FROM THE CHAIR
By Richard E. Climan

Our Committee will hold its Fall 2003 stand-alone meeting on Saturday afternoon, October 18th, at the Park Hyatt in Toronto. This will be our Committee’s third stand-alone meeting north of the border, and our first stand-alone meeting in Toronto (although Committee veterans will recall that we met in Toronto in conjunction with the ABA’s Annual Meeting in 1998).

Our Committee meeting will be preceded by separate task force and working group meetings on Thursday afternoon, throughout the day Friday and on Saturday morning. This extended meeting schedule is intended to minimize conflicts for Committee members who serve on multiple task forces.

At our full Committee meeting, as part of the ongoing effort to expand the substantive content of these meetings, Henry Lesser will make a short presentation debunking some of the myths surrounding the use of representation and warranty insurance and other M&A-related insurance products; and Jon Hirschoff and Scott Whittaker (the co-chairs of our Subcommittee on Recent Judicial Developments) will lead a discussion of the recent decision of the U.S. District Court for the Southern District of New York in AIH Acquisition Corp. LLC v. Alaska Industrial Hardware, Inc., which is summarized in their report in this issue of

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Deal Points. Immediately following our full Committee meeting on Saturday, David Albin will lead a Committee Forum presentation titled “Everything You Say Can and May Be Used Against You: Tips for Sharing Privileged and Competitively Sensitive Information During the Due Diligence Process.”

There will be two Committee cocktail receptions and dinners in Toronto – the first on Friday evening and the second on Saturday evening. Many thanks to our Toronto contingent – consisting of representatives of Borden Ladner Gervais LLP, Goodman & Carr LLP, Heenan Blaikie LLP, McCarthy Tetrault LLP, McMillan Binch LLP, Ogilvy Renault and Stikeman Elliott LLP – for organizing and sponsoring these events.

I look forward to seeing you in Toronto.

FEATURE ARTICLE

M&A ACQUIRORS BEWARE: WHEN YOU SUCCEED TO THE LIABILITIES OF A TRANSFEROR, DON'T ASSUME (AT LEAST, IN CALIFORNIA) THAT THE EXISTING INSURANCE TRANSFERS TOO

Henry Lesser  
Mike Tracy  
Nathaniel McKitterick¹

A recent California Supreme Court decision applying an anti-assignment clause in a liability insurance policy surprised the insurance bar and caught the eye of the M&A bar. The case, Henkel Corporation v. Hartford Accident and Indemnity Company, et al. (decided on February 3, 2003 and reported in 129 Cal. Rptr. 2d 828), deserves to be widely known because of its potentially significant impact on the structuring, and even on the economics, of corporate acquisitions.

What Henkel Holds

What Henkel seems to hold (more on its reach below) is this: under California law, when one company (call it S) transfers its assets to another company (call it B) and B assumes (i.e., agrees to be liable for) S’s related liabilities, B does not necessarily get the benefit of any existing insurance that already had been issued to S applicable to the assumed liabilities if the policy contains a clause prohibiting its assignment without the insurance company’s consent, and such consent was not obtained before the transfer. This result might attach even if the assumed liabilities already had ripened into a claim against S before the transfer.

Why Did Henkel Surprise Insurance Lawyers?

The view of courts in the vast majority of jurisdictions that have considered the question is that an anti-assignment clause in a liability insurance policy does not prevent a successor to the insured from recovering under the policy for events which had occurred or liabilities that had arisen before the transfer, because the coverage follows the liabilities. This also has been the rule followed by federal courts in the 9th Circuit (which includes California). See Northern Ins. Co. v. Allied Mut. Ins. Co., 955 F.2d 1353 (9th Cir. 1992). The principle behind this approach is simple and logical: an insurance company is entitled to select the parties it insures, and the terms of the coverage; but once the insured event has occurred or the liability has arisen (whether or not known or a claim has been made yet), transferring the liability does not

¹ Henry Lesser and Mike Tracy are partners in, and Nathaniel McKitterick is an associate with, the law firm of Gray Cary.
change the insured risk -- the ownership of the assets and the identity of the transferee are irrelevant to that risk. So, while there may be a cognizable rationale for prohibiting contractual transfer of coverage for events, actions and liabilities which the successor might influence, there is no such rationale for pre-transfer occurrences and liabilities. Nevertheless, Henkel (with one dissent) refused to follow the majority approach.

Why Does Henkel Matter to M&A Lawyers and Their Clients?

To answer this, it is helpful to look at the five basic ways in which B can acquire S’s business (Henkel aside, a variety of corporate, tax, and other considerations will determine which form is used in a given deal):

- **An Asset Sale.** Here, S transfers to B the assets B wants (which may be the entire business or just a division or line) and B assumes responsibility for the liabilities related to those assets (typically, with exclusions for agreed-upon categories of non-assumed liabilities).

- **A Stock Purchase.** Here, B buys all the outstanding shares of S and, instead of owning certain assets and related liabilities, owns the entire company, which continues to exist as a separate legal entity.

