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Deal Contract Language Revamped After Meltdown

By **Christie Smythe**

Law360, New York (September 14, 2009) -- Along with altering the size and number of deals, the financial meltdown has led to significant changes in how deals are structured and the provisions agreements contain, according to attorneys specializing in mergers, acquisitions and financing arrangements.

Three years ago, buyers and sellers were not as concerned about “companies melting down overnight” or a financing provider becoming insolvent or no longer existing, said Matthew Herman, a partner at Freshfields Bruckhaus Deringer LLP who handles mergers and acquisitions.

But that has all changed, Herman said.

Now buyers, sellers and lenders providing acquisition financing are more concerned about potential risks in transactions and are trying to minimize the problems they could encounter, merger and deal attorneys said.

In the absence of big private-equity deals and leveraged buyouts, the current deal environment has seen renewed focus on so-called strategic deals — those struck between companies entering mergers and acquisitions for expansion or consolidation.

Financing for acquisitions is still not easy to come by, however; lenders are not interested in taking on loans they cannot syndicate, and buyers are wary of being held to deal commitments they cannot finance, attorneys said.

Meanwhile, sellers are not eager to enter transactions from which a prospective buyer might too easily walk away, they said.

“Everybody is reading clauses that they took for granted for years much closer than they ever have,” Herman said. “I think people spend a lot more time looking at the what-ifs with any given transaction structure."

Now buyers, sellers and other parties involved in deals are more concerned about unique circumstances and situations, and deal documentation is shifting to reflect that, attorneys said.

“You want your transaction to reflect reality, and the reality has changed,” said Paul Ware, a partner at Bradley Arant Boult Cummings LLP who handles mergers and acquisitions. “And now we’re trying to have our documents match up to and reflect reality.”

Here are some specific ways deal agreements are shifting as a result of the meltdown:

Strategic Deals Mimicking Private Equity Deals

Back in the recent M&A boom, private equity deals often gave buyers an out by providing for a reverse breakup fee — which set a specified amount of damages that would be paid in the event a deal was not consummated, attorneys said.

Meanwhile, strategic deals did not generally provide for a reverse breakup fee and often provided for specific performance remedies, allowing parties to potentially hold each other to the deal, they said.

But now strategic deals are starting to contain reverse breakup fees, providing buyers with an opportunity to back out if a desired financing source falls through, attorneys said.

“Probably the greatest change we’ve seen in purchase agreements is that strategic buyers are starting to take more measures to protect themselves in the event they can’t obtain financing,” said Steven M. Haas, an attorney at Hunton & Williams LLP specializing in mergers and acquisitions.

Previously, strategic buyers were typically confident that they could finance mergers and did not require such protections, Haas added.

Protections for Sellers

But while reverse breakup fees are being used in strategic deals, they are also getting bigger, in part to discourage a buyer from walking away too easily, attorneys said.

In the midst of the meltdown, some private equity deals fell through because the buyers found it more advantageous to pay the reverse breakup fee, they said.

About two years ago, when the buyout market was strong, reverse breakup fees were typically as low as 3 percent, said Philip Richter, a corporate practice partner with Fried Frank Harris Shriver & Jacobson LLP.

Now, however, they can be “significantly higher than 3 percent” to discourage prospective buyers from backing out of deals, Richter said.

“People obviously realized after a lot of these private equity deals didn't get done the reverse breakup fees didn't appropriately compensate sellers for broken deals,” he said.

MAC Clauses Becoming More Specific

Material adverse change or material adverse event clauses in deal documents, allowing buyers to back out under certain extenuating circumstances, are also becoming much more specific, including key financial thresholds and other metrics, attorneys said.

This specificity is a shift from more general terms, which have been held to a high standard in the courts, they said.

Clauses are now being “designed to address business deteriorations on a more objective basis as opposed to the typical subjective factors,” Freshfields' Herman said.

Interest in Antitrust Issues Growing

While it has not necessarily appeared in deal documents yet, attorneys also say they are seeing heightened concern about possible antitrust actions under the Obama administration, and that may eventually be reflected in agreements.

"I have not seen firsthand this affecting transaction agreements, but with the new administration applying greater scrutiny to transactions, the allocation of antitrust risk is certainly on the minds of buyers and sellers,” said Robert M. Katz, a partner in the mergers and acquisitions group at Shearman & Sterling LLP.

However, in some deal negotiations now, buyers are being asked to shoulder the risks associated with antitrust concerns, including committing to making divestitures or adhering to other potential regulatory requirements, Herman said.

In such situations, sellers and buyers may use antitrust concerns as a negotiating chip in order to ensure that deal certainty, he said.

Antitrust issues are generally more of a concern in strategic deals than in private equity acquisitions, attorneys said.

Financing Contingencies

Financing contingencies were sometimes absent from deals during the recent M&A boom, but they are now not only appearing in deals, but are often carefully tailored to the deal at issue, attorneys said.

This year, for instance, most of the larger transactions, including the merger of Pfizer Inc. and Wyeth Inc., have very specific and carefully negotiated provisions relating to the failure of a purchaser to obtain financing, said Michael E. Gilligan, a partner at Allen & Overy LLP in the firm's mergers and acquisitions group.

That is part of a trend in contingencies becoming "more carefully crafted, and better thought-out," he said.

"Buyers aren't willing to take risks," and they are "being much more specific about the way the financing risk is being allocated between the parties," Gilligan said.

Benchmarks for Interest Calculations

In credit agreements in particular, the basic benchmarks for determining interest rates are evolving to address concerns about the London Interbank Offered Rate, or Libor, a measurement of the rate at which banks lend to each other, said David Brittenham, a partner at Debevoise & Plimpton LLP and chair of the firm's leveraged finance group.

In the midst of the credit crisis, Libor's reliability came under question, with some suggesting that it understated the actual cost of funds in the London interbank market, Brittenham said, adding that significant fluctuations in the Libor rate further contributed to the difficult lending environment.

Now credit agreements often impose a minimum floor on interest rate calculations rather than simply referring to Libor, and there is often more focus on the provisions dealing with the possibility that Libor could not be calculated, he said.