FROM THE CHAIR

By Richard E. Climan

We will hold our next Committee meeting at the Atlanta Hilton on Sunday afternoon, August 8th, in conjunction with the Annual Meeting of the American Bar Association.

Our full Committee meeting will be preceded by separate subcommittee, task force and working group meetings throughout the day on Friday and Saturday, and on Sunday morning. (This extended, three-day meeting schedule is intended to minimize conflicts for those Committee members serving on multiple subcommittees and task forces.) In order to alleviate the time crunch we’ve experienced at past Committee meetings (while continuing to expand the substantive content of our meetings), I’ve decided to extend the length of our full Committee meeting to two hours.

Immediately following our full Committee meeting on August 8th, a panel of Committee members will present a Committee Forum program titled “What You Should Know About Stock Options in M&A Transactions.” Our Committee is also sponsoring a program titled “Earnouts in Business Acquisitions: A Practical Solution or a Trap for the Unwary?” on August 7th, and is co-sponsoring two additional programs. You can find descriptions of these programs elsewhere in this issue of Deal Points in the report by Neal Brockmeyer, co-chair of our Programs Subcommittee.
Our Committee cocktail reception and dinner will take place on Saturday evening, August 7th, at the Capital City Club in downtown Atlanta. Many thanks to Tom Hyman for his efforts in organizing this event.

More than 200 new members have joined the Committee so far this year, pushing our total membership well past the one thousand mark. We expect that many of our newest members will become active members, and will be joining us in Atlanta. Committee “veterans” are encouraged to assist in integrating our new members and introducing them to the Committee and its multifaceted activities.

We will hold our Fall stand-alone meeting (and related Halloween festivities) at the Ritz-Carlton in New Orleans on Friday, October 29th, and Saturday, October 30th. Please mark your calendars (and reserve your costumes).

See you in Atlanta.

FEATURE ARTICLE

Impact of the New Form 8-K Rules on M&A Transactions

By

Diane H. Frankle

and

Mark F. Hoffman

Background

The SEC on March 16, 2004 released final rules adopting several revisions to the Form 8-K disclosure requirements, including the addition of eight new Form 8-K disclosure items and a four-business-day filing deadline (replacing the current five to 15-day filing periods) for all required disclosure items. No extensions of time are available. The new SEC rules and release can be found at http://www.sec.gov/rules/final/33-8400.htm (the “Release”). These rules are effective as of August 23, 2004.

Companies involved in M&A activity should be aware of the several ways that the new rules can apply to M&A transactions – before, during, and after the transaction. From an M&A perspective, some of the rules impose new, and faster, disclosure requirements, a number of which require subjective judgments in determining when, and whether, disclosure is required. The rules also relate to M&A transactions in ways that may not immediately appear obvious, and companies should be aware that a single transaction may trigger required disclosure under multiple items. The purpose of this article is to focus attention on those aspects of the new rules that will specifically impact M&A transactions and related disclosures.

Several important new and modified disclosure requirements that may affect M&A transactions include (under the SEC’s new numbering system):

- Item 1.01 – Entry into a Material Definitive Agreement,
- Item 1.02 – Termination of a Material Definitive Agreement,
- Item 2.01 – Completion of Acquisition or Disposition of Assets,
- Item 2.03 – Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant,
- Item 3.02 – Unregistered Sales of Equity Securities,
- Item 5.01 – Changes in Control of Registrant, and

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1 Diane H. Frankle and Mark F. Hoffman are partners in the East Palo Alto, California and Seattle, Washington offices, respectively, of Gray Cary Ware & Freidenrich LLP.
• Item 5.02 – Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers.

In addition to adding new disclosure requirements, the SEC added a new “check the box” provision on the facing page of Form 8-K to permit a Form 8-K filing also to cover disclosures required under Rules 165 (referencing Rule 425), 14d-2 or 14a-12, as further discussed below. This eliminates the need for duplicative filings, which is a welcome change for companies and one that bears remembering. These new requirements, and their potential impact on M&A transactions, are summarized below.

Form 8-K Disclosure Items that May Implicate M&A Transactions

Entry into a Material Definitive Agreement

Rule

New Item 1.01 of Form 8-K requires companies to disclose “material definitive agreements not made in the ordinary course of business.” This new disclosure requirement is significant for companies involved in M&A activity because it means that companies will be required to disclose material business combination transactions in a Form 8-K within 4 business days after the time of signing the definitive agreement. Public company targets typically make immediate disclosure of the terms of the proposed transaction, and also file the definitive agreement for an acquisition of the company close to the time of signing, but this filing of the actual agreement (in addition to the disclosure concerning the transaction) has been considered voluntary and a way to permit discussions by both the buyer and the target with investors about the transaction while complying with Regulation FD and Regulation M-A. Buyers acquiring a private company had often issued a press release to announce a definitive acquisition agreement, but did not file the actual agreement on Form 8-K until the transaction closed. Thus, given the prompt disclosure of transactions that is often made as a matter of practice, for many issuers and categories of transactions the new disclosure requirements under Item 1.01 are not likely to significantly change the amount of disclosure concerning M&A transactions.

One key issue raised by Item 1.01 of course is what do the terms “material” and “ordinary course” mean? The Release states that the “materiality” and “ordinary course” thresholds are intended to parallel the standard for determining which material contracts must be filed as exhibits to Forms 10-K and 10-Q (under Item 601(b)(10) of Regulation S-K). The threshold would generally require disclosure of any contract:

• calling for the acquisition or sale of any property, plant or equipment for a consideration exceeding 15% of the fixed assets of the issuer,

• to which directors or officers are parties;

• upon which the company’s business is substantially dependent; or

• involving a “material lease.”