- **A Forward Direct Merger.** Here, S merges directly into B and ceases to exist as a separate legal entity, with B succeeding to its assets and liabilities. While this may look like the equivalent of S transferring all of its assets and liabilities, it has important differences from an asset purchase, including the fact that if a majority of the outstanding S shares approve the merger, all S shareholders are bound (subject, in some cases, to dissenting shareholders having the right to payment of the appraised cash value of their shares), whereas a stock purchase cannot be imposed on shareholders who do not wish to sell.

- **A Forward Triangular Merger.** Here, as in the prior case, S ceases to exist but, instead of merging into B, it merges into a B subsidiary (often, one formed solely for the merger, with no existing operations) and that subsidiary, not B, succeeds to S’s assets and liabilities.

- **A Reverse Triangular Merger.** Here, instead of S merging into B or a B subsidiary, a “transitory” B subsidiary, formed just for the merger, merges into S and S becomes a wholly-owned subsidiary of B. While this may look like the equivalent of a stock purchase, it has important differences, including the fact that the requisite shareholder vote binds all shareholders (again, subject to appraisal rights being available in some cases).

Before Henkel, the choice among these alternate structures would likely have been made without regard to whether B would get the benefit of S’s existing insurance for those S occurrences and liabilities that had taken place or arisen before the closing. Now, where there is a real prospect that insurance coverage for third party claims based on S’s pre-acquisition acts or liabilities will be determined under California law (as occurred in Henkel), the availability of S’s insurance will become an additional, possibly crucial, factor. This is particularly the case because, ordinarily, B’s own insurance is not likely to cover S’s pre-closing actions or liabilities, which occurred or arose when S was not affiliated with B.
Why is *Henkel* Potentially Crucial to the Choice of Acquisition Structure?

The answer to this question turns on answering yet another question: how narrowly or broadly is *Henkel* to be read in light of its particular facts? The facts are complicated but can be reduced to the following series of transactions, as described in the Court’s opinion:

- In 1977, Union Carbide acquired an independent company called Amchem by stock purchase and merger. Amchem, which became a wholly-owned Carbide subsidiary, had two product lines, agricultural chemicals and metallic chemicals.

- In 1979, Carbide transferred the assets and liabilities of Amchem’s metallic chemicals line to another wholly-owned Carbide subsidiary, Amchem No. 2, retaining the agricultural chemicals line in its Amchem No. 1 subsidiary.

- In 1980, Carbide sold all the stock of Amchem No. 2 to Henkel (presumably in a stock sale, though interestingly the opinion is not clear on this point) and then the two companies merged (presumably in a forward direct merger), with Henkel succeeding to Amchem No. 2’s assets and liabilities.

- In 1986, Carbide sold Amchem No. 1 to Rhone Poulenc, and the two companies merged in 1992.

- In 1989, employees of Lockheed (one of the end-users of the Amchem metallic chemicals products) sued Henkel and Amchem No. 1 for alleged bodily injuries. Henkel tendered the claims to the insurance companies that had insured Amchem No. 1 during portions

of the period in which the injuries allegedly occurred (1959–1976), and to its own insurers. All insurers denied coverage.

- In 1992, the same plaintiffs also sued Rhone Poulenc but Rhone Poulenc later was dismissed out of the case with plaintiffs’ consent on the grounds that it was Henkel (through Amchem No. 2) that was solely answerable for the claims.

- In 1995, Henkel settled the suit for $7.65 million, but pursued its insurance claims under the policies applicable to liabilities of Amchem No. 1 during the period in which the alleged injuries occurred, asserting that the policies were among the assets transferred to Amchem No. 2 by Carbide in 1979.

The essential question in the case was: could Henkel pursue the $7.65 million, and pursue other claims under the policies issued to the original Amchem? The trial court said no. The appellate court reversed, invoking the principle that the right to indemnity follows the liability rather than the insurance policy. The California Supreme Court, however, sided with the trial court.

What is *Henkel’s* Impact on the Choice of Acquisition Structure?

The California Supreme Court focused on whether, ignoring the language utilized in the deals, the liability was of the type that would pass as a matter of law to the entity that is asserting the right to coverage. *Henkel* outlines three general circumstances where that is the case: 1) if the transaction amounts to a consolidation or merger of the two corporations (leaving no survivor); 2) the purchasing corporation is a mere continuation of the seller; or 3) the transfer of assets is for the fraudulent purpose of escaping liability of the seller.
that otherwise would transfer under 1) or 2). If any of the above is true, the insurance coverage probably passes as well. Unfortunately, the California Supreme Court – like almost all courts dealing with this issue - did not delve into whether the type of “consolidation or merger” or “mere continuation” would make a difference in the analysis. Instead of technical terms describing the exact type of merger, phrases such as “de facto merger” are common in relevant opinions.

