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Transforming the Allocation of Deal Risk Through Reverse Termination Fees

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INTRODUCTION	1163
I. THE STRUCTURES OF ACQUISITION TRANSACTIONS	1168
A. <i>Strategic Buyers vs. Private Equity Buyers</i>	1169
B. <i>The Traditional Structure of Acquisition Agreements</i>	1170
1. Representations, Covenants, and Closing Conditions.....	1170
a. <i>Representations and Warranties</i>	1171
b. <i>Covenants</i>	1171
c. <i>Closing Conditions</i>	1172
d. <i>Termination Rights</i>	1173

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2.	Deal Protection	1175
3.	Termination Fees and Equitable Remedies.....	1176
a.	<i>Specific Performance</i>	1177
b.	<i>Termination Fees</i>	1179
i.	Standard Termination Fees.....	1179
ii.	Reverse Termination Fees.....	1180
C.	<i>The Structure of Acquisition Agreements in Private Equity Transactions</i>	1184
1.	Traditional Methods for Addressing “Financing Risk”	1185
2.	From Boom to Bust.....	1190
II.	AN EMPIRICAL STUDY OF REVERSE TERMINATION FEES IN STRATEGIC TRANSACTIONS	1193
A.	<i>The Limited Use of Reverse Termination Fees in Strategic Transactions in 2003 and 2004</i>	1194
1.	Reverse Termination Fee Triggers	1194
2.	Remedies.....	1196
B.	<i>The Transformation of Reverse Termination Fees in Strategic Transactions in 2008 Through mid-2009</i>	1199
1.	Reverse Termination Fee Triggers	1199
2.	Remedies.....	1201
a.	<i>Option-Style Reverse Termination Fees</i>	1202
b.	<i>Reverse Termination Fees with Specific Performance—the Hybrid Approach</i>	1203
c.	<i>The Two-Tiered Approach</i>	1204
III.	ASSESSING THE EVOLUTION OF REVERSE TERMINATION FEES	1206
A.	<i>The Role of Economic and Financing Uncertainty</i>	1207
B.	<i>The Increasing Leverage of Buyers</i>	1209
C.	<i>The Potential for Greater Certainty?</i>	1211
D.	<i>Sell-Side Value Creation</i>	1213
E.	<i>The Conundrum of Specific Performance vs. Damages</i>	1216
IV.	THE IMPLICATIONS OF REVERSE TERMINATION FEES	1218
A.	<i>Contractual Innovation and RTFs</i>	1219

<i>B. The Potential Drawbacks of the Reverse Termination Fee Structure</i>	1220
1. Pricing Issues	1221
2. Board Fiduciary Duties, Disclosure, and the Reverse Termination Fee Structure.....	1223
CONCLUSION.....	1226
APPENDIX A – METHODOLOGY.....	1230
APPENDIX B – SAMPLE REVERSE TERMINATION FEE PROVISIONS	1232

INTRODUCTION

Acquisition agreements are peppered with various provisions designed to mitigate, allocate, or address the ramifications of deal risk.¹ The potential for deal risk is particularly pronounced in acquisition transactions involving public companies, which generally entail a significant interim period between the date of the signing of the acquisition agreement and the date of the completion of the transaction.² Allocation of deal risk is a vital component of deals where millions, if not billions, of dollars are at stake for buyers and sellers, as well as their shareholders and stakeholders.

Perhaps the most obvious deal risk is of one party abandoning the transaction. One of the primary ways of dealing with this risk is through termination fee provisions. Typically, acquisition agreements provide for a standard termination fee (“STF”) to be paid by the seller in the event that the seller does not complete the transaction due to specific triggers. These triggers commonly involve situations where a

1. Deal risk includes all the factors that could prevent or delay the closing of an announced acquisition transaction. For an overview of deal risks in business combinations, see Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2015–34 (2009), and Albert H. Choi & George G. Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 851–54 (2010).

2. See Lou R. Kling, Eileen Nugent Simon & Michael Goldman, *Summary of Acquisition Agreements*, 51 U. MIAMI L. REV. 779, 781 (1997) (explaining corporate and regulatory reasons for delay between signing and closing, including stockholder approval by Seller’s and/or Buyer’s shareholders, antitrust filings under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 or other needed regulatory approvals, and time needed to line up financing, if necessary). Various corporate and regulatory requirements may mean that acquisition transactions can take months to complete. See THERESE H. MAYNARD, *MERGERS AND ACQUISITIONS* 415 (2d ed. 2009). In transactions with a significant regulatory component, the time between signing and closing can take over six months. See Miller, *supra* note 1, at 2029 (discussing possible time frames for transactions).

third-party bidder for the seller emerges.³ In an increasing number of transactions, acquisition agreements provide for a reverse termination fee (“RTF”)—that is, a payment by the buyer in the event the buyer cannot or does not complete the acquisition as specified in the agreement.⁴

Scholars and practitioners have analyzed STFs in numerous articles.⁵ RTFs, on the other hand, have received minimal attention from legal scholars despite their growing significance.⁶ RTFs came under focus following the private equity acquisition boom of 2005–2007.⁷ While RTFs were seldom used prior to 2005, in an unprecedented manner, private equity buyers used RTF provisions to either renegotiate pending deals or to abandon deals altogether.⁸ While the private equity RTF structure ultimately proved problematic for public company sellers, it may have paved a way for innovation in

3. See Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-Ups in Negotiated Corporate Acquisitions*, 75 MINN. L. REV. 239, 249 (1990) (discussing the threat of third party bids); John C. Coates IV & Guhan Subramanian, *A Buy-Side Model of M&A Lockups: Theory and Evidence*, 53 STAN. L. REV. 307, 314–15 (2000) (stating that termination fees are deal lock-ups that “have proven [the] most popular over time”); Kling et al., *supra* note 2, at 808. For a recent discussion of standard termination fees in the context of change of control transactions, see *In re Toys “R” Us, Inc. S’holder Litig.*, 877 A.2d 975, 1002–03 (Del. Ch. 2005).

4. RTFs are also referred to as “reverse breakup fees,” “bidder termination fees,” and “acquirer termination fees.”

5. See, e.g., Coates & Subramanian, *supra* note 3, at 311–12 (analyzing previous legal scholarship on termination fees and arguing lockouts substantially increase likelihood initial bid will be consummated); Ely R. Levy, *Corporate Courtship Gone Sour: Applying a Bankruptcy Approach to Termination Fee Provisions in Merger and Acquisition Agreements*, 30 HOFSTRA L. REV. 1386, 1396–97 (2002) (assessing termination fees and arguing that tests utilized by bankruptcy courts should be implemented by the Delaware judiciary in interpreting termination fee provisions); David A. Skeel, Jr., *A Reliance Damages Approach to Corporate Lockups*, 90 NW. U. L. REV. 564, 564–67 (1996) (exploring termination fees and proposing reliance damage model); Judd F. Sneirson, *Merger Agreements, Termination Fees, and the Contract-Corporate Tension*, 2002 COLUM. BUS. L. REV. 573, 577–84 (discussing termination fees and their implications and tension under both contract and corporate legal doctrines); Thomas A. Swett, *Merger Terminations After Bell Atlantic: Applying a Liquidated Damages Analysis to Termination Fee Provisions*, 70 U. COLO. L. REV. 341, 342–43 (1999) (arguing that corporations should use termination fee provisions drafted as liquidated damages provisions to avoid enhanced business judgment rule and corresponding fiduciary duties).

6. See Kevin A. Rinker & Shelby E. Parnes, *Something Old, New, Borrowed and Blue*, DAILY DEAL, Jul. 29, 2009.

7. According to practitioner surveys, in 2005–2006, over sixty percent of all private equity buyouts had reverse termination fees. Franci J. Blassberg & Kyle A. Pasewark, *Trendwatch: Deal Terms*, DEBEVOISE & PLIMPTON PRIVATE EQUITY REP., Winter 2006, at 11; DOUG WARNER & ALISON HAMPTON, WEIL, GOTSHAL & MANGES, LLP, SURVEY OF SPONSOR-BACKED GOING PRIVATE TRANSACTIONS 15 (2006).

8. For an excellent account of the rise of RTFs in private equity deals and their contribution to the demise of some of these deals, see generally Steven M. Davidoff, *The Failure of Private Equity*, 82 S. CAL. L. REV. 481, 482–87 (2008).

strategic deals entered into during the economic crisis.⁹ The migration of private equity-style RTF provisions to strategic deals and their rising prominence indicate that there is much to discuss about the nature of these provisions.