In addition, any non-ordinary course agreement that is material to a company, such as a material merger or acquisition agreement, would have to be disclosed (where, in the words of Item 601(b)(10), such agreement is not the type of agreement “as ordinarily accompanies the kind of business conducted by the registrant….”) An agreement for the sale of a company would of course always be material to the target. As to the buyer, materiality would presumably be judged on the basis of the impact of the acquisition and likelihood of consummation. As noted above, many of these agreements have not been filed by the buyer in the case of private company acquisitions even at the time of the filing of a Form 10-Q or Form 10-K prior to closing of the transaction, on the theory that the transaction was...
not yet closed. The SEC has clarified that material definitive agreements that are subject to “customary closing conditions” (legal opinion, comfort letters, completion of due diligence, regulatory approval) – as most business combination agreements are – must be disclosed under Item 1.01 even where such conditions have not yet been satisfied. Accordingly, it is likely that more of such agreements will be disclosed at this early stage.

**Disclosure of Material Amendments**

Item 1.01 also requires disclosure of material amendments to such agreements, even if the issuer has not previously disclosed the underlying agreement. The SEC notes that such disclosure requirement would be triggered where the amendment itself results in the agreement becoming a material definitive agreement. Amendments to definitive acquisition agreements may fall in this category, as well as changes to benefit or equity plans.

**Required Disclosure Once Item is Triggered**

The required disclosure includes: the date of the agreement or amendment; the identity of the parties; a brief description of any material relationship between the company or its affiliates and any party to the agreement or amendment; and a brief description of the terms and conditions of the agreement or amendment material to the company. Unlike the SEC’s proposed rule, the final rules do not require that the material agreement itself be filed as an exhibit to the Form 8-K. Instead, the issuer will continue to be subject to the requirement to file the agreement as an exhibit to the issuer’s next periodic report or registration statement; however, the SEC is encouraging issuers to file the exhibit with the Form 8-K anyway, particularly where confidential treatment is not requested. For a public company M&A transaction, this compromise is not particularly meaningful because, as noted above, companies have long filed the business combination agreement for a public company acquisition in a filing under Rule 425 and/or Form 8-K to permit discussions of the terms of the transaction with investors and to assist in providing a market check post-signing for the deal. For private company acquisitions by public companies, however, a filing of the acquisition agreement may be an invitation to commentary or perhaps competition for the deal. Note that the disclosure required in the Form 8-K is of those terms material to the registrant, so that many deal terms may not need to be disclosed; alternatively, if the agreement is filed with the Form 8-K or later with a Form 10-Q or Form 10-K, all terms are of course disclosed (subject to a request for confidential treatment of selected provisions). In the case of a private company acquisition agreement, the buyer has a choice as to whether to file the agreement with the Form 8-K or provide only disclosure of the terms of the acquisition material to the buyer at this stage and await the filing in the Form 10-Q or 10-K; it remains to be seen how practice will evolve.

**Subjective Analysis May be Required**

Despite the SEC’s attempt at clarity, companies involved in M&A activity will need to address certain subjective elements of Item 1.01 and the related definitions, including: is a particular business combination agreement considered “material”? Another issue in some cases is the “date on which the agreement was entered into” – new Item 1.01 lends greater importance to the timing of signing the agreement, which starts the four business day clock ticking.

**Nonbinding Letters of Intent Do Not Need to be Disclosed**

The final rule reverses the position of the proposed Rule on nonbinding letters of intent; the final rule does not require disclosure of non-binding letters of intent or other non-binding agreements – this is a particularly welcome result for companies involved in M&A transactions, where nonbinding LOIs and term sheets frequently precede the signing of a definitive merger agreement. Further, the SEC
expressly notes that a non-binding letter of intent or memorandum of understanding that also contains some binding, but non-material, elements, such as a confidentiality agreement or a no-shop agreement, need not be filed.

Regulation M-A Coordination

Prior to the adoption of Regulation M-A, companies would often file a definitive acquisition agreement under Form 8-K. Following adoption of Regulation M-A, to ensure the availability of the safe harbors that the SEC created under the Securities Act of 1933 (pursuant to Rule 165 by a Rule 425 filing), the proxy rules (pursuant to Rule 14-a-12 of the Exchange Act) and the tender offer rules (pursuant to Rule 14d-2(b) of the Exchange Act), many companies began to file with the SEC the same disclosure in a separate filing under each of such rules, and in some cases also filed the agreement under Form 8-K. To avoid duplicative filings, new Item 1.01 of Form 8-K provides that the revised Form 8-K will include boxes that the issuer can check to indicate that a single Form 8-K filing is also being made in satisfaction of the filing obligations under Rules 165 (referencing Rule 425), 14a-12 or 14d-2. To be compliant, the Form 8-K filing must generally include the substantive information and legends required by those rules.

Termination of a Material Definitive Agreement

Rule

New Item 1.02 requires companies to disclose the termination of a “material definitive agreement” that was “not made in the ordinary course of business” (i.e. an agreement previously disclosed under Item 1.01), other than termination by expiration on a stated termination date or as a result of the parties completing their obligations under the agreement, if in any case the termination of the agreement is material to the company.

Required Disclosure Once Item is Triggered

Once Item 1.02 is triggered, companies must disclose: the date of termination; identity of the parties; a brief description of any other material relationship between the company or its affiliates and any party; a brief description of the terms and conditions of the agreement or amendment material to the company and of the material circumstances of the termination; and any material early termination penalties incurred by the company.

Given the abbreviated (four business day) Form 8-K filing period, the SEC did not adopt the provisions of the proposed rule that would have required disclosure of management’s analysis of the effect of termination, sometimes referred to as “mini-MD&A” (although the SEC is quick to remind issuers that “any disclosure made in a report on Form 8-K must include all other material information, if any, that is necessary to make the required disclosure, in the light of the circumstances under which it is made, not misleading”).