While some insurer-oriented counsel have claimed that *Henkel* means that insurer consent is required for any merger-type transaction, such a position is incorrect. Under the more reasonable reading of *Henkel*, Henkel’s coverage claim was defeated by the 1979 asset transfer, when Carbide split Amchem into two companies and Amchem No. 2 succeeded to Amchem No. 1’s liabilities related to the metallic products line. On the other hand, the question that remains is whether the Court’s opinion goes further than an asset purchase agreement of the sort at issue in *Henkel*.

Thus, reverting to our five forms of acquisition, the result under California law (where there is an anti-assignment clause in the policy and the insurer’s consent to assign is not obtained) may be as follows:

- **Asset Sale.** The transaction may well be a prohibited assignment and B may not get the benefit of S’s pre-existing coverage.

- **Stock Purchase.** The transaction is not an assignment of the policy because S continues to exist and keeps its own existing coverage, so S remains insured and may pursue claims under the policy.

- **Forward Direct Merger.** Unclear. Because S ceases to exist and merges completely into B as a matter of state merger law, a good argument can be made that B gets the benefit of S’s preexisting coverage because this is precisely the sort of “de facto merger” that the courts appear to respect, even though, because of the form of the merger, S no longer is in existence. However, the contrary argument would be that a forward direct merger transfers S’s assets to B, making it analogous to an asset sale. The defect with this contrary argument is that since S ceases to exist, and B is the only defendant, this argument would not find support in the logic of cases such as *Henkel*.

- **Forward Triangular Merger.** Ditto, except that if the coverage transfers, B’s subsidiary would get the benefit of S’s insurance, not B.

- **Reverse Triangular Merger.** Same as a stock purchase – not an assignment of the policy, because S continues in existence and may pursue existing coverage.

Note that there may be facts specific to the particular transaction which could affect the insurer’s duties. For example, where the transaction triggers the purchase of a runoff/tail policy, for which the insurer accepts additional premium, the insurer may have a difficult time denying the successor company's rights under such a policy. Furthermore, the particular policy at issue may have non-standard anti-assignment language.

Finally, *Henkel* may have left open the question of the circumstances under which a pending liability insurance claim may be transferred as part of a transaction. However, the *Henkel* Court did discuss the issue in passing, in a manner that should give a cautionary pause to policyholders. Specifically, the Court noted that such claims could be transferred if they had been “reduced to a sum of money due” under the policy. This may be a restrictive test. Thus, even with already-reported liability claims, it is of paramount importance that
insurance counsel be retained when the value of the transaction still is being deliberated, so that the potential effect of Henkel - and possible ameliorative measures - can be considered.

**Other Jurisdictions**

In cases of a complete merger with one surviving company (what courts might mean when they use terms such as “de facto merger”), most, and perhaps all, jurisdictions would hold that the insurance rights will transfer to the surviving company as a matter of state merger law, and likely would disregard a general anti-assignment clause. *Brunswick Corp. v. St. Paul Fire & Marine Ins. Co.*, 509 F.Supp. 750, 752-53 (E.D. Pa. 1981) (applying either Delaware, Maryland, or Pennsylvania law); *Chatham Corp. v. Argonaut Ins. Co.*, 334 N.Y.S.2d 959 (1972) (applying New York law). Many jurisdictions have no reported opinions on this issue, however.

Going one step further, most jurisdictions that have considered the issue will allow transfer of insurance policies pursuant to a sale of assets, and disregard anti-assignment language. For example, many courts have upheld the transfer of a policy under a circumstance such as in Henkel, arguing that the insurer is taking on no greater risk due to the asset sale, because the alleged events on which liability is founded already have occurred. See, e.g., *Gopher Oil Co. v. American Hardware Mut. Ins. Co.*, 588 N.W.2d 756, 764 (Minn. 1999) (asset purchase); *Citicorp Indus. Credit, Inc. v. Federal Ins. Co.*, 672 F.Supp. 1105, 1007 (N.D. Ill. 1987) (applying Missouri law; asset acquisition); *National Am. Ins. Co. v. Jamison Agency, Inc.*, 501 F.2d 1125, 1128-30 (8th Cir. 1974) (applying Illinois or South Dakota law; fire policy rights transferred to buyer pursuant to stock purchase agreement followed by dissolution and assignment); *Total Waste Management Corp. v. Comm. Union Ins. Co.*, 857 F.Supp.140, 143, 152 (D. N.H. 1994) (asset purchase agreement); *BSB Diversified Co. v. American Motorists Ins. Co.*, 947 F.Supp. 1476, 1480-81 (W.D. Wash. 1996) (holding broadly that insurance coverage transfers in asset sale, regardless of anti-assignment provision). A minority of decisions (such as Henkel) have rejected that position, arguing that liability for purposes of assignment has not been fixed until, at the least, a claim has been made against the insured, and perhaps even requiring a judgment. See also *Red Arrow Production v. Employers Ins. of Wausau*, 607 N.W.2d 294 (Wis. Ct. App. 2000). Unfortunately, it does not appear that published appellate opinions in many important jurisdictions to M&A lawyers, such as New York and Delaware, have yet addressed this issue.