An analysis of RTF provisions is particularly timely. In part due to the current financial crisis, the payment of such fees and their role as an exclusive remedy in acquisition agreements have recently been at the center of debate among parties in broken deals and the subject of heated litigation in the Delaware courts.¹⁰ Moreover, RTFs have emerged even in the face of somewhat improved economic conditions and, as this Article argues, will remain a significant feature of acquisition agreements.

This Article presents the first detailed study in legal literature of the use of RTFs to allocate deal risk in strategic acquisitions. The author uses original data collected from an empirical study of strategic acquisition agreements involving public companies in the United States announced during two separate periods: January 1, 2003 through December 31, 2004 (“2003–2004 period”), and January 1, 2008 through June 30, 2009 (“2008–2009 period”).¹¹ While these two periods provide a limited pool of data and do not cover the full period of time in which parties have used RTFs,¹² this study reveals two

9. Strategic acquisition transactions are deals where the buyer and seller are both operating companies and agree to the transaction in order to achieve operating synergies, market power or empire building. *See infra* notes 20–27 and accompanying text.

10. *See, e.g.*, *United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810, 822 (Del. Ch. 2007) (discussing a party’s payment of reverse break-up fees as its exclusive remedy); *see also infra* notes 116–123 and accompanying text (discussing recent controversy and litigation over these fees).

11. The empirical study excluded transactions announced during the period from January 1, 2005 to December 31, 2007. RTFs were seldom used in acquisition transactions overall prior to 2005, however they began to play a prominent role in hundreds of private equity acquisitions of public companies in the 2005–2007 period. *See generally* Davidoff, *supra* note 8 (addressing private equity acquisitions in utilizing a reverse termination fee structure). This study aims to assess the impact on strategic transactions from the changing allocation of deal risk in private equity transactions and the ultimate breakdown of many of these deals. *See* Part I for a description of the increasing use of the RTF structure in private equity acquisitions of public companies to permit the buyer to walk away from the transaction by paying the RTF.

12. Earlier empirical investigations by finance scholars found reverse termination fees in one percent of deals in 1989, and about thirteen percent in 1998. Thomas W. Bates & Michael L. Lemmon, *Breaking Up Is Hard To Do? An Analysis of Termination Fee Provisions and Merger Outcomes*, 69 J. FIN. ECON. 469, 470 (2003); Micah S. Officer, *Termination Fees in Mergers and Acquisitions*, 69 J. FIN. ECON. 431, 435 (2003). An expansive study of RTF provisions for deals announced from 1997 through 2007, using a data set of 2,024 observations, found that 463 observations, or approximately twenty-three percent, included RTF provisions. *See* Elizabeth Nowicki, *Reverse Termination Fee Provisions in Acquisition Agreements* (Third Annual

important findings. First, this study demonstrates that RTFs are indeed on the rise. Second, and more importantly, this study identifies the changing and increasingly complex nature of these fee provisions and how parties are using them to transform the allocation of deal risk between buyers and sellers.

In analyzing the transformation of deal risk through the use of RTF provisions, this Article goes beyond the classic economic analysis of contracts¹³ to contribute to an understanding of the organizational perspective on contracts.¹⁴ Accordingly, this Article explains why buyers and sellers have increasingly turned to RTFs to govern the ramifications of one party walking away from the deal. In providing this explanation, this Article is informed by, but not limited to, the social and economic contexts in which these deals took place.¹⁵

This Article argues that the rise and use of RTFs in strategic deals have a number of important implications for both deal-makers and corporate law scholars. Strategic buyers are not only borrowing from the private equity playbook, but they are also expanding upon and altering the private equity RTF structure. As this Article reveals, the types of RTFs that have been employed by strategic deals in the wake of the economic crisis have been numerous and are still evolving. The differing uses of the RTF provision present important models for structuring deal risk. These evolving deal terms and the reallocation of deal risk in acquisition agreements reflect not only a more thoughtful approach to deal-making as a result of the lessons learned

Conference on Empirical Legal Studies Paper, Apr. 16, 2008), available at <http://ssrn.com/abstract=1121241> (examining data concerning termination fees).

13. There are numerous theoretical debates in the economic analysis of contracts about how parties use contracts to allocate risks through breach of contract remedies to shift risks to parties who can bear them most efficiently. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 105–08 (7th ed. 2007) (analyzing and citing examples of contracts as insurance); A. Mitchell Polinsky, *Risk Sharing Through Breach of Contract Remedies*, 12 J. LEGAL STUD. 427, 428 (1983) (addressing the effects of risk allocation via the use of examples); see also Eric A. Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure*, 112 YALE L.J. 829, 832 (2003) (highlighting the basics of the economics of contract law). One of the seminal articles illuminating the economic analysis of contract law is Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977).

14. See D. Gordon Smith & Brayden G. King, *Contracts as Organizations*, 51 ARIZ. L. REV. 1, 2–3 (2009) (discussing theoretical perspectives, the role of economic theories, and the application of organizational theories to contract law). According to Smith and King, “organizational theories attempt to explain why organizations do what they do.” *Id.* at 3.

15. Numerous contract law scholars have argued that understanding deals requires an understanding of the “institutional and social context in which the parties strike a deal.” Victor Fleischer, *Brand New Deal: The Branding Effect of Corporate Deal Structures*, 104 MICH. L. REV. 1581, 1589 (2006); see also Smith & King, *supra* note 14, at 7–10 (presenting overview of relational contract theory).

from deals that failed in connection with the financial crisis, but also the evolutionary nature of deal-making. Exploring the evolution of the RTF provision can give us greater insights into how parties use complex contractual provisions to engage in contractual innovation. This Article also explains that, while RTFs can provide potential flexibility and predictability for both sides in an acquisition transaction, the option-style structure that has emerged in some strategic transactions could present significant problems for sellers and buyers. Recent troubles in strategic transactions using RTF provisions reveal the somewhat problematic nature of these provisions. Furthermore, the varied uses of RTF provisions have important implications for courts' assessment of the invocation and content of such provisions.

With these considerations in mind, this Article proceeds in four parts. Part I provides an overview of the structure of acquisition transactions and the contractual remedies generally set forth in acquisition agreements. Part I also provides a coherent explanation of the differences between strategic and financial (private equity) transactions.¹⁶ In doing so, it illustrates how parties in each of these types of transactions traditionally allocated deal risk.

Part II describes the results of the empirical study undertaken in this Article. The study examines the use of RTFs during two separate periods: January 1, 2003 through December 31, 2004, the period prior to the private equity boom of 2005–2007; and January 1, 2008 through June 30, 2009, the period after the failure of a number of private equity deals with RTF structures. The study of strategic deals announced between January 1, 2003 and December 31, 2004 illustrates the infrequent use of RTF provisions in strategic transactions prior to the aggressive private equity deal-making era of 2005–2007.¹⁷ Moreover, a contract-by-contract analysis demonstrates that parties generally used RTF provisions to allocate risks similar to those allocated by STFs, such as the risk that the transaction would fail to close due to a superior proposal *for the buyer*. Thus, parties in strategic transactions in 2003–2004 used RTFs in a limited manner to compensate the non-terminating party—in other words, the seller—for

16. The term “private equity” as used in this Article refers to privately held partnerships, which acquire and “take private” publicly held companies, primarily using a leveraged financing structure. See Brian Cheffins & John Armour, *The Eclipse of Private Equity*, 33 DEL. J. CORP. L. 1, 9 (2008) (using similar terminology).

17. See Appendix A for details of the methodology used to identify strategic transactions. Appendix B includes sample RTF provisions from the two periods included in the empirical study.

the expenses that it incurred during the transaction and to deter bidders for the buyer from obstructing the transaction. Furthermore, the vast majority of these contracts continued to include a right for the seller to seek the remedy of specific performance in lieu of the RTF.¹⁸

Part II also provides the results of the empirical study of strategic deals announced between January 1, 2008 and June 30, 2009, along with a comparison of this data with the results from the 2003–2004 period. While RTFs were of limited use in strategic deals in the 2003–2004 period, in the 2008–2009 period, they emerged in numerous strategic acquisition agreements and in forms that differ significantly from their prior use. An analysis of each of these agreements demonstrates that parties are utilizing RTFs more frequently to allocate different types of deal risk, such as the risk that the buyer will be unable to obtain financing for the transaction or that the buyer will refuse to close the transaction for any reason. Furthermore, RTFs are increasingly being used as the seller's sole and exclusive remedy in the event of the buyer's failure to close the transaction. Thus, buyers have greater flexibility to walk away from a deal, while sellers face a greater risk that the transaction will not be completed.