Practical Considerations

Several commentators to the proposed rule were concerned that one party to an agreement, including a business combination agreement, could use the disclosure requirement under this new Item as a negotiation tool to force the other party to modify the agreement or face a potentially negative market response to the required disclosure – note that even a verbal termination could trigger the required disclosure. In response to these concerns, the SEC has added an Instruction to the Item, which states that no disclosure is required under the Item during negotiations or discussions regarding termination of a material definitive agreement unless and until the agreement has been actually terminated. Furthermore, the SEC has added a second Instruction to the Item stating that no disclosure is required if the issuer believes, in good faith, that the agreement has not been terminated, unless the issuer has received a notice of termination pursuant to the terms of the agreement.
As a practical matter, however, companies involved in M&A activities should be aware of the subjective judgment that may be required in determining when an agreement was “actually terminated” given the lack of a requirement for termination in writing prior to the disclosure obligation.

Perhaps in response to the potential for ambiguity, the SEC notes that an issuer that has a good faith belief that the agreement has not been terminated, but that still makes the Item 1.02 disclosure, could disclose under this Item a statement of its good faith belief as to any matter it deems relevant, including, for example, that not all conditions to termination have been satisfied or that a termination has otherwise not occurred – although from an M&A perspective, it is hard to imagine that a company would make an Item 1.02 disclosure before absolutely required, given the potential negative stock price implications of such disclosure, message to the market and the company’s competitors, and possible break-up fee implications of a termination. The bottom line is that, absent receipt of a written notice of termination, companies will need to be vigilant in considering the stage and tenor of negotiations concerning termination of a material definitive agreement in light of these new disclosure requirements.

Completion of Acquisition or Disposition of Assets

\textit{Rule}

New Item 2.01 requires disclosure where the company or any of its majority-owned subsidiaries has completed the acquisition or disposition of a “significant” amount of assets, other than in the ordinary course of business. The new Item retains most of the substantive requirements of former Item 2 of Form 8-K, including the test for what is considered “significant,” and the definitions of “acquisition” and “disposition,” each of which includes mergers, consolidations, asset sales and other business combination transactions. An acquisition or disposition is generally considered “significant” where it involves consideration in excess of 10% of the total assets of the company, or if it involves a “significant business,” as determined under Regulation S-X. Companies need to be aware of various tests for determining “significance,” some of which are based on financial information existing as of the end of the most recently completed fiscal year, when the parties’ financial performance may have been less strong.

\textit{Required Disclosure Once Item is Triggered}

The required disclosure includes: the date of completion of the transaction; a brief description of the assets involved; the identity of the person(s) from whom the assets were acquired or to whom they were sold and the nature of any material relationship, other than in respect of the transaction, between such person(s) and the issuer or any of its affiliates, or any director or officer of the issuer, or any associate of any such director or officer; the nature and amount of consideration given or received for the assets and, if any material relationship is disclosed pursuant to Item 2.01, the formula or principle followed in determining the amount of such consideration; and if the transaction being reported is an acquisition and if any material relationship is disclosed pursuant to Item 2.01, the source(s) of the funds used, unless all or any part of the consideration used is a loan made in the ordinary course of business by a bank as defined by Section 3(a)(6) of the Act, in which case the identity of such bank may be omitted under certain circumstances. As described below, companies are still required to file financial statements of the acquired company and pro forma financial statements for the combined business under new Item 9.01 within 71 calendar days after closing (and note that pro forma financial statements with respect to a disposed business, if required, are still due concurrently with the (now accelerated) Form 8-K filing).
**Practical Considerations**

On its face, it appears as though many business combination transactions would be captured under both Items 1.01 and 2.01 – requiring possibly duplicative disclosure. In response to this concern, the SEC notes that:

Typically, a company will report its entry into a material definitive agreement to acquire or dispose of assets under Item 1.01, and then later disclose the closing of the acquisition or disposition transaction under Item 2.01. However, a company will not necessarily be required to provide the Item 2.01 disclosure regarding every material definitive acquisition or disposition agreement disclosed under Item 1.01, as Item 2.01 includes a bright-line reporting threshold that is not included in Item 1.01. Under this threshold, a company need only report a completed acquisition or disposition of assets if the transaction meets the significant asset test as set forth in the item.

Companies should be aware that some acquisitions may meet the “significance” test under Item 2.01 without actually being a transaction that the buyer would otherwise consider material, although disclosure would still be required.

**Comparison to Current Item 2 of Form 8-K**

Current Item 2 requires disclosure of the source of funds used unless all or any part of the consideration used is a loan made in the ordinary course of business by a bank. In response to comments that disclosure of the source of funding for an acquisition typically has not produced meaningful disclosure, the SEC has limited such disclosure to instances in which a material relationship exists between the company and the source of the funding. In addition, disclosure is no longer required regarding the nature of the business in which the acquired assets were used and whether the company acquiring the assets intends to continue such use.

**Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant**

**Rule**

New Item 2.03 requires companies to disclose when they become either (i) obligated on a material “direct financial obligation” (which includes a “long-term debt obligation, a capital lease obligation, an operating lease obligation or a short-term debt obligation,” each as described or defined in the accounting literature, as further described in the Release) to the company, or (ii) directly or contingently liable for a material obligation arising out of an off-balance sheet arrangement (as described and defined in the accounting literature, as further described in the Release).

**Required Disclosure Once Item is Triggered**

Once Item 2.03 is triggered, companies generally must disclose the date of the obligation, and a description of the obligation, including the amount, terms, acceleration and increase provisions and maximum potential future payments.