Another issue is raised where liability is based on a statute that is enacted after the asset sale, but the incident giving rise to such liability occurred prior to the asset sale; courts are split on this point. See, e.g., *Gopher Oil, supra*, 588 N.W. 2d at 764 (insurance does transfer); *Quemetco, Inc. v. Pacific Auto. Ins. Co.*, 29 Cal.Rptr.2d 627, 631 (Cal. 1994) (insurance does not transfer). Because of the broad-reaching successor liability of laws such as CERCLA, this is not a small consideration where the transaction will involve the transfer of industrial real estate assets, for example.

While choice of law rules in this context are complex and beyond the scope of this article, they tend to be sufficiently broad that proactive counsel may be able to secure a more favorable jurisdiction or choice of law for resolution of the insurance dispute.

**Conclusion**

*Henkel* is a troubling case, in direct conflict with 9th Circuit decisions and the prevalent judicial view in other jurisdictions. But, whether California law might apply, or the law of another jurisdiction, there are steps that can be taken, when determining the type of transaction and the language of the relevant agreements, that may increase the chance that coverage will lie with the desired entity. Even more foresight may be displayed by taking the proactive measure, when negotiating the terms and
conditions of insurance policies, of negotiating hard
for language restricting the insurer’s unbridled
ability to withhold consent to assignment in the
context of a subsequent transaction.

In any event, buyers in asset sales should
understand that, to the extent California law is
applicable, there is substantial risk that the seller’s
insurance coverage will not be available for pre-
closing events and assumed liabilities, which will
impact transaction terms, pricing, and perhaps even
feasibility.

## TASK FORCE REPORTS

### Task Force on Acquisitions of Public Companies

We had a very busy meeting of our Task
Force in San Francisco (standing room only). We
believe this was our largest turnout ever.

#### Next Meeting - Toronto

We will be meeting at the stand-alone Committee on Negotiated Acquisitions meeting in Toronto on Friday, October 17. Ed Kerwin and Lorna Telfer have graciously offered to host our Task Force meeting at the offices of McCarthy Tétrault [Suite 4700, Toronto Dominion Bank Tower, Toronto Dominion Centre, Toronto, Ontario; (416) 601-7997] from 2:15 – 5:15 p.m. on Friday. Ed and Lorna will also be arranging the all-important Task Force dinner in Toronto on Thursday evening, October 16.

In light of the significant material we need to cover, we will have a second meeting from 9:00 a.m. to 12:00 p.m. on Saturday, October 18; Alison Youngman has graciously offered to host this meeting at the offices of Stikeman Elliott [Commerce Court West, Suite 1400, Toronto, Ontario; (416) 869-5684].

At our meetings in Toronto, we will review the following materials:

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<td>Sections 4 and 5</td>
<td>Bill Payne</td>
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It will be a busy set of meetings, so we hope you can attend.

#### Winter Stand-Alone Meeting

We also agreed to meet for our traditional full-day stand-alone meeting of the Task Force in Wilmington, Delaware. The centerpiece of the meeting will be another interactive session with the Delaware bench. In order to accommodate the members of the bench, our Wilmington meeting will be held February 6 – 7, 2004. Steve Bigler of Richards Layton & Finger has agreed to host our meeting in Wilmington and Rick Alexander of Morris Nichols Arsh & Tunnell has agreed to host the meeting’s cocktail party and dinner. We will be developing plans with our Wilmington task force members for meeting times and places and our dinner and will advise you of the details of our meeting soon. Mark Morton, Steve Bigler and Rick Alexander will be working with the bench to develop a program that assures opportunities for Delaware jurists to ask and respond to questions from the Task Force.
What Happened in San Francisco

We have made substantial progress on the model agreement and we are now generating ancillary agreements. At our meeting, we discussed Tricia Vella’s excellent commentary for Section 1. Eileen and Tricia will be revising Section 1 for our October meeting. We also discussed in concept a supplemental “white paper” prepared by Yvette Austin-Smith on business issues raised by exchange ratios. Our current plan is to provide the final draft of this memo as a stand-alone supplement to the model agreement in the published materials.

We then turned to Bryan Davis’ voting agreement and addressed the form of agreement and possible commentary. Finally, we began a discussion of the covenants section and will continue this discussion in Toronto.

Conclusion

We are on a path to completion in 2005, but there is a lot of work to do, so we welcome your participation at the meetings and by sending comments directly to the authors. We look forward to seeing you in Toronto and Wilmington.

Diane Holt Frankle
Stephen H. Knee
Co-Chairs

International Transactions Task Force

The International Transactions Task Force had a very well attended meeting in San Francisco with approximately 50 participants representing 15 countries.

The principal focus of the meeting was on the newest project of the Task Force, which is to attempt to internationalize the Model Asset Purchase Agreement by creating a new form of the agreement that can be used in transactions outside the United States. We discussed and commented in detail at the meeting on the proposed fact pattern to be used as a framework for the agreement. This project is designed to provide all Task Force members with an opportunity to participate in and contribute to the development of the form of agreement. Given that this project has just started, it would be a very good point of entry for any member of the full committee that would be interested in joining our Task Force. We welcome and encourage any such participation.

