Allocation of risks between Signing and Closing

Business Law Section Spring Meeting
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Today’s Panel

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30 March 2019
ABA BLS Spring Meeting - Which party should bear the risk of events occurring between Signing and Closing
Agenda

- Means to shorten period between signing and closing
- Deal certainty
  - Anti-trust clearance
    - Fulfillment of conditions (hell and high water clauses)
    - Gun jumping
  - Ensuring funding (equity commitment and debt funding)
  - Break fees and reverse break fees
- Appraisal rights
- MAC clause
- No-shop provisions
- Bring-down disclosure
- W&I Insurance
Means to shorten period between signing and closing

- Use of a Transition Services Agreement – when deal is a carve-out
- Allows for accelerated closing
  - Buyer risks: failure to identify all services needed, transition services may be needed for longer post-closing period than expected
  - Seller risks: potential lack of personnel to provide services, administrative burden after closing
- Can be challenging to engage business teams in process of developing the transition services plan and details
- Buyer: Try to have as many actions as possible prior to signing (e.g. approval third parties, securing key employees, data protection compliance)
Deal certainty – Regulatory approval

- Conditions to Closing
  - Local antitrust agencies
  - Regulatory agencies (if applicable)
  - Land laws

- Japan: Anti-trust clearance
  - The merge filing shall be made based on the amount of domestic turnover of buyer group and seller group. To have clearance in the first 30 days waiting period, the advanced preparation is quite important.
  - No gun jumping case has been charged, but JFTC carefully watches.
Deal certainty - Securing funding

- Provides vendor comfort that funds are or will be available on closing to pay the purchase price
- Equity commitment letters and/or guarantees often provided in support of institutional or financial buyer transaction; rare in a strategic buyer transaction
- Debt funding commitment practices vary between jurisdictions, but lenders often only provide a detailed term sheet and comfort letter in support of financing the transaction; target often covenants to provide information and support to complete debt financing arrangements
- Availability of debt financing rarely a condition of closing; circumstances giving rise to termination related to lack of debt or equity financing are often negotiable.
Deal security - No-shop provisions

- Provides exclusivity from signing of agreement to closing or termination
- It is a breach of no-shop for the company or its shareholders to engage in discussions with other potential buyers
- The no shop reduces the incentive and ability of buyer to breach the contract and seek a better deal
- (Japan) Rarely seen no-shop provisions in the definitive agreement, risk of breach of share transfer obligation sufficiently plays a role to prevent
Deal security – (reverse) break fees

- Break fees in private deals (as opposed to public deals) are much less common; more prevalent where target shareholder approval is required post signing.
- Reverse break fees (buyer pays) can often arise in transactions involving significant and complex regulatory risk where the outcome is uncertain – anti-trust, foreign ownership restrictions (CFIUS, Investment Canada Act and others) and strategic sectors approval requirements.
Deal Security - Appraisal rights

- Allows stockholders to elect to obtain “fair value” of shares where cash consideration is to be received
  - Procedures in connection with stockholder meeting and vote
  - Timeline
- Often a condition to closing that no more than x% of stockholders exercise appraisal rights
- Use of voting agreement to add certainty
MAC clause

- General concept: The Akorn Case vs Wegfall der Geschäftsgrundlage vs Théorie de l'imprévision

- Relevant international exceptions:
  - International markets
  - Local financial markets: fx rate (i.e. local financial statements in local currencies);
  - Local regulatory frameworks

- Disputes re: MAE

- Legal consequences of violation
Bring-down disclosure

- Ongoing communications between target and buyer is important between signing and closing

- The length of time between signing and closing and the degree to which change is anticipated in the ongoing operations of the target will be factors in whether buyer will want regular notification on developments (rather than just a bring-down of disclosure on closing)

- It is uncommon for targets to be entitled to update a disclosure letter between signing and closing (possible exception for competitive auctioned deals)
Bring-Down disclosure (cont’d)

- Double materiality scrape: “… for determining the accuracy of such representations, all MAE qualifications and other qualifications in such representations shall be disregarded.”

- (Japan) Quite customary to have signing and closing Reps, and rarely seen bring-down disclosure, probably like US
W&I Insurance

- If the Buyer is the insured, Buyer wants closing to be conditional upon Buyer entering into the policy with the insurer

- Different forms of arranging W&I policy
  - Policy comes into effect on signing: – limited coverage of violations of representations and warranties for period between signing and closing
  - Policy comes into effect on closing – language in SPA providing for recourse against insurer sufficient for violations of warranties between signing and closing? – Should Seller stand behind the warranty in such case?