**Practical Considerations**

M&A activity – either as part of the merger itself or in connection with financing a transaction or financing the surviving entity or another subsidiary or division after the transaction (or arranging for or guaranteeing financing or a debt facility) – frequently involves either the assumption of a third party’s debt or the direct incurrence of debt, or a pledge of the company’s assets as security for another party’s debt obligations. Companies involved in M&A activity should carefully consider the financial aspects of a transaction and the liabilities assumed, both prior to a transaction and following a transaction as the merged parties are
integrating their financial and other operations, on the company’s new disclosure obligation under Item 2.03. As with other new disclosure items, compliance with Item 2.03 may often require subjective judgment.

Unregistered Sales of Equity Securities

Rule

The SEC has moved the disclosure previously required under Forms 10-Q and 10-K regarding recent sales of unregistered securities to new Item 3.02.

Required Disclosure Once Item is Triggered

This new Item requires companies to disclose on Form 8-K the information it otherwise must disclose in periodic reports concerning sales of unregistered securities, where the aggregate amount of such securities sold since the later of the issuer’s last report filed under this item or last periodic report constitutes more than 1% (or 5% in the case of a small business issuer) of the issuer’s outstanding securities of that class. The required disclosure includes: the date that the securities were sold and the title and amount of securities sold; the nature of the transaction and the nature and aggregate amount of consideration received by the company for the issuance; the specific exemption from registration claimed; and the facts relied on to make the exemption available.

Practical Considerations

Among several types of transactions captured by this disclosure requirement are acquisition transactions that don’t otherwise meet the “materiality” or “significance” thresholds under new Items 1.01 and 2.01, respectively. Companies involved in M&A activity should remember the disclosure required under this Item – which now requires more rapid disclosure of certain types of business transactions. Note, however, that this Item requires only very limited information regarding the terms of the transaction and would not be triggered until the closing of the transaction.

Change in Control of Registrant

Rule

Item 5.01 mirrors current Item 1 of Form 8-K, and requires disclosure where the board, a board committee or an officer knows that a change in control of the company has occurred. Note that a company might be required to make disclosure under this Item as well as under Item 1.01 or 2.01.

Required Disclosure Once Item is Triggered

Where a change in control has occurred, the company must disclose: the identity of the person(s) acquiring control; the date and a description of the transaction(s) resulting in the change in control; the basis of the control, including the percentage of voting securities of the issuer now beneficially owned directly or indirectly by the person(s) who acquired control; the amount of the consideration used by such person(s); and the source(s) of funds used by the person(s), unless all or any part of the consideration used is a loan made in the ordinary course of business by a bank; the identity of the person(s) from whom control was assumed; and any arrangements or understandings among members of both the former and new control groups and their associates with respect to election of directors or other matters.

Practical Considerations

Companies need to be aware that the triggering threshold under Item 5.01 is a “change of control,” which is a different standard than under the “materiality” and “significance” thresholds under Items 1.01 and 2.01. Disclosure under this Item (as prior to the new Form 8-K rules) would be required even where the company has no role in the change of control transaction, i.e. where a majority shareholder sells its stake in the company.
Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers

Rule

New Item 5.02 requires companies to disclose the retirement, resignation, or termination of “principal officers” (CEO, President, CFO, CAO, COO), and the retirement, resignation, removal or refusal to stand for re-election of a director (in the case of directors, whether or not tied to a disagreement with the company). Companies also must disclose the appointment of a new principal officer and the election of a new director except by vote of shareholders at an annual or special meeting convened for such purpose.

Required Disclosure Once Item is Triggered

When any of the foregoing events occurs (other than a director’s departure due to a disagreement, which requires new, and more detailed, disclosure), companies generally are required, among other things, to disclose: the name of the relevant party; the date of the event; the position of the newly appointed principal officer; a brief description of the material terms of any employment agreement with such officer; the date of the election of a new director; and the committees on which such new director serves.

Practical Considerations

Officers and directors frequently resign, or are hired, appointed or elected, prior to or in connection with M&A transactions. Companies should be particularly aware of these new disclosure requirements because (i) the date of the resignation or departure can sometimes be difficult to determine, and (ii) in the case of directors, companies will need to consider whether a departure is due to a “disagreement with the registrant, known to an executive officer of the registrant” (in which case additional disclosure and actions are required), which once again imposes a subjective element to the company’s analysis.

Financial Statement Disclosures

Item 9.01 mirrors current Item 7 of Form 8-K, and requires disclosure of financial statements of businesses acquired where disclosure has been made under Item 2.01 (Completion of Acquisition or Disposition of Assets). Given the new four-day filing requirement for disclosures under Item 2.01, the corresponding financial statement disclosures are required within 71 calendar days after the date that the initial report on Form 8-K must be filed (as opposed to current Item 7 of Form 8-K, which requires such disclosures within 60 calendar days after the date that the initial report on Form 8-K must be filed – disclosure under Items 1 and 2 of current Form 8-K, relating to changes in control and the acquisition or disposition of assets, must be made within 15 calendar days after the occurrence of the event).

Conclusion

The new Form 8-K rules contain many areas that will require companies to make subjective determinations on a broader array of issues, and often more quickly, than under the current 8-K rules. While the new 8-K rules will result in less duplicative disclosure of definitive agreements due to the “check the box” option, companies should take time to consider all potential direct and indirect impacts of an M&A transaction and the corresponding disclosure requirements – and the timing and triggering events for such disclosures, noting that a single M&A transaction can give rise to multiple (and different) disclosure requirements under the new rules. In light of the array of new disclosures, the real challenge regarding these rules is likely to be meeting the four day filing requirement – this is particularly true where it is unclear whether a triggering event for disclosure has occurred. It may be helpful to rely on clear board authority to set the triggering date for such actions. The new rules will also result in earlier
disclosure of the terms of private acquisitions, and also could result in earlier filing of the definitive agreement.