There was also a substantive presentation made at the meeting by Francesco Portolano, one of our Task Force members from Italy, on some of the key issues and considerations in doing an acquisition in Italy.

On the program front, the Task Force continues to be active at the annual meetings of the ABA with its sponsorship this year of the program
titled “Acquiring a European Business; Negotiating Strategies.” We wish to extend our appreciation and thanks to Nat Doliner who spent a considerable amount of time and effort in putting this very successful program together. Nat acted as moderator of the program and Henry Lesser, Franziska Ruf, Ian Fagelson, Oleg de Lousanoff, Andrew Saul and Robert Wethmar were panelists.

With respect to the project of the Task Force on public company cross border acquisitions, the questionnaire was finalized at the spring meeting in Los Angeles. Our Task Force previously decided to include this product as part of the publication of the materials being developed by the Task Force on Acquisitions of Public Companies. We agreed at this meeting that representatives of our Task Force should meet with members of the Task Force on Acquisitions of Public Companies to start coordinating the timing of publication as well as the selection of the countries to be covered and the selection of law firms to provide the responses.

On the publications front, a quick update on the project next in line for publication - the private company stock acquisition international overview. The form of questionnaire has been finalized and the responses are being edited by an editorial committee headed by John Grossbauer. This project is intended to be a stand alone project and we are about six months away from having a product ready for publication. Wilson Chu’s sub-group is also close to finalizing for publication its product on cross border due diligence.

John W. Leopold
Guy-Martial A.X. Weijer
Co-Chairs

Manual on Acquisition Practice and Process Task Force

At the Annual Meeting in San Francisco in August, a working group of 25 Task Force members critiqued a number of new draft chapters for the Manual. Vince Garrity described the publication schedule for the Manual. The Publications Committee has set the end of 2004 as the deadline for the Task Force’s submission of the Manual. To meet this aggressive goal, the Task Force expects to have first drafts of all chapters completed by the end of 2003.

Since the Task Force has completed nearly all topic outlines and commenced work on draft text at the April meeting, the Co-Chairs asked several authors of completed topic outlines to commence drafting chapters or subchapters under broad style guidelines developed by the Co-Chairs and based on the Master Outline developed by our Reporter, Rob Ouellette. The following Task Force members submitted either new or revised text for discussion at the August meeting: David Gavsie on "The Acquisition Team" and "Style Issues"; Tom Van Dyke on "Finding an Acquisition Partner"; Neal Brockmeyer on "Auctions: The Process and Issues"; Dennis White on "Financing Contingencies and Dealing with Third Party Sources of Funding"; Bill Payne on "Due Diligence" and "The Purchase

Joint Venture Task Force

The Joint Venture Task Force is coming to the end of its current project. The text of the model joint venture agreement and commentary is with the Editorial Committee. At our session in Toronto on Saturday morning, we will update the Task Force members and bring to the Task Force issues that have arisen as a result of the Editorial Committee deliberations.

We hope to see many of you at that meeting as we finally prepare to deliver the text to the ABA Publications group.

Thomas B. Hyman, Jr.
Alison J. Youngman
Co-Chairs

John W. Leopold
Guy-Martial A.X. Weijer
Co-Chairs
Agreement and Related Documentation"; Gordon Cooper on "Aborted Deal Consequences"; and Jon Hirschoff on "Valuation Issues." Neal Brockmeyer also submitted for discussion an updated Lexicon, which had been greatly expanded from the earlier draft. The Task Force spent the bulk of the meeting discussing the text developed by the authors and discussing style and different presentation formats.

The Co-Chairs assigned more chapters to outline authors and other volunteers and established a timetable for submission before the October meeting. The Task Force will meet again in October in Toronto with an objective of having all chapters in draft.

The Task Force on the Model Stock Purchase Agreement

The Model Stock Purchase Agreement Task Force held very productive meetings at the Annual Meeting in San Francisco. Members of our Working Groups (agreement revisions, sellers’ response documents and ancillary documents) produced significant materials for review and comment. We had extended discussions on a number of topics and additional project assignments were made. The deadline for new projects was September 15, 2003.

Although the Working Groups met separately in San Francisco, we will return to the combined Working Group format for meetings in Toronto. On Thursday, October 16, 2003 the Working Groups on Revisions to the MSPA and the Sellers’ Response will meet from 9:00 to 12:00 noon. Task Force Members are encouraged to attend all Working Group Meetings.

The Task Force is always seeking new members and we hope you will be able to attend our meetings in Toronto. There are still plenty of assignments available, so if you are interested in signing up or have any questions, please send me an email at rtharper@klettrooney.com.

Robert T. Harper
Chair

SUBCOMMITTEE REPORTS

Committee Forum Subcommittee

Title: "Everything You Say Can and May be Used Against You: Tips for Sharing Privileged and Competitively Sensitive Information During the Due Diligence Process."