Part III examines the increasing use of RTFs in the 2008–2009 period and the migration of the RTF provision from private equity transactions to strategic transactions following the advent of the financial crisis. Part III also analyzes why strategic buyers have eagerly embraced these provisions and the competing rationales of sellers that have agreed to such provisions. Part IV assesses the implications of RTF provisions for acquisition transactions. It argues that, while the increasing use of RTFs demonstrates how parties use complex contractual provisions to allocate deal risk, there are a number of shortcomings in the RTF structures being used. A brief conclusion summarizes the Article.

I. THE STRUCTURES OF ACQUISITION TRANSACTIONS

Before discussing the transformation of RTF provisions in acquisition agreements, a basic overview of acquisition transactions and agreements is helpful.¹⁹ Section A below begins by explaining the

18. Specific performance is an extraordinary equitable remedy that compels a party to execute a contract according to the precise agreed terms or to execute it substantially so that, under the circumstances, justice will be served. See *infra* notes 55–65 and accompanying text.

19. For a detailed overview of the various provisions included in acquisition agreements, see Kling et al., *supra* note 2, at 781.

differences between the two most oft-discussed acquisition types, strategic transactions and financial transactions, which are generally undertaken by private equity buyers. Section B sets forth an overview of acquisition agreements. It explains the origins of RTFs and their initial limited use in strategic transactions. Section C then examines the significant differences in acquisition agreements involving strategic buyers and those involving private equity buyers and explains the rise of RTFs in private equity buyouts.

A. Strategic Buyers vs. Private Equity Buyers

As set forth in a leading book on mergers and acquisitions, there are two basic types of buyers—*strategic* and *financial*.²⁰ This distinction is frequently used in academic and industry literature, as well as in Delaware court opinions.²¹ Strategic transactions generally involve operating synergies between the businesses of the buyer and the seller, or the aggregation of greater market power in a particular product line, for example the combination of two pharmaceutical companies.²² Accordingly, strategic buyers are companies in competition with the seller or companies that operate in a similar industry and can use the seller's assets to supplement and/or complement their existing business.²³ In terms of the acquisition consideration, strategic buyers can use cash, stock, or a combination of the two, and a significant portion of strategic transactions uses buyer

20. STANLEY FOSTER REED & ALEXANDRA REED LAJOUX, *THE ART OF M&A: A MERGER ACQUISITION BUYOUT GUIDE* 7–8 (3d ed. 1999).

21. See, e.g., *In re Lear Corp. S'holder Litig.*, 926 A.2d 94, 122 (Del. Ch. 2007) (stating that “a strategic buyer would seemingly have been presented with substantial freedom to develop a topping bid for [the seller] premised on a post-consummation business strategy that incorporated the greater synergies that arguably can be reaped in a cash conquest resulting in a combined asset base under the acquirer's sole control”); *In re Topps S'holder Litig.*, 926 A.2d 58, 62 (Del. Ch. 2007) (addressing a situation where, in the process of contacting both strategic and financial bidders, the only serious bidder for a corporation was its main competitor); WILLIAM J. CARNEY, *MERGERS AND ACQUISITIONS: THE ESSENTIALS* 111 (2009); MAYNARD, *supra* note 2, at 10, 63 (discussing explosive growth of private equity buyers); Paul M. Healy, Krishna G. Palepu & Richard S. Ruback, *Which Takeovers Are Profitable? Strategic or Financial?*, 38 *SLOAN MGMT. REV.* 45 (1997); Christina M. Sautter, *Shopping During Extended Store Hours: From No Shops to Go-Shops—the Development, Effectiveness, and Implications of Go-Shop Provisions in Change of Control Transactions*, 73 *BROOK. L. REV.* 525, 555 (2008) (discussing differences in negotiation style of private equity buyers versus strategic buyers).

22. See CARNEY, *supra* note 21, at 111; REED & LAJOUX, note 20, at 2 (addressing merger movements); STEPHEN M. BAINBRIDGE, *MERGERS AND ACQUISITIONS* 41–42 (2d ed. 2009) (discussing strategic acquisitions in different contexts).

23. See, e.g., MAYNARD, *supra* note 2, at 10–11 (discussing differences between goals of strategic versus financial buyers).

stock as consideration.²⁴ In addition, since strategic buyers can generate revenues from functioning businesses or sell stock to interested investors, they can often generate their own cash to fund acquisitions.

Financial transactions emerged in the 1980s, which witnessed the heyday of corporate raiders and junk bonds and the formation of private equity powerhouses such as Kohlberg Kravis Roberts & Co.²⁵ Financial transactions differ from strategic transactions in both their goals and structure. Private equity buyers seek to acquire companies that they can grow and/or improve with the ultimate goal of selling “the cleaned up company to another buyer within a few years for a substantial gain, or alternatively, [taking] the company public.”²⁶ Unlike strategic transactions where the merger consideration consists of cash or stock, financial buyers generally tend to acquire companies through the use of leverage, which includes debt financing commitments from a consortium of lenders. In a typical private equity-sponsored leveraged buyout, the seller’s assets are used as collateral and the seller’s income is used to service the debt.²⁷ As discussed in Part I.C, this use of leverage necessitates certain contractual terms in private equity acquisition agreements.

Traditionally, acquisition agreements in strategic transactions have differed markedly from those governing private equity transactions. These differences reflect the distinct goals of strategic buyers versus private equity buyers and the variation in the structures used to achieve each type of transaction. The discussion below begins with a brief general description of acquisition agreements and follows with an overview of the traditional differences between acquisition agreements involving these two types of buyers.

B. The Traditional Structure of Acquisition Agreements

1. Representations, Covenants, and Closing Conditions

Most acquisition agreements, whether involving strategic or private equity buyers, follow a similar structure with several key

24. See Theodore N. Mirvis, *Takeover Law and Practice 2008*, in WHAT ALL BUSINESS LAWYERS MUST KNOW ABOUT DELAWARE LAW DEVELOPMENTS 2009, at 83, 210 (2009).

25. For a brief overview of the emergence of financial transactions, see MAYNARD, *supra* note 2, at 516–19.

26. See *id.* at 63.

27. Jeffrey Blomberg, *Private Equity Transactions: Understanding Some Fundamental Principles*, 17 BUS. L. TODAY 51, 51–52 (2008).

parts which make up the bulk of the agreement. These include representations and warranties, covenants, closing conditions, and termination rights.²⁸ These parts are interrelated so that parties are in essence designing a package of rights and obligations with respect to closing the transaction. The complex relationship among these provisions is necessitated in part by the often significant delay between signing and closing of the transaction.²⁹ The sections below provide a brief overview of each of these key parts.

a. Representations and Warranties

The representations and warranties serve as both a “disclosure tool” and as a “risk allocation tool.”³⁰ The seller’s representations allow the buyer to perform due diligence on the company and to understand the seller’s business. If the seller’s representations are not true at closing, subject to a materiality or material adverse effect qualification, then the buyer has the opportunity to walk away from the deal without payment of a termination fee.³¹ The buyer’s representations and warranties allow the seller “to know who it is dealing with, to understand exactly what has to happen before the buyer can close the deal and to be as sure as possible that on the day of closing the buyer can actually come up with the purchase price.”³²

b. Covenants

The covenants address the period between signing and closing and include a forward-looking set of provisions, which obligate both the buyer and seller to perform, or refrain from performing, a variety of actions. For example, most acquisition agreements include covenants that govern the transaction process, such as a covenant from the seller to take certain actions to obtain any necessary stockholder approvals.³³ Buyers also insist on a covenant from the

28. See MAYNARD, *supra* note 2, at 307–13.

29. See *id.*

30. *Id.* at 309–10. The “bring-down” of the representation and warranties to the time of closing is subject to a material adverse effect in order to exclude minor inaccuracies from serving as a failure of closing conditions. See Choi & Triantis, *supra* note 1, at 892 (describing “bring-down” provisions as constraints on a seller); Kling et al., *supra* note 2, at 800 (addressing the bring-down of representations and warranties and the function of materiality qualifiers).