Diane Holt Frankle  
Mark F. Hoffman

**TASK FORCE REPORTS**

**Task Force on Acquisitions of Public Companies**

We had a great dinner Friday evening at The Dahlia Lounge in Seattle — we were glad to see all who attended! Our Task Force met on Friday, April 2, from 1:00 – 3:30 p.m. The following task force members and guests were present: Diane Frankle (Co-Chair), Steve Knee (Co-Chair), Rick Alexander, Steve Bigler, Jay Bothwick, David Bronner, Richard Canady, Bruce Cheatham, Rick Climan, Bryan Davis, Nat Doliner, Joel Greenberg, Mark Hoffman, Mike Hutchings, Hendrik Jordaan, Edward Kerwin, Peter Koerber, Jim Melville, Mark Morton, Eileen Nugent, Teri O’Brien, Mike O’Bryan, Bill Payne, Darrel Rice, Jane Ross, Paul Sassalos, Yvette Austin Smith, Lorna Telfer, Craig Trover, Jim Walther, Leigh Walton, Scott Whittaker, and Robert Zierman.

The chairs thanked all of the Task Force members who made the Wilmington, Delaware meeting in early February a great success (Rick Alexander, Mark Morton, Steve Bigler, Joel Greenberg and Jim Melville). Rick Climan advised that a full report of the meeting would be included in the Committee meeting on Sunday.

**Future Meetings**

The chairs then reviewed the schedule for upcoming meetings. The Task Force will meet in Atlanta on Saturday, August 7. Our Task Force dinner will be held Friday, August 6. Thanks to Bryan Davis and Pete November for organizing our Atlanta dinner. We will meet on Friday or Saturday, October 29 or 30 in New Orleans as part of the Committee’s stand alone meeting. Future meetings include a possible meeting in Wilmington in January/February 2005. The Spring 2005 Business Law Section meeting is in Nashville, Tennessee and the Summer ABA meeting is in Chicago, August 5-9, 2005. (The 2006 meetings will be in Tampa (Spring) and Honolulu (Summer).

**Model Agreement**

We then turned to Yvette Austin Smith’s Article on Exchange Ratios. The Committee provided various comments to Yvette and she agreed to revise the article for our Atlanta meeting. Joel Greenberg and Leigh Walton then led a discussion of the representations and warranties section and agreed to provide commentary by the August meeting in Atlanta.

We then discussed drafting issues relating to the voting agreement with Bryan Davis. We concluded that commentary for the voting agreement should contain a cross reference to a brief discussion on registration rights in Section 4.9. Bill Payne agreed to draft several paragraphs on when registration rights might be requested We agreed that the commentary to the voting agreement would address Section 203 issues and issues under proposed Rule 159 under the Aircraft Carrier Release.

Finally, we reviewed Bill Payne’s revisions to Section 4.2. After a lengthy discussion, we agreed that we would revisit the “best efforts” issues at the Atlanta meeting. We need to decide the standard(s) (best efforts, reasonable best efforts and commercially reasonable efforts) that should be used in the agreement and whether a definition of such standard(s) should be provided. We also provided Bill with comments on the first half of Section 4.2. Task Force members agreed to fax or email additional comments to Bill.
For our August meeting in Atlanta, we will plan to cover Conditions (revisions), Covenants (revisions), Section 1 (revisions), Exchange Ratio (revisions), Voting Agreement (commentary), and the Miscellaneous category.

We will be pursuing specialty representations (intellectual property, benefits and environmental) through conference calls between meetings – contact Steve Knee if you wish to participate.

In our October meeting in New Orleans we will plan to cover Representations & Warranties, Termination, the Nondisclosure Agreement, Exclusivity Letters, and any other sections not covered in Atlanta.

Depending on how much we cover in Atlanta, we may propose both a Friday and a Saturday meeting of the Task Force in New Orleans.

Diane Holt Frankle
Stephen H. Knee
Co-Chairs

**Task Force on International Transactions**

The International Transactions Task Force met in Seattle and had a very well attended meeting.

The Task Force’s principal focus at the meeting was its efforts to “internationalize” the Model Asset Purchase Agreement by creating a new form of the agreement that can be used in acquisitions outside the United States. At our meeting in Toronto, we had discussed and commented on the proposed fact pattern to be used as a framework for the agreement. A revised draft of the fact pattern was prepared by Stan Freedman and circulated prior to our meeting in Seattle. We did not discuss the fact pattern in Seattle and agreed that we should revisit the fact pattern once we progressed further with the draft agreement. With respect to the agreement itself, we agreed that internationalizing the agreement would consist, on the one hand, of “genericizing” the language and, on the other hand, including representations, warranties and covenants (by way of schedule) for given countries that would supplement or supersede the terms of the main body of the agreement. The Task Force believes that the vast majority of the work relates to the “genericizing” of the language and that there should not be many representations and covenants that will need to be covered by way of schedule. While we started the process of reviewing the representations (sections 3.1 and 3.2), we concluded that it would be more effective to have mark-ups of the sections distributed prior to the meetings. To that end, the following drafting assignments were agreed upon:

- Henry Lesser: Sections 3.1, 3.2 and the definition of Governing Documents
- Freek Jonkhart: Sections 3.3 - 3.5, 3.13
- Jorge Yañez: Sections 3.6 - 3.10
- Rick Silberstein: Sections 3.11, 3.12
- Francesco Portolano: Sections 3.17, 3.18

Two substantive presentations were made at the meeting, one by Daniel Rosenberg on the Takeover Directive and the other by Rick Silberstein on some of the key issues and considerations that should be addressed when doing deals in Spain.