Description: A panel of leading M&A practitioners will discuss attorney-client privilege, antitrust and other issues that arise in connection with disclosure of confidential information during the due diligence process and pre-closing period.

Location: Park Hyatt, Toronto.
Date: Saturday, October 18, 2003.
Time: 3:30 – 4:30 p.m.

Speakers: David I. Albin (Moderator) - Finn, Dixon & Herling LLP
George M. Taylor III - Burr & Forman LLP
Christopher J. Grasset - Goodman and Carr LLP
Byron F. Egan - Jackson Walker LLP

Keith A. Flaum
Chair
Recent Judicial Developments Subcommittee

The Subcommittee on Recent Judicial Developments met in San Francisco to discuss cases that might be included in our 2003 survey of significant judicial decisions in the area of mergers and acquisitions. From the many cases reviewed by Subcommittee members in advance of the San Francisco meeting, we narrowed the list down to a few dozen cases. By the time we meet in Toronto, we expect to have narrowed the list further, and to have first drafts of the case summaries that we expect to include in the 2003 survey (for decisions rendered year-to-date).

We will continue to collect 2003 cases through year-end, and we are asking all members of the Committee on Negotiated Acquisitions to send to us significant judicial decisions for possible inclusion in this survey. Submissions can be sent by email to either Scott Whittaker at swhittaker@stonepigman.com, or Jon Hirschoff at jhirschoff@fdh.com. You also can fax the case either to Scott at (504) 596-0836 or to Jon at (203) 348-5777. If possible, please include in your email or fax cover sheet a brief statement as to why you consider the case to be significant. Many thanks to everyone who has sent us cases for consideration.

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 General Corporation Law of the State of Delaware, 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 significant please send it, even if it does not meet the foregoing criteria.

Decisions to be Discussed at Toronto Committee Meeting

We believe the following cases will provide good food for thought and lively discussion at our upcoming Committee Stand-Alone meeting in Toronto. In *AIH Acquisition Corp. LLC v. Alaska Industrial Hardware, Inc.*, a federal District Court in New York granted to the buyer specific performance of an acquisition agreement that the seller refused to sign, holding that the execution of the agreement was a “mere formality.” In *Horizon Holdings, L.L.C. v. Genmar Holdings, Inc.*, a federal District Court in Kansas upheld a jury verdict awarding the seller $2,500,000 because the buyer’s post-closing operational decisions caused the seller to lose an earnout.


On July 1, 2003, the United States District Court for the Southern District of New York issued an Order in *AIH Acquisition Corp. LLC v. Alaska Industrial Hardware, Inc.*, arising out of alternative claims for specific performance or damages for breach of an unexecuted stock purchase agreement.

*AIH Acquisition Corp. (“Acquisition”) entered into a letter of commitment to purchase the stock of Alaska Industrial Hardware (“Alaska Industrial”). Acquisition had completed its due diligence, participated in extensive negotiations and thought it had reached agreement on a final stock purchase agreement that only awaited execution. At that point, Alaska Industrial’s majority shareholder refused to sign the agreement.*
Plaintiffs sought specific performance of the contract or, in the alternative, contract damages. Plaintiffs also brought claims for fraud and negligent misrepresentation against Alaska Industrial, its stockholders and its attorneys. Defendants sought to dismiss the claims, inter alia, for failure to state a claim.

The Court found that the parties had a “complete agreement containing all material terms in final form with signatures coming the next day as a mere formality.” The Court’s conclusion was based in part on an email from Acquisition’s counsel to Alaska Industrial’s counsel stating that the “final” stock purchase agreement was attached and indicating that “everyone, including the lawyers, has stated it is final without qualification.” The Court also found that because plaintiffs had alleged that Alaska Industrial was a closely held company without readily ascertainable value, they had properly alleged that there was no adequate remedy at law and had properly stated a claim for specific performance.

The Court dismissed plaintiff’s fraud and misrepresentation claims against Alaska Industrial and its lawyers, rejecting the theories that the lawyers fraudulently offered repeated assurances that the deal would close and that their failure to disclose information as to the majority stockholder’s mental condition constituted fraudulent misrepresentation.

This decision surprised many business lawyers, who routinely operate under the legal premise that where the parties intend their agreement will be reduced to writing, they are not bound until the written agreement is executed. The decision in this case does not contain much detail regarding the underlying facts, but it may be that the Court’s decision was influenced by allegations that the majority shareholder exhibited particularly egregious behavior. Nevertheless, this case is a reminder that there are exceptions even to the rule that the deal is not done until the documents are signed.


In this case the court denied several post-trial motions through which the defendants sought to overturn a jury verdict awarding $2,500,000 to the plaintiffs for a lost earnout. The case involved the acquisition by Genmar Manufacturing of Kansas, L.L.C. (“Genmar Kansas”) of the aluminum boat manufacturing business of Horizon Holdings, L.L.C., f/k/a Horizon Marine L.C. (“Horizon”). The purchase agreement explicitly provided that Horizon and Geoffrey Pepper (“Pepper”) would have an opportunity to realize up to $5,200,000 in earn-out consideration, defined in the agreement as part of the purchase price.