31. Kling et al., *supra* note 2, at 783; Miller, *supra* note 1, at 2044.

32. Kling et al., *supra* note 2, at 794.

33. Under state corporate code, completion of the merger is dependent on approval by the seller’s, and at times the buyer’s, shareholders. See, e.g., CAL. CORP. CODE § 1201 (West 2006)

seller that it will operate its business only in the “ordinary course” and “consistent with past practice” between signing the acquisition agreement and closing in order to ensure that no significant or unusual transactions are undertaken without the buyer’s knowledge and consent.³⁴ Some of the most negotiated covenants in acquisition agreements are related to the buyer’s acquisition consideration—for example, covenants related to obtaining financing. Other highly negotiated covenants relate to deal protection. These are discussed in Part I.B.2 below.

c. Closing Conditions

The closing conditions section of the agreement sets forth the obligations that must be satisfied by the parties at or before the closing of the transaction. Thus, closing conditions give rise to walk rights for the parties.³⁵ The intersection of these various provisions with termination rights can be difficult to understand and the terms vague.³⁶ For example, a determination of the extent to which a failure of certain closing conditions will result in termination rights involves judgments about the interplay of these terms. Moreover, assessing the extent to which parties are allocating risk through certain closing and termination rights depends on a careful reading and interpretation of the intricacies of the contractual language.³⁷

In addition to closing conditions related to the continuing veracity of the representations and warranties, the closing obligation typically includes a condition that the other party has complied with its covenants between signing and closing. For example, a closing condition may stipulate the delivery “of certain written assurances from [the seller’s] auditors. If [the seller] cannot satisfy this condition at (or before) the date set for closing, then [the buyer] can walk away from the deal without any recourse on the part of [the seller].”³⁸ Other closing conditions relate to exogenous circumstances deemed necessary to close the transaction, such as the availability of

(addressing shareholder approval requirements in corporate reorganizations); DEL. CODE ANN. tit. 8, § 251 (2002) (addressing requirements for merger of Delaware corporations).

34. See CARNEY, *supra* note 21, at 106.

35. See Choi & Triantis, *supra* note 1, at 12 (describing closing conditions as “contingencies under which the parties are free to walk away from a deal”).

36. See Claire A. Hill, *Bargaining in the Shadow of the Lawsuit: A Social Norms Theory of Incomplete Contracts*, 34 DEL. J. CORP. L. 191, 194–99 (2009) (describing ambiguities in complex acquisition agreements).

37. See *id.* at 200 (giving examples of contract clause problems).

38. MAYNARD, *supra* note 2, at 313.

financing, governmental and other third-party consents, or shareholder approval.

Both parties spend a considerable amount of time addressing the closing conditions and related provisions, in part to balance the seller's desire for certainty and the buyer's desire to maintain flexibility until closing. Sellers, especially public companies subject to the demands of shareholders, place a great deal of emphasis on the certainty of closing.³⁹ This emphasis is due to the seller's risks in connection with the proposed sale of the company, including the loss of employees and senior management, the prolonged disruption of ordinary business operations, and the fear of securities class action lawsuits in the event that the transaction fails to close. Furthermore, the breakdown of a publicly-announced acquisition will likely mean that "the rejected [seller] will suffer valuation backlash [and] . . . is going to be viewed by the market as tainted, and that taint is going to be directly reflected in the target's stock price."⁴⁰ Buyers, on the other hand, want to maintain maximum flexibility to avoid closing the transaction—that is, optionality—in the event of some change in expected circumstances.⁴¹

d. Termination Rights

In order to balance the inevitable tensions between the goals of sellers and buyers, acquisition agreements provide for termination rights. These rights typically derive from the agreement's closing conditions and can be exercised in the event that specified conditions to closing are not satisfied or waived.⁴² For example, termination rights arise if the transaction is not completed by a specified date or "if a final, non-appealable injunction against the transaction is obtained or if the conditions otherwise become impossible to satisfy."⁴³

39. See Brian JM Quinn, *Bulletproof: Mandatory Rules for Deal Protection*, 32 J. CORP. L. 865, 882–83 (setting forth reasons why sellers want to ensure that a signed transaction becomes completed).

40. Elizabeth Nowicki, *Lessons Learned from Private Equity Deals 4* (2008) (unpublished working paper), available at <http://ssrn.com/abstract=1430213>.

41. See Choi & Triantis, *supra* note 1, at 858 ("In light of the foregoing objectives of contracting and the tension between the needs for commitment and flexibility, an important feature of modern contracts is the right of one party or another to walk away from the contract: to terminate, cancel or be excused from its obligations."). Practitioners sometimes refer to this as the characteristic of "optionality."

42. See *id.* at 862 ("Contracting parties do not choose between conditions and termination rights, but rather design a package of these terms.").

43. Kling et al., *supra* note 2, at 807.

Parties often spend considerable time negotiating two specific termination rights: (1) terminations in the event of a material adverse event or change (“MAC”)⁴⁴ with respect to the seller (and sometimes the buyer) in the interim period between signing and closing;⁴⁵ and (2) terminations related to the emergence of a third-party bidder. The sections below discuss these provisions in more detail.

44. See COMM. ON NEGOTIATED ACQUISITIONS OF THE ABA’S SECTION OF BUS. LAW, PRIVATE EQUITY BUYER/PUBLIC TARGET M&A DEAL POINTS STUDY 16–17 (2007), available at <http://blogs.law.harvard.edu/corpgov/files/2007/09/20070914-private-equity-deal-points-study.pdf> [hereinafter 2007 ABA DEAL POINTS STUDY] (discussing “Buyer’s MAC/MAE Walk Right” issues); James R. Griffin, *2008 M&A Deal Point Study: Strategic Buyer/Public Company Targets*, M&A LAW., Jan. 2009, at 5 (finding that ninety-eight percent of deals studied contained MAC walk right). Typically a MAC is defined as:

[A]ny change, event, violation, inaccuracy, circumstance or effect that is materially adverse to the business, assets, liabilities, financial condition, results of operations or prospects of the Target and its Subsidiaries taken as a whole, other than as a result of: (i) changes adversely affecting the United States economy (so long as the Target is not disproportionately affected thereby); (ii) changes adversely affecting the industry in which the Target operates (so long as the Target is not disproportionately affected thereby); (iii) the announcement or pendency of the transactions contemplated by this Agreement; (iv) the failure to meet analyst projections, in and of itself; (v) changes in laws; (vi) changes in accounting principles; or (vii) acts of war or terrorism.

2007 ABA DEAL POINTS STUDY at 19. Of course, the carve-outs set forth in this definition differ based on the industry and circumstances of the parties to the transaction. For a comprehensive study of MAC provisions, see Miller, *supra* note 1. See also Ronald J. Gilson & Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisitions*, 21 J.L. ECON. & ORG. 330, 330–31 n.3 (2005).

45. While the parties generally spend considerable time negotiating the definition of a MAC, courts have interpreted this provision very narrowly. In a recent decision, *Hexion Specialty Chem. v. Huntsman Corp.*, the Delaware Chancery Court reiterated that the Delaware courts take a long term view with respect to determining whether a MAC has occurred and have in fact never found a MAC to have occurred in the context of an acquisition transaction. 965 A.2d 715, 738 (Del. Ch. 2008) (“The important consideration . . . is whether there has been an adverse change in the target’s business that is consequential to the company’s long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months Many commentators have noted that Delaware courts have never found a material adverse effect to have occurred in the context of a merger agreement. This is not a coincidence.”); see also *Frontier Oil v. Holly Corp.*, No. Civ.A. 20502, 2005 WL 1039027, at *34 (Del. Ch. Apr. 29, 2005) (noting that it is the court’s function to determine what the parties mean by “material adverse effect”); *In re IBP, Inc. S’holders Litig.*, 789 A.2d 14, 68 (Del. Ch. 2001) (“Merger contracts are heavily negotiated and cover a large number of specific risks explicitly. As a result, even where a Material Adverse Effect condition is as broadly written as the one in the Merger Agreement, that provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner. A short-term hiccup in earnings should not suffice; rather the Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquiror.”) (citation omitted).

