writing and given by personal delivery, by certificate or registered U.S. mail (postage paid, return receipt requested), by U.S. express mail or nationally recognized overnight delivery service or by facsimile transmission as follows (or to such other address as any party may give in a notice given in accordance with the provisions hereof):

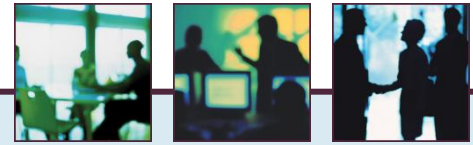
Party A sends a notice to Party B with a pdf letter attached, via e-mail. Does the e-mail delivery of the Letter constitute a valid notice under the Agreement?



Due to transmission and security concerns, e-mail is rarely used as an accepted method of delivery of notices.

However, if parties want to permit notice by e-mail, they should provide explicitly in the agreement

- add by electronic mail (with duplicate via one of the other means)
- specify the e-mail address for the parties
- specify when the notice will be deemed given (lost in cyberspace concerns; effective upon delivery/confirmation of transmission; but only if a duplicate is sent via one of the other means)



Conclusion

- Precise wording matters
- No agreement is perfect