It appears from the court’s opinion that a number of issues relating to the earnout discussed by the parties prior to the execution of the agreement were not covered in the agreement. These included (1) the authority Pepper would have as President of Genmar Kansas, (2) whether the Horizon brand name would be continued, (3) the extent to which Genmar Kansas could be required to produce at its facility other brands of boats sold by other Genmar companies, and (4) the basis on which Genmar Kansas would be reimbursed for producing such other brands.

The operations of Genmar Kansas following the acquisition did not produce earnings supporting the payment of any earnout consideration under the formula set forth in the purchase agreement. Horizon and Pepper sued for the lost earnout, claiming that defendants breached both the express terms of the purchase agreement and the duty of good faith and fair dealing implied in the purchase agreement. They also claimed that defendants made a variety of fraudulent misrepresentations to induce them to enter into the purchase agreement. There were also employment agreement claims in the case, which will not be discussed here.
Pepper testified that “in his mind” the 13% gross profit margin necessary to achieve the earnout was reasonable and obtainable but that he needed a certain level of autonomy with respect to the management of Genmar Kansas to ensure that it would realize the profits and revenues necessary to support the earnout. Specifically, he testified that he sought (and received) assurances that the buyer would allow him “to do what is necessary in managing the company to obtain that earn-out.” He also testified that he was assured that he would be in control of Genmar Kansas’ operations.

The plaintiffs’ claim with respect to the implied covenant of good faith and fair dealing was that it was a breach of that covenant for the defendants to undermine Pepper’s authority as president of Genmar Kansas and to take other actions that had the effect of depriving plaintiffs of the opportunity to achieve the earnout. The defendants claimed that plaintiffs were purporting to rewrite the contract and supply omitted provisions. The agreement specified that it would be governed by Delaware law. The jury was instructed that under Delaware law they should consider “whether it is clear from what was expressly agreed upon by the parties that the parties would have agreed to prohibit the conduct complained of as a breach of the agreement had they thought to negotiate with respect to that matter.” The jury was further instructed that a “violation of the implied covenant of good faith and fair dealing implicitly indicates bad faith conduct.”

The defendants argued to the jury and to the court that the plaintiffs’ characterization of the evidence made no sense because defendants made no money on the Horizon acquisition. With respect to this argument, the court thought the evidence sufficient to support the conclusion that “defendants believed (but were ultimately incorrect) that they could still turn a profit through the production of Ranger and Crestliner boats at Genmar Kansas while simultaneously preventing Mr. Pepper from realizing any earn-out by stifling the production of Horizon boats and reimbursing Genmar Kansas only at standard cost for the production of other boats.” Thus, in the court’s view, the jury could reasonably find bad faith.

The defendants also sought judgment as a matter of law on the plaintiffs’ damages claim, asserting that there was no evidence permitting the jury to ascertain what position plaintiffs would have been in had the purchase agreement been properly performed, and that recovery was precluded because Genmar Kansas was a new business with no profit history and there was no evidence from which the jury could conclude that Genmar Kansas was reasonably certain to realize the gross profit margins necessary to achieve the earnout. The court stated that any doubts on the proof of damages should be resolved against the party in breach, and cited evidence that Pepper thought 13% gross profit margins could be achieved, and evidence from which the court believed the jury could conclude that Horizon Marine was about to “break into the black” just before the acquisition, as evidence from which a jury could reasonably
conclude that if defendants had allowed Pepper to direct daily operations, the requisite profit margins would have been achieved.

The court denied defendants’ new trial motions for the reasons that it gave for denying the motion for judgment as a matter of law. One ground for the new trial motions was that the court erred in admitting parol evidence regarding the parties’ negotiations. The defendants argued that parol evidence is inadmissible to prove bad faith in a breach of contract claim. The court pointed out that the evidence had been admitted with respect to plaintiffs’ claim that the defendants had fraudulently induced them to enter into the agreement, and that the defendants at that point failed to request a limiting instruction with respect to consideration of the evidence with respect to the good faith and fair dealing claim. The court therefore reviewed the admission of the evidence under the plain error standard, concluding that there was no plain error, and further stating that the issue was largely moot because the court would have permitted the jury to consider the evidence in connection with the good faith and fair dealing claim in any event. The court also asserted that because the purchase agreement was silent as to the majority of the issues discussed by the parties prior to execution of the agreement, evidence as to those discussions is entirely appropriate to “provide context” for the good faith and fair dealing claim.

Finally, the court awarded the plaintiffs over $800,000 in attorneys’ fees and expenses under a provision of the purchase agreement providing that the prevailing party shall be entitled to recover from the defaulting party all costs and expenses, including reasonable attorneys’ fees, incurred in connection with enforcing the terms of the purchase agreement.