At the Atlanta meeting, the International Transactions Task Force will be co-sponsoring a program with the International Corporate Governance Sub-Committee. The program, entitled “On the Border Between Good Deals and Good Governance: Corporate Governance Issues in Cross-Border M&A Transactions,” is discussed in the Programs Subcommittee Report appearing elsewhere in this issue of Deal Points.

On the publications front, the Task Force’s next publication will be the private company stock acquisition international overview. The form of
questionnaire has been finalized and the responses are being edited by an editorial working group led by John Grossbauer. The project is intended to be a stand-alone project and we are currently projecting having a product ready for submission to the ABA by the fall of this year. Wilson Chu’s subgroup is also close to finalizing its product on cross border due diligence.

John W. Leopold
Chair

Task Force on Joint Ventures

The Joint Venture Task Force is rapidly winding up its work on the Model Joint Venture Agreement and is beginning to consider "its future" -- and the most likely topics are the "LLCing" of the agreement and the internationalization project.

At our meeting on Sunday, August 8, we intend to highlight certain issues on which the Task Force and the Editorial Working Group have been focused, with an expectation that a final document will be presented to the full Committee at the fall meeting in New Orleans.

At that meeting we also intend to talk about the two follow up projects - the “LLCing” of the agreement and the internationalization project. The Task Force does not believe the “LLCing” project will be a significant amount of work; therefore, that project would be undertaken by a very small group. On the other hand, the Task Force believes the internationalization project would benefit from input from a number of people as we develop the questionnaire (which we propose to do by drawing on the experience of the International Task Force) and then from various lawyers around the world to bring the project to fruition.

We look forward to seeing you all in Atlanta.

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

Task Force on the Manual of Acquisition Practice and Process

The Task Force met in Washington, D.C. on January 24, 2004 and in Seattle on April 3, 2004, and critiqued a number of new and revised draft chapters for the Manual. The Task Force has completed first drafts of nearly all chapters of the Manual and is in the process of revising the text, eliminating duplication and attempting to develop a more uniform format and style.

The following Task Force members submitted new or revised text for discussion at the Washington, D.C. and Seattle meetings: Bill Payne on "Your Own Firm or Law Department Team—Dealing with the Specialists"; John Clifford and Christian Franz on "International Aspects of Transactions"; Bob Copeland on "Ethical Issues in the Acquisition Process"; Neal Brockmeyer on "Related Documentation"; Dennis White on "The Context and Position of the Parties as They Begin the Pre-Agreement Documents Preparation"; David Benson and Murray Perleman on "The First Draft and Controlling Thereafter"; and Brian Belanger on "Issues as to Other Stakeholders."

The Task Force is wrestling with how to describe, capture and reconcile best practices and practical approaches to closings and execution of documents. Task Force and other Committee members have been asked to develop “sidebars” to highlight special war stories, notable illustrative cases and other informal references to illustrate points made in the text.
The Task Force will meet in Atlanta and review the new draft of the Manual, in particular the new text and the overall coverage of the Manual.

Thomas M. Thompson
Vincent F. Garrity, Jr.
Co-Chairs

Task Force on the Model Stock Purchase Agreement

Work on revisions to the Model Stock Purchase Agreement and Ancillary Documents has proceeded briskly since the Spring Meeting in Seattle. Task Force members have provided revised provisions of the underlying text, as well as new commentary. The Ancillary Documents Working Group completed a new draft of the Earnout Agreement, which will be the subject of a program at the ABA Annual Meeting in Atlanta. (The program, entitled “Earnouts in Business Acquisitions: A Practical Solution or a Trap for the Unwary?” is discussed in the Programs Subcommittee report below.) The Editorial Working Group, which held conference call meetings on May 8 and June 12, continues to work in earnest on revisions to the text of the Model Stock Purchase Agreement. There is still a great deal of work to be done, particularly in the area of commentary. Volunteers interested in working on the commentary are encouraged to contact Hendrik Jordaan by email jordaah@hro.com or phone (719) 381-8454 to discuss potential assignments. I look forward to seeing you at our meetings in Atlanta.

Robert T. Harper
Chair

SUBCOMMITTEE REPORTS

M&A Market Trends Subcommittee

The Market Trends Subcommittee held its kickoff meeting last April in Seattle with standing room only attendance. In the near term, we will focus on (i) a study of publicly available acquisition agreements for deals completed in 2004 between public buyers and private targets; (ii) a similar study involving public buyers and targets; (iii) a survey of essential M&A related state laws designed to assist counsel in multi-state deals (we call it “Local Counsel 911”); (iv) an online Market Check Message Board; and (v) an online Dealmaker’s Chatroom. Details may be found at http://www.buslaw.org/cgi-bin/controlpanel.cgi?committee=CL560007&info=Mission.

Wilson Chu
Lawrence Glasgow
Co-Chair

Membership Subcommittee

The Committee has experienced tremendous growth thus far in 2004. As of July 1st, our membership stands at 1114 members – a 37% increase from 2003.

We now rank eighth in membership among all Section of Business Law committees, and we are now officially the fastest growing committee in the Section of Business Law. Our membership recruitment was given a boost by the Section of Business Law’s June membership drive, which featured our Committee. In less than two weeks, we had almost 200 “new joins.”

Our representation in America’s largest firms increased by just over 30% from 2003. About 383 of our members are from National Law Journal Top 250 firms (up from 293 around this time last
year). With just over one-third of our Committee members, we cover almost two-thirds (154/250) of America’s largest firms. The remaining two-thirds of our members include lawyers in firms with less than 150 attorneys (which is just below the cutoff for the NLJ’s Top 250), lawyers in corporate legal departments and non-U.S. lawyers.