2. Deal Protection

Parties to acquisition transactions generally include certain “deal protection” devices, such as STFs, in order to provide “protections from, or compensation for, interference with the transaction by a third party.”⁴⁶ These deal protection devices are woven into the covenants, conditions, and termination sections of the agreement. Deal protection devices have long been blessed by the Delaware courts, particularly in transactions not involving a sale of control, as an accepted method for shielding the deal from third-party bidders.⁴⁷ However, the Delaware courts have significantly limited the parties’ ability to use deal protection covenants in such a way that the acquisition agreement prevents the seller from accepting a superior offer from a third-party bidder.⁴⁸ This series of Delaware cases have been described by scholars as resulting in a “judicially-created fiduciary put.”⁴⁹

Generally, the buyer seeks to limit the emergence of and the seller’s ability to court third-party bidders after the execution of the acquisition agreement. In most negotiations, lawyers spend considerable time drafting and negotiating covenants that address to what extent one of the parties, most often the seller, can negotiate with a third-party bidder that emerges after the signing of the original acquisition agreement. More recently, some buyers (generally private equity firms) have provided for a brief “go-shop” period in order to

46. Mirvis, *supra* note 24, at 159.

47. For a detailed discussion of the Delaware court’s treatment of deal protection devices, see Quinn, *supra* note 39, at 873–76.

48. In transactions not involving a change of control, the Delaware courts have reviewed deal protection devices under the two-step *Unocal* enhanced scrutiny standard. See *Omicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 927–39 (Del. 2003) (discussing the standard of judicial review and level of scrutiny in such cases). Under the first step of the *Unocal* enhanced judicial scrutiny of deal protection measures designed to protect a corporation’s merger agreement, the seller’s board of directors must demonstrate they had reasonable grounds for believing that a third-party bid would be a danger to corporate policy and effectiveness. *Id.* at 935. The second step requires that the directors “demonstrate that their defensive response was reasonable in relation to the threat posed” meaning that such deal protection devices were not “coercive” or “preclusive,” and were within a “range of reasonable responses” to the perceived threat. *Id.* Deal protection devices in change-of-control transactions involve the more exacting *Revlon* test which requires that the device is designed to secure the best value reasonably available to shareholders. *Id.* at 928 (citing *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986)).

49. Brian JM Quinn, *Optionality in Merger Agreements*, DEL. J. CORP. L. (forthcoming) (manuscript at 1), available at <http://ssrn.com/abstract=1503556>.

alleviate fiduciary duty concerns.⁵⁰ However, most buyers will insist on a “no-shop” covenant, which prohibits the seller from soliciting or encouraging a third-party bidder.⁵¹ Due to judicially-mandated restrictions, almost all merger agreements give the seller a “fiduciary out” exception to the no-shop provision to permit the seller to negotiate with and provide information to the third-party bidder with a superior proposal in the event the seller board’s fiduciary duties require them to do so.⁵²

The emergence of a third-party bidder can also lead to termination rights under an acquisition agreement. “The key issue is often whether the [seller] can terminate the agreement in order to accept a competing proposal . . . [or] whether the mere emergence of a third party bid” should give the original buyer the right to terminate the initial agreement even if the seller seeks to close the transaction.⁵³ In addition, to further protect the deal, buyers generally insist on an STF in the event the agreement is terminated prior to closing due to a competing proposal for the seller. The section below addresses in more detail the role of and limitations on such fees.

3. Termination Fees and Equitable Remedies

As discussed above, acquisition agreements generally include a set of termination rights for the parties. In connection with termination provisions, certain sections address remedies for a breach or termination of the agreement by either party. Traditionally, acquisition agreements have included a specific performance remedy for both the buyer and seller, subject to payment of termination fees as an alternative remedy under certain circumstances.⁵⁴ While specific performance has traditionally played a significant role in strategic acquisition agreements, the empirical study in Part II of this Article demonstrates limitations on this remedy in strategic deals in the

50. A “go-shop” is a provision that provides for a period of time after the signing of the transaction during which the seller can actively solicit third-party bidders. For a detailed discussion of go-shops, see Sautter, *supra* note 21, at 557.

51. See Kling et al., *supra* note 2, at 799 (noting that buyers often push sellers to agree to a “no-shop” provision); see also Keith A. Flaum, *2007 M&A Deal Point Study: Public Targets*, M&A LAW., Feb. 2008, at 8 (finding that no strategic transaction in 212 deals studied included go-shop provisions).

52. Kling et al., *supra* note 2, at 799.

53. *Id.* at 808.

54. See Griffin, *supra* note 44, at 11 (finding in 2008 study of large strategic acquisitions that ninety-three percent included specific performance remedy, of which almost all granted that remedy to both buyer and seller).

2008–2009 period. Instead, the RTF has begun to replace specific performance in a number of transactions. Part III of this Article explores why that is the case. Before turning to the recent limitations on specific performance in strategic deals, it is worth discussing the availability of specific performance in strategic acquisitions.

a. Specific Performance

Specific performance is an extraordinary equitable remedy that compels a party to execute a contract according to the precise agreed terms or to execute it substantially so that under the circumstances, justice will be served. The goals of specific performance are to ensure the promisee receives the full benefits of his bargaining efforts and to deter opportunistic promisors from breaching the contract.⁵⁵

While specific performance is generally viewed as “an extraordinary remedy” to be granted when there is irreparable injury or an inadequate remedy at law, courts have granted specific performance in the merger context.⁵⁶ In fact, “courts routinely award specific performance to enforce contracts to sell businesses”⁵⁷ More frequently, the specific performance remedy is sought by and granted to a buyer that claims “it cannot be made whole unless it can specifically enforce the acquisition agreement, because the [seller] company is unique and will yield value of an unquantifiable nature, once combined with the acquiring company,” and that damages would not be an adequate remedy.⁵⁸ Nevertheless, in a number of high-profile cases, courts have granted specific performance to sellers as well, as most visibly demonstrated in the famous case of *IBP v. Tyson* and more recently demonstrated in the *Genesco v. Finish Line* litigation.

The Delaware Court of Chancery surprised many with its specific performance ruling on the contentious acquisition of IBP by Tyson. Tyson, the country’s largest chicken producing company, attempted to invoke a MAC clause in order to exit its merger with IBP, the largest beef producer.⁵⁹ In rejecting Tyson’s MAC claim, the court explained that Tyson decided to purchase IBP “fully aware of the

55. Yair Listokin, *The Empirical Case for Specific Performance: Evidence from the Tyson-IBP Litigation* 2 J. EMPIRICAL LEGAL STUD. 469, 470 (2005).

56. Jordan A. Goldstein, *The Efficiency of Specific Performance in Stock-for-Stock Mergers*, 29 DEL. J. CORP. L. 747, 751 (2004).

57. *Id.*

58. *In re IBP, Inc. S’holders Litig.*, 789 A.2d 14, 82–83 (Del. Ch. 2001).

59. See Listokin, *supra* note 55, at 471 (outlining the facts of the case).

cyclical factors that affect commodity meat products.”⁶⁰ Yet following a post-merger agreement cyclical downturn in the beef industry, Tyson attempted to invoke its MAC clause to walk away from the deal. The court ruled that the “notion that the [MAC clause] gave Tyson a right to walk away simply because of a downturn [in the industry] is equally untenable.”⁶¹ The court viewed Tyson’s attempt to assign the external risk of the deal to IBP via the MAC as inappropriate.⁶² Instead of awarding typical money damages for breach, the Delaware Court of Chancery ruled for specific performance of the merger agreement, explaining that specific performance was necessary due to the difficulty in calculating damages.⁶³

Similarly, in a 2007 dispute between shoe and hat retailer Genesco, Inc. and sportswear retailer Finish Line, Inc., the Tennessee Chancery Court ruled that Finish Line must complete its \$1.5 billion acquisition of Genesco. After intense criticism of Finish Line’s handling of the details of the merger, the Tennessee court concluded that the agreement did not permit Finish Line to refuse to close the transaction by claiming material adverse changes at Genesco. In ordering specific performance of the acquisition agreement, the court recognized that the announcement of a merger transaction and the ensuing litigation between the parties placed the seller “in a state of limbo. Uncertainty has negatively affected its stock price, vendor relationships, employee morale, public perception, and virtually every other aspect of its business.”⁶⁴ Furthermore, the court stated that the agreement itself placed tremendous pressure on the ongoing operations of the seller during the pendency of the transaction: “Due to restrictions that the Merger Agreement imposes on its activities pending closing, it has been unable to open new stores, make significant capital expenditures, and otherwise engage in ordinary business activities that would be inconsistent with [the buyer’s] plan for [the target] but that would be necessary or desirable for an independent [target].”⁶⁵ Curiously, while the acquisition agreement provided for a specific performance remedy, the court ordered specific performance in reliance solely on Tennessee principles of equity rather than citing the provision in the actual agreement requiring it.