The Horizon Holdings case illustrates some of the tensions that are created when an earnout is in place. The buyer will normally assume that, at least as to significant business decisions, it is entitled to operate the business it has purchased. But decisions in the buyer’s interest (such as using the acquired facility to produce several lines of boats and thus achieve some synergistic benefits) may be directly against the seller’s interest in achieving the earnout. The buyer and the seller will also have conflicting interests as to how earnings are measured, and as to a number of other matters. (See the Comments to the Earnout Agreement in the Ancillary Documents to the Model Asset Purchase Agreement.) Earnout agreements are frequently quite detailed in order to deal explicitly with these conflicting interests. Although either party may decide for good reasons not to explicitly address in the document one or more earnout related issues where there are conflicting interests, this case illustrates the risks in that approach, particularly if the issues were discussed during negotiation.

Jon T. Hirschoff
Scott T. Whittaker
Co-Chairs

Technology Subcommittee

The Technology Subcommittee, the newest addition to the Committee’s roster of active entities, has been quite active over the past few months. In connection with the ABA’s Annual Meeting in San Francisco in August we began the process of recruiting members, announced a number of preliminary accomplishments and began to develop a framework for the Subcommittee’s goals and objectives. This is the Technology Subcommittee’s first Deal Points report.

The mission of the Technology Subcommittee is to keep the Committee’s web site current and to focus on technological developments that affect M&A practice. The Subcommittee will also be responsible for facilitating electronic communication among members of Subcommittees and Task Forces, and for developing or implementing technologies to facilitate the conduct of Subcommittee and Task Force business between meetings.
Membership

The initial membership of the Subcommittee consists of the following individuals: David Lipkin, Cooley Godward LLP, Acting Chair; Joel Greenberg, Kaye Scholer LLP; Hal Leibowitz, Hale and Dorr LLP; David Gemunder, Fowler White Boggs Banker; Jay Lefton, Aird & Berlis; and Jonathan Lampe, Goodmans LLP. We are seeking approximately five to 10 interested individuals to join the Subcommittee as active members. You don’t need to be a technology whiz or “power user” to join the Subcommittee, but you will want to have an interest in and appreciation for the benefits to an M&A practice of implementing technology tools wisely. Please contact David at dlipkin@cooley.com or by telephone at 650-843-5223 to express your interest in joining the Subcommittee or for further information.

Preliminary Accomplishments

In connection with the Annual Meeting, the Subcommittee undertook and accomplished the following:

• The Subcommittee has completely overhauled, and is in the process of republishing, the Committee’s website. Among other things, the new site includes more detailed descriptions of the activities of each Task Force and Subcommittee, provides linked access to Committee publications and other information of interest to M&A practitioners, and enhances the ability of Committee members to communicate with the leadership of the Committee and its various Task Forces and Subcommittees. The new site should be up and running by the time this issue of Deal Points reaches your hands.

• The Subcommittee, working in tandem with the new Dictionary of M&A Terms Task Force, has helped to develop a template for the Dictionary that will add enhanced linking and cross-referencing capabilities to the on-line and CD-ROM versions of the Task Force’s ultimate work product.

• The Subcommittee has upgraded the latest online versions of Deal Points to include an electronic table of contents providing linking to each article and section of the publication.

Goals and Objectives

The goals and objectives of the Subcommittee, subject to revision and expansion based on input from members of the Subcommittee and the Committee membership generally, are as follows:

• The Subcommittee will be responsible for keeping the Committee’s web site current, and continually enhancing the quality and quantity of the information at the site for the benefit of Committee members.

• The Subcommittee is working to develop and implement a system for collaborative interaction between and among the various members of the Committee leadership and each Task Force and Subcommittee between formal meetings, to supplant the outmoded “listserv” system currently in use.

• Starting with its collaboration with the Dictionary of M&A Terms Task Force described above, the Subcommittee intends to offer its services to each Task Force and Subcommittee to help each such group enhance the electronic capabilities and features of its work product. Where appropriate, this may include the provision of linking capabilities between the work product of different groups (for example, possible links from the M&A Dictionary, when published, to other Committee publications).
• The Subcommittee intends to study, disseminate information regarding and advocate the increased use in Committee members’ M&A practices of technology tools such as online deal rooms, electronic datarooms and extranets, and generally increase the level of awareness of new technological developments that have the capability to increase the efficiency of or otherwise enhance an M&A practice.

On behalf of all of the members of the Technology Subcommittee, we welcome the opportunity to serve the Committee and each of its Task Forces and Subcommittees in the manner described above, and look forward to your feedback on our preliminary activities, goals and objectives.

David Lipkin
Acting Chair

American Bar Association, Section of Business Law, Committee on Negotiated Acquisitions. The views expressed in the Committee on Negotiated Acquisitions Newsletter are the authors’ only and not necessarily those of the American Bar Association, the Section of Business Law or the Committee on Negotiated Acquisitions. If you wish to comment on the contents, please write to the Committee on Negotiated Acquisitions, Section of Business Law, American Bar Association, 750 North Lake Shore Drive, Chicago, Illinois, 60611.