Any way you cut it, Committee membership is growing dramatically and we still have plenty of upside for future growth!

If anyone would like to assist with membership recruitment, please contact the Chair of the Membership Subcommittee, Wilson Chu at Wilson.Chu@Haynesboone.com.

Wilson Chu
Chair

Programs Subcommittee

The Committee will be sponsoring or co-sponsoring several programs and a Committee Forum at the ABA's Annual Meeting in Atlanta, all of which will take place at the Atlanta Hilton.

On Saturday, August 7, 2004, from 10:30 a.m. to 12:30 p.m., we will present “Earnouts in Business Acquisitions: A Practical Solution or a Trap for the Unwary?” The program will cover the use and misuse of earnouts and related accounting, tax and drafting issues, and will include a mock negotiation over the terms of an earnout that has been developed by the Working Group on Ancillary Agreements for the Model Stock Purchase Agreement. The moderator will be Murray Perelman, and the panel will consist of Garrett DeVries, Bill Payne, Leigh Walton and Dennis White.

On Sunday, August 8, 2004, from 10:30 a.m. to 12:30 p.m., we will co-sponsor a program with the Environmental, Energy and Natural Resources Law Committee entitled “Changing Laws on Environmental Liability for Successor Corporations.” This program will present ways to manage and mitigate risk of environmental liability imposed on successor entities from both the transactional negotiating perspective and the environmental perspective. Stephen Humes will be the moderator, and Lindsay Boyd, Byron Egan and Jon Hirschoff will be participating on the panel.

Also on Sunday, August 8, 2004, the Committee Forum will be held at the conclusion of our Committee meeting. The Forum will take up the topic—“What You Should Know About Stock Options in M&A Transactions.” The panel will examine the effect on the buyer and on option holders of the terms typically encountered, as well as some of the accounting, tax, corporate and securities law considerations arising from various M&A transactions. The moderator will be Steven Tonsfeldt and the panel will consist of Michael Frank, Drew Fuller and Jeremy Garvey.

Finally, on Monday, August 9, 2004, from 3:00 p.m. to 4:30 p.m., we will co-sponsor with the Corporate Governance Committee a program entitled “On the Border Between Good Deals and Good Governance: Corporate Governance Issues in Cross-Border M&A Transactions.” This program will examine the impact of governance issues in structuring and negotiating cross-border deals, including issues of board representation, management allocation, executive compensation, corporate ethics, internal governance practices and regulatory requirements. Carol Hansell and Henry Lesser will chair the program, and the panel will consist of Wolfgang Kau from Dusseldorf, Daniel Rosenberg from London, Reid Feldman from Paris, Alfredo Rovira from Buenos Aires, Akiko Mikumo from New York and Francesco Portolano from Rome.

Neal H. Brockmeyer
Elizabeth A. Dellinger
Co-Chairs
Subcommittee on Recent Judicial Developments

As of the writing of this report, the 2003 Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions is in the page proof stage, leading up to publication in the upcoming August issue of The Business Lawyer. We are currently compiling cases for possible inclusion in the 2004 Survey, and our Subcommittee will be meeting in Atlanta to move that project forward.

To make the Survey more timely, we have requested from The Business Lawyer an earlier annual publication slot. Based on the feedback we have received, we are hoping that the 2004 Survey will be scheduled for publication in the February 2005 issue. This accelerated publication schedule, however, will give our Subcommittee much less time to identify significant 2004 cases and prepare the 2004 Survey. Therefore, we are asking all members of the Committee on Negotiated Acquisitions to send 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. Or you 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 to one of us even if it does not meet the foregoing criteria.

Decision to be Discussed at Atlanta Committee Meeting

At our full Committee meeting in Atlanta, we will discuss Annecca Inc., et al v. Lexent, Inc. (307 F.Supp. 2d 999; 2004 WL 442604), a decision rendered by the United District Court for the Northern District of Illinois (Eastern Division) in March 2004. In this case, the Court granted summary judgment in favor of a buyer who terminated a stock purchase agreement based on the sellers’ failure to fulfill certain conditions precedent. A summary of the Annecca v. Lexent decision follows.

Scott T. Whittaker
Jon T. Hirschoff
Co-Chairs

Case Summary (Annecca v. Lexent)

In February 2001, Lexent entered into a Stock Purchase Agreement with all of the stockholders of Annecca (the “Sellers”), pursuant to which Lexent was to acquire from the Sellers all of the ownership interests in Annecca and its related companies (collectively "Annecca"). The target closing date under the Agreement was April 1, 2001. The Agreement included several key provisions upon which the Court’s analysis turned.

First, the Agreement contained typical, reciprocal conditions precedent that all of the representations and warranties of the parties "shall be true, complete and correct as of the Closing Date .....” One of the representations and warranties
made by the Sellers was that Annecca’s "books, records and accounts ... accurately and fairly reflect [its] transactions, assets and liabilities in accordance with GAAP." With respect to the financial statements for the year 2000, which were in process but not yet complete when the parties executed the Agreement, the Sellers represented and warranted that “the 2000 Financial Statements ... will be prepared in accordance with GAAP.” Another condition precedent was that the Annecca have a net worth (as defined in the Agreement) of at least $9,000,000 “as of the Closing Date.” Either party was allowed to terminate the Agreement if the conditions precedent to its obligations "have not been met by the Closing Date." The Agreement also contained the following provision regarding notice and opportunity to cure:

In the event that Buyer's due diligence review shall disclose any condition of [sic] matter which Buyer, in its sole reasonable judgment, deems to be unsatisfactory, Buyer shall notify Sellers in writing . . . and Seller's [sic] shall then have the period of thirty (30) days from the date of Buyer's written notice to correct the condition or matter to the sole reasonable satisfaction of Buyer, or Buyer may terminate this Agreement on ten (10) days written notice to Sellers.