60. *IBP*, 789 A.2d at 45.

61. *Id.* at 66.

62. *See* Listokin, *supra* note 55, at 477 (explaining the decision).

63. *IBP*, 789 A.2d at 83.

64. *Genesco, Inc. v. The Finish Line, Inc.*, No. 07-2137-II(III), 2007 WL 4698244 (Tenn. Ch. Dec. 27, 2007).

65. *Id.*

b. Termination Fees

In addition to the specific performance remedy, and under certain circumstances in lieu of specific performance, acquisition agreements can provide for a termination fee to be paid by one of the parties to the deal as a remedy to the other party. The sections below describe each type of termination fee—that is, STFs (the fee payable by the seller) and RTFs (the fee payable by the buyer) in turn.

i. Standard Termination Fees

The vast majority of acquisition agreements include STF provisions.⁶⁶ STFs are payable by the seller to the buyer in the event the seller terminates the agreement prior to closing under certain circumstances. These circumstances generally encompass a failure to close the transaction because (1) the seller's board terminates the agreement in order to accept a competing offer; (2) the seller's board changes its recommendation in favor of the transaction and the buyer elects to terminate the merger agreement rather than proceed with the shareholder vote; or (3) the transaction fails for some other specified reason, such as being voted down by the seller's shareholders after a competing proposal has been announced and is agreed to or closed within a specified period of time (ranging from six to eighteen months).⁶⁷ To the extent that the STF is payable because of the judicial mandate that the seller must have the option to terminate the acquisition agreement in the face of a superior third-party bid, the STF can then be seen as the strike price of this option.⁶⁸

STFs serve a number of uses in the acquisition transaction. An STF provision can ensure that the buyer “will receive a material consolation prize to defray the [buyer's] investment—in time, out-of-pocket expense and opportunity cost—in the event the transaction is not consummated.”⁶⁹ Most often, STF provisions are used by the buyer as a deal protection device in order to deter a third-party bidder and are agreed to by sellers in order to “cement a deal with a favored [buyer] while keeping hostile [buyers] at bay.”⁷⁰ In addition, STFs

66. See CARNEY, *supra* note 21, at 112.

67. See HOULIHAN LOKEY, 2005 TRANSACTION TERMINATION FEE STUDY 2 (2006), available at <http://www.directorsandboards.com/DBEBRIEFING/December2006/TerminationFeeStudy2005.pdf>.

68. See Quinn, *supra* note 49, at 10 (“The strike price of this option is the termination fee.”).

69. HOULIHAN LOKEY, *supra* note 67, at 2.

70. David A. Skeel & John Armour, *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1735 (2007);

reflect a recognition by sophisticated parties that “leaving the outcome of a breach, including assessment of damages to a judge or even a jury, creates enormous uncertainty and a high degree of variance in expected outcomes which may be either outrageously high or low from the ex ante view of the parties.”⁷¹

The size of STFs has been limited by fiduciary duty principles that require directors to maximize shareholder value in a change of control transaction and to not enter into an agreement that deters a competing buyer or coerces the seller’s stockholders to accept the agreement.⁷² A study of termination fees in acquisition transactions announced during 2005 found that these fees ranged from 0.1–10.0 percent of deal value, with a median of 3.2 percent and a mean of 3.1 percent.⁷³ The study found similar results for transactions announced in 2004 and 2003.⁷⁴

ii. Reverse Termination Fees

Far less common than STFs are RTFs—that is, fees payable by the buyer to the seller. As recently as 2003, some experts deemed them to be an interesting and new method for parties to allocate deal risk in acquisition transactions.⁷⁵ Perhaps reflecting in part their specialized use, the scholarly literature analyzing RTFs has been limited.⁷⁶

RTF provisions arose in the late 1980s in the context of two competitors entering into an acquisition transaction. Because the

see, e.g., In re Toys “R” Us, Inc. S’holder Litig., 877 A.2d 975, 1017–21 (Del. Ch. 2005) (an example of such behavior).

71. CARNEY, *supra* note 21, at 113.

72. *See In re Toys “R” Us*, 811 A.2d at 999–1000. The court explains that under *Revlon* and its progeny, once directors decide to sell corporation, they should do what any fiduciary should do when selling assets, which is maximize sales price for benefit of those to whom their allegiance is pledged. In the corporate context, that means that directors must seek the highest value deal that can be secured for stockholders regardless of whether it is in best interests of other corporate constituencies. *See also Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 923 (Del. 2003).

73. *See HOULIHAN LOKEY, supra* note 67, at 4.

74. *Id.*

75. Spencer Klein & Steven Epstein, *Risky Business*, DAILY DEAL, Jun. 30, 2003, at 2; *see also Huntsman/Rexene Mired in Acrimony*, 20 MERGERS & RESTRUCTURING 47 (Dec. 9, 1996) (detailing failed bid by Huntsman Corp. to purchase Rexene Corp. when Rexene insisted on RTFs and noting that “a reverse break-up fee is virtually unheard of”).

76. *See Bates & Lemmon, supra* note 12, at 470 (“Although merger events have been studied in great detail, there has been little analysis of the role of termination fee provisions in these transactions.”); Nowicki, *supra* note 12, at 2 (“To date, only one academic paper has discussed in any detail reverse termination fee provisions.”).

combination of two competitors potentially involved regulatory risk or the risk of a third-party bidder for the buyer as well as for the seller, the acquisition agreement at times included provisions for termination fees to be paid by the buyer in the event that such risks caused the deal to fail.⁷⁷ The 2003–2004 empirical study in Part II of this Article describes in greater detail the typical uses of RTFs in strategic transactions.

Not only were RTF provisions used in a minority of acquisition transactions, but prior to the breakdown of deals with the onset of the 2007 financial crisis, the courts saw little litigation over these provisions. Prior to 2007, the two most prominent disputes over RTFs, Thomson-CSF, S.A.'s proposed acquisition of LTV Corporation and Central and South West Corporation's proposed acquisition of El Paso Electric,⁷⁸ arose in cases involving companies in bankruptcy. Each case demonstrates one of the traditional uses of RTF provisions—to allocate regulatory risk in acquisition transactions. The award of the RTF provisions in each of these cases and the seller's insistence on such provisions in the acquisition agreements reveal the utility of such fees in allocating regulatory risk to the buyer and in providing compensation to the seller in the event that regulatory approval hinders completion of the transaction.⁷⁹

77. See Bates & Lemmon, *supra* note 12, at 470 (finding that in 1989 less than two percent of all deals included seller termination fees and one percent included buyer termination fees while by 1998 termination fees were significantly more prevalent with over sixty percent of all deals including seller termination fees and one percent including buyer termination fees); see also Darren S. Tucker & Kevin Yingling, *Keeping the Engagement Ring: Apportioning Antitrust Risk with Reverse Breakup Fees*, ANTITRUST, Summer 2008, at 71, 71 (“Reverse breakup fees have been used in strategic transactions to mitigate the antitrust risk of the seller.”).

78. See *Company News; El Paso Sued After a Merger Collapses*, N.Y. TIMES, June 16, 1995, at D1 (“El Paso had . . . filed a breach-of-contract lawsuit against Central, which is based in Dallas, entitling El Paso to claim the \$25 million in termination fees.”); Cent. & S.W. Corp., Current Report (Form 8–K) (June 9, 1995), available at <http://www.sec.gov/Archives/edgar/data/18540/0000018540-95-000097.txt>. When CSW terminated the merger agreement in 1995 due to a failure to receive state and federal regulatory approvals, El Paso filed suit against CSW seeking a \$25 million RTF pursuant to the agreement, as well as unspecified damages for various contract and tort claims. Cen. & S.W. Corp., Annual Report (Form 10–K), at 2-23 (Dec. 31, 1997), available at <http://www.sec.gov/Archives/edgar/data/18540/0000018540-98-000028.txt>. The bankruptcy court issued an interim order finding CSW liable for the \$25 million RTF. Cent. & S.W. Corp., Current Report (Form 8–K) (Apr. 11, 1997), available at <http://www.sec.gov/Archives/edgar/data/18540/0000018540-97-000052.txt>.

79. A number of other high-profile strategic transactions have also involved reverse breakup fees tied to specific regulatory or industry risk. For example, in the \$500 million all-cash acquisition of ProBusiness Services Inc. by Automated Data Processing Inc., ProBusiness negotiated a \$25 million RTF as a result of antitrust concern. The fee was payable if ProBusiness terminated the agreement “if any litigation or proceeding . . . has been threatened to be instituted by any Person or governmental body” that in the “board’s good faith judgment is

The 1992 dispute over the RTF between Thomson-CSF, S.A. (“Thomson”), a defense electronics company that was primarily owned by the French government, and LTV Corporation is the quintessential example of the traditional use of RTFs. Prior to entering into the acquisition agreement, Thomson had engaged in a heated contest with Lockheed Corporation (“Lockheed”) and Martin Marietta Corporation (“Martin Marietta”) in order to acquire and operate the aircraft and missile business of LTV Corporation (“LTVAD”).⁸⁰ A significant portion of LTVAD’s revenues was derived from U.S. military contracts.⁸¹ Despite the fact that Thomson offered a higher bid, LTVAD indicated that it preferred Lockheed and Martin Marietta’s offer.⁸² LTVAD’s primary concern with the Thomson acquisition was that it involved a significant risk that the deal might be unable to obtain approval necessary under Exon-Florio legislation from the Committee on Foreign Investment in the United States (“CFIUS”).⁸³ After numerous hearings before the bankruptcy court regarding concerns with Thomson’s bid and assurances from Thomson that the

reasonably likely to enjoin or impair the benefits of the deal.” Agreement and Plan of Merger by and among Automatic Data Processing, Inc., ADP Merger Corp. and ProBusiness Servs., Inc., Current Report (Form 8-K) § 7.1(c) (Jan. 5, 2003); *see also* Agreement and Plan of Merger between Guidant Corporation, Diane Acquisition Corporation and Cook Group Incorporated (Form 8-K) §§ 6.2, 6.3 (July 30, 2002) (providing for \$50 million fee to seller in event that agreement was validly terminated based on condition to closing that was contingent upon positive clinical trial results and resolution of patent suit in favor of target).

80. *In re Chateaugay Corp. (Chateaugay I)*, 186 B.R. 561, 564 (Bankr. S.D.N.Y. 1995). According to the court, fifty-eight percent of Thomson-CSF’s outstanding shares and seventy-five percent of its voting shares were owned by a corporation wholly owned by the government of France. *In re Chateaugay Corp. (Chateaugay II)*, 198 B.R. 848, 850 (S.D.N.Y. 1996).

81. *Chateaugay II*, 198 B.R. at 850.

82. *Id.* at 852; *see also* Anthony Velocci, Jr., *Thomson, Carlyle Face Challenges in Bid to Win LTV’s Aviation Business*, 136 AVIATION WEEK & SPACE TECH. 23 (Apr. 13, 1992). In addition to the regulatory risk, LTVAD was also concerned that Thomson’s ownership of LTVAD’s missile business would substantially impair the company’s performance of contracts with the Pentagon. *Id.*

83. *See Chateaugay II*, 198 B.R. at 851–53. Approval of the President is required under the Exon-Florio Amendment to the Defense Production Act of 1950, Pub. L. No. 100-418, 102 Stat. 1107 (1988). The Exon-Florio Amendment authorizes the President “to suspend or prohibit any . . . acquisition . . . by or with a foreign person, of a person engaged in interstate commerce in the United States when, in the President’s view, the foreign interest exercising control over that person might take action that threatens to impair the national security.” 31 C.F.R. § 800.101 (2008). The President has delegated authority for implementing Exon-Florio to CFIUS, which is comprised of representatives from the Departments of Treasury, State, Commerce, and Defense, as well as the Council of Economic Advisors, Office of Management and Budget, and the U.S. Trade Representative. Exec. Order No. 12,661, 3 C.F.R. 618 (1988). The Treasury Department has issued regulations that implement Exon-Florio by means of a voluntary filing system, pursuant to which the parties to a foreign acquisition notify CFIUS of a proposed transaction. *See* 31 C.F.R. §§ 800.101–402 (2008).

company would be able to insulate foreign ownership, control, or influence through a Special Security Agreement, the court finally approved the sale of the divisions to Thomson. Significantly, in order to alleviate the concerns of LTVAD and the bankruptcy court, Thomson offered LTVAD a \$20 million RTF to cover LTVAD's potential losses, payable in the event that Thomson "failed to close the transaction due to an inability to obtain the requisite security approvals from the U.S. government."⁸⁴

After months of wrangling with the U.S. government to obtain clearance for the transaction and strident objections by members of Congress to Thomson's planned acquisition, it became clear that Thomson would be unable to obtain CFIUS approval. Accordingly, Thomson informed LTVAD that "it considered the acquisition agreement terminated."⁸⁵ However, Thomson refused to pay the RTF, arguing that LTVAD had violated its covenant to use reasonable efforts to consummate the transaction by assisting Thomson in procuring necessary government clearance. After a seven-day trial before the bankruptcy court, the court ordered Thomson to pay a \$29.3 million judgment to LTVAD to cover the RTF and expenses.

While historically of limited use in strategic acquisition transactions, RTFs began to take on a much more significant role in private equity acquisition agreements beginning in 2005.⁸⁶ In order to understand the surge in the use of RTF provisions, one must first understand the principal ways in which the structure of private equity acquisition agreements have differed from the structure of strategic acquisition agreements.

84. *Chateaugay II*, 198 B.R. at 853; *see also Chateaugay I*, 186 B.R. at 593 (stating, "the fee was a significant factor in the creditors' and the Court's decision to approve the sale to Thomson").

85. *In re Chateaugay Corp. (Chateaugay III)*, 155 B.R. 636, 645 (Bankr. S.D.N.Y. 1993).

86. *See* Michael Aiello et al., *Outline for Key Issues in Negotiation: Will the Pendulum Swing? Panel of the Private Equity Presentation*, in GOING PRIVATE: DOING IT RIGHT 2009, at 259 (PLI Corp. Law & Practice, Course Handbook Series No. 18768, 2009). The most highlighted example of this approach during the private equity boom was the March 2005 \$11.3 billion acquisition of SunGard Data Systems, Inc. by a private equity consortium. *See* Davidoff, *supra* note 8, at 494–96 (describing the structure of the transaction); Paul D. Ginsberg et al., *Shifting the Risk: An Evolving Approach to Financing Contingencies in LBO Acquisition*, M&A LAW., Mar. 2006, at 4; *see also* Martin Sikora, *LBO Funds Offer Incentives to Drive High-Priced Deals*, MERGERS & ACQUISITIONS, Sept. 2005, at 18 (describing SunGard transaction as "a major shift from traditional leveraged dealmaking").

C. The Structure of Acquisition Agreements in Private Equity Transactions

The discussion in Part I.B describes the general architecture of most acquisition agreements. However, there have traditionally been significant differences between acquisition agreements used in financial transactions involving private equity buyers and those in strategic transactions. These differences are necessitated by two important characteristics in private equity buyouts.⁸⁷ First, private equity buyers typically use a newly formed special purpose acquisition vehicle to purchase a company. The shell buyer is generally the only buyer entity that is a party to the acquisition agreement so as to limit the seller's recourse to the private equity firm for breaches of the agreement. Second, in acquiring a company, private equity firms often do not use their own equity or cash to finance the entire purchase price of the acquisition.⁸⁸ More commonly, the transaction is a leveraged buyout ("LBO"), whereby the shell buyer draws on financing from two separate sources, equity financing commitments from the private equity firms and debt financing commitments from a consortium of lenders. Therefore, in order to complete a typical LBO transaction the shell buyer must receive equity financing from the private equity funds involved in the transaction and loans from a syndicate of banks.