Finally, the Agreement contained a choice of New York law, and an integration clause to the effect that the Agreement represented the entire agreement of the parties and superseded any prior oral understandings or arrangements.

On March 29, 2001, three days before the target date for the closing under the Agreement, Lexent notified the Sellers in writing that it was exercising its termination option. The decision contains the following description of Lexent’s termination notice:

Lexent asserted two main reasons for its choice, although it said that they did not represent “a complete list of Lexent’s reasons for terminating”:

1. Annecca's net worth was "very substantially and materially less than the $9 million threshold at the end of 2000."
2. Annecca's records and financial statements were so incomplete, and in some cases inaccurate, that they could not provide Lexent with a sufficient understanding of Annecca's critical financial condition.

After failing in its attempts to convince Lexent to change its mind, Annecca filed suit, alleging a breach of the Stock Purchase Agreement. Although Annecca made a variety of arguments, this summary focuses only on the two that we consider noteworthy. Those arguments were, in general terms, that (a) it was improper for Lexent to complain that Annecca’s financial statements did not comply with certain GAAP requirements, because Lexent was aware of such GAAP non-compliance when it signed the Agreement, and (b) it was improper for Lexent to terminate the Agreement without first giving Annecca the right to cure the deficiencies listed in Lexent’s termination notice.

Citing Oppenheimer & Co. v. Oppenheim, Apple, Dixon & Co. (86 N.Y.2d 685, 636 N.Y.S. 2d 734, 660 N.E. 2d 415, 418, (1995)), the Court stated that "express conditions precedent must be literally performed – substantial compliance is not enough to compel the other party’s performance of its resultant obligation.” Using that standard, the Court noted that the Agreement allowed Lexent to terminate the Agreement if any one of Annecca's conditions precedent were not fulfilled. The decision relies heavily on the Court’s finding that it was beyond question that the $9,000,000 net worth condition was not fulfilled, and this alone gave Lexent the right to terminate the Agreement.
In its pleadings, Annecca admitted that its net worth was between $8.4 and $8.9 million "on or about March 31, 2001" (the day before the closing date set forth in the Agreement). Annecca argued, however, that the shortfall was curable because it could have been made up by capital contributions from the Sellers so as to fulfill the $9,000,000 net worth condition. The Court admitted that such capital contributions would indeed have resulted in Annecca having the requisite net worth; however, the Court interpreted the Agreement as requiring the net worth to have resulted from Annecca's "preacquisition activities" rather than capital contributions. In the Court's words, Annecca's curability argument ignored "the obvious difference between the net worth of a business that is being purchased as a going concern when that net worth has resulted from its preacquisition activities and the net worth of that same business that is artificially boosted by the injection of cash." The Court further stated that:

It simply will not do for the Seller to prime the going business with cash in a form of an artificial one-time capital contribution, a contribution that will present the Buyer with a dramatically different deal from the one for which it had bargained. Such a cash infusion when coupled with the preexisting going concern assets, would obviously not generate the same kind of business results as the originally contemplated full-blown net worth business assets – the bargained for acquisition.

After reading into the Agreement the requirement that the net worth be created by Annecca's preacquisition activities, the Court concluded that the "futility exception" under New York law absolved Lexent from its failure to give Annecca an opportunity to cure. The Court stated that "express repudiation, abandonment of performance, unfeasibility of cure and -- critical to this case -- incurability are some of the circumstances that justify a party's decision to bypass the cure requirement and proceed directly to termination" (Citing Needham v. Candie's, Inc., 2002 WL 1896892, at *4 (S.D.N.Y. August 16, 2002)).

The Court also concluded that the Sellers’ representations and warranties requiring Annecca’s financial statements to comply with GAAP were inaccurate, and Lexent therefore had a separate right to terminate the Agreement based on failure of the condition requiring accuracy of the Sellers’ representations and warranties. Annecca agreed that its financial statements were not in accordance with GAAP in all respects. Annecca argued, however, that Lexent was aware of this prior to the execution of the Agreement, and therefore should be precluded from terminating the Agreement on this basis. The Court stated that "Lexent’s awareness that Annecca’s balance sheets were not GAAP-compliant at the outset of negotiations [does not] alter the unambiguous terms of the Agreement as to conditions precedent." The Court also stated that "the effect of the integration clause … is that any such claim based on asserted prior oral understandings or arrangements is precluded" (citing Marine Midland Bank-s. v. Thurlow, 53 N.Y.2d, 381, 442 N.Y. So. 2d 417, 425 N.E.2d 805, 807 (1981)). The Court also found this argument inapplicable to Annecca’s year 2000 financial statements, which had not been prepared as of the time of the execution of the Agreement, and which the Agreement required be prepared in accordance with GAAP. Instead of fully GAAP-compliant financial statements, Annecca apparently delivered statements that included the same deviations from GAAP as did the financial statements that it delivered before the Agreement was signed.

Some practitioners may be surprised at the Court’s conclusion that the net worth condition in the Annecca-Lexent agreement was not curable. Therefore, this case illustrates the importance of clear drafting in acquisition agreements. This case also illustrates the importance of proper drafting with respect to GAAP references in an acquisition agreement (and accounting provisions in general). As lawyers may not always be familiar with
accounting matters, this case supports the practice of having the accountants review and comment on the provisions of the agreement dealing with accounting matters.

Scott T. Whittaker
Jon T. Hirschoff
Co-Chairs