In most LBOs, prior to signing the acquisition agreement, the buyers obtain debt commitment letters signed by the lenders.⁸⁹ Sellers historically insisted on debt commitment letters because of a perception that the third-party debt financing used by private equity buyers, as opposed to strategic ones, was riskier to the selling company.⁹⁰ Generally, both the debt and equity commitment letters include certain conditions to the funder's obligation to finance the

87. For a detailed explanation of the structure of private equity acquisitions of companies, see Davidoff, *supra* note 8, at 488–98; see also Robert P. Bartlett III, *Taking Finance Seriously: How Debt Financing Distorts Bidding Outcomes in Corporate Takeovers*, 76 *FORDHAM L. REV.* 1975, 1980–82 (2008); Ronald J. Gilson & Charles K. Whitehead, Essay, *Deconstructing Equity: Public Ownership, Agency Costs, and Complete Capital Markets*, 108 *COLUM. L. REV.* 231, 231–40 (2008).

88. See Bartlett, *supra* note 87, at 1980 ("By the end of 2006, private equity firms were routinely outbidding strategic bidders, with LBOs representing over twenty-five percent of all acquisitions for the year.").

89. See Davidoff, *supra* note 8, at 491–92 (explaining the private equity structure).

90. The debt commitment letter negotiated by the sponsor, and later the target, was designed to reduce the conditionality of the disbursement and line these terms up with the underlying acquisition agreement. *Id.* at 492.

transaction, including conditions regarding adverse changes in the seller or financing markets, additional diligence and finalization of definitive documentation, and “marketflex” provisions allowing the lender or underwriter to alter the pricing, structure, and terms of the commitment in order to achieve a successful syndication.⁹¹ Accordingly, despite the receipt of a debt commitment letter, there remained a risk that the lenders would attempt to change the terms of the financing, or more drastically, would refuse to provide the financing. The traditional structure of acquisition agreements in LBOs therefore included specific provisions to address the financing risks inherent in these transactions.

1. Traditional Methods for Addressing “Financing Risk”

Because of risks attached to reliance on outside financing, for years private equity buyers sought to include provisions in the acquisition agreement that would allow them to retain the ability to terminate the agreement in the event the financing necessary to effect an LBO structure could not be attained on the expected terms.⁹² In contrast to strategic deals, which did not require that the buyer obtain financing as a closing condition and which provided sellers with the right to seek specific performance, sellers agreed to provide private equity buyers with a “financing out.”⁹³

Prior to 2005, an important component of acquisition agreements in private equity sponsored LBOs was the “financing out”—a condition to the buyer’s obligation to close an acquisition based on the availability of debt financing.⁹⁴ The financing condition was especially important to private equity firms because they were in the business of buying companies using debt financing, and hence

91. *Id.* at 492–93.

92. See John L. Graham & Bradley C. Vaiana, *Mergers & Acquisitions: Rolling the Dice*, N.Y. L.J., Nov. 7, 2005 (calling such provisions a traditional way to “protect private equity sponsors from the risk of obtaining financing”).

93. John G. Finley, *Evolving Agreements Offer Flexibility in Credit Crunch*, N.Y. L.J., July 30, 2009.

94. The typical financing condition states the following as a condition to the buyer’s obligation to close the transaction: “Financing. The Buyer shall have obtained the financing described in the Commitment Letters on the terms set forth in the Commitment Letters and on such other terms as are reasonably satisfactory to the Buyer.” 2007 ABA DEAL POINTS STUDY, *supra* note 44, at 24. The 2007 ABA Deal Points Study found in an analysis of seventy-nine deals announced in 2005 and 2006 that in 2005 forty-eight percent included a financing condition, but just one year later only twenty-three percent included a financing condition. *Id.* at 25.

stood to lose a lot of money if forced to go through with a deal without this leverage.⁹⁵

The financing conditions in LBO acquisition agreements necessarily involved an allocation of risk between private equity buyers and target company sellers. As explained above, sellers place heavy emphasis on certainty of closing.⁹⁶ The private equity buyer, on the other hand, seeks assurance in the agreement regarding both the circumstances in which it can terminate the agreement if the assumptions on which it agreed to buy the business have materially changed and the maximum amount of liability in the event the buyer terminates the agreement.

There were a number of reasons why sellers agreed to shoulder some of the risk associated with the financing in acquisition contracts. First, sellers agreed to transactions with “financing outs,” which exposed them to increased uncertainty about the probability that a deal would go through, but insisted on covenants that required the shell buyer to engage in a “good faith” effort, or more often “reasonable best efforts,” to obtain the necessary financing.⁹⁷ Of course, the enforceability of such covenants was uncertain given that the shell subsidiaries were empty acquisition vehicles and would be unable to complete the acquisition without the parent private equity firm.⁹⁸ Hence, one could argue that the financing out served as insurance for a private equity buyer and little more than a false sense of security to targets. In retrospect, as articulated by Professor Steven Davidoff, attorneys for sellers, along with their clients, actually relied on the private equity firm’s reputation as collateral, believing that the implications of walking away from a deal would motivate private equity firms to voluntarily cooperate in using best efforts to obtain financing.⁹⁹

95. More recently, especially in the period of relatively easy access to credit, private equity firms were even willing to enter into acquisition agreements without any financing condition and without any specific provision that would allow the buyer to walk away from the transaction in the event that financing could not be obtained.

96. See *supra* notes 39–41 and accompanying text.

97. Davidoff, *supra* note 8, at 514.

98. *Id.* at 523. This problem was coupled with the fact that the Delaware courts have yet to substantively define the meaning of reasonable best efforts. *Id.* at 514.

99. See *id.* at 485, 502; see also Graham & Vaiana, *supra* note 92 (stating that private equity buyers would be unlikely to rely on financing conditions as they cannot “afford to be seen as the high risk choice in a competitive auction—as that reputation would put pressure on other deal terms, particularly price”). Of course, it may be that the seller’s reliance on reputation was not wholly irrational. Private equity firms may have an incentive to achieve a high reputation by investing their committed capital and completing acquisition deals. This commitment to completing transactions may be beneficial to the private equity firm in a number of ways. A

In addition to financing-related covenants, sellers agreed to bear the financing-related risk by including a specific performance remedy in the acquisition agreement. As discussed above, courts have been known to grant specific performance in the merger context, at least in strategic transactions.¹⁰⁰ There is also an argument that a specific performance provision may have the effect of reducing the probability of a breakdown in the transaction prior to closing of the acquisition, thereby potentially reducing deal uncertainty.¹⁰¹

Nevertheless, it is unclear whether this specific performance remedy had any real value since most agreements were between the shell buyer and the seller. In order for a specific performance provision to work under the traditional private equity structure, the seller would need not only to persuade a court to order the buyer to perform its covenants under the acquisition agreement, but it would also need the shell buyer “to cause its parent . . . to fund its equity commitment and . . . to . . . [cause] its debt financing sources to live up to their financing commitments, complete definitive [financing] documentation, and fund the debt financing” before the expiration date of the debt commitment letters.¹⁰² Private equity firms, armed with billions in funds and aided by relatively easy acquisition financing, heartily courted public companies, which were happy to choose among the competing high-profile suitors.¹⁰³ By 2007, private equity transactions dominated the financial press as the number and

recent study by Demiroglu and James found that LBOs initiated by private equity firms with good reputation typically pay narrower loan spreads, have fewer, less restrictive loan covenants, utilize less traditional bank debt, and borrow more at a lower cost from institutional loan markets. Cem Demiroglu & Christopher M. James, *The Role of Private Equity Group Reputation in Buyout Financing*, 96 J. FIN. ECON. 306, 310 (2010).

100. *IBP, Inc. v. Tyson, Inc.*, 789 A.2d 14 (Del. Ch. 2001); see also *Genesco, Inc. v. The Finish Line, Inc.*, 2007 WL 4698244 (Tenn. Ch. Dec. 27, 2007).

101. See Listokin, *supra* note 55, at 472 (citing the IBP case as an example).

102. Malcolm Landau et al., *A Closer Look at Reverse Termination Fees and Exclusive Remedy Provisions*, WEIL BRIEFING: MERGERS & ACQUISITIONS 4 (Nov. 29, 2007). It is not clear that practitioners realized the weakness in the specific performance remedy in the LBO structure prior to 2007. As stated by Professor Davidoff, despite including a specific performance remedy in acquisition agreements, “attorneys failed to fully account for the problems with enforcing this arrangement through shell subsidiaries, the lack of judicial precedent governing enforcement of this mechanism, and the difficulty of forcing shell subsidiaries to enforce debt and equity commitment letters with differing choice-of-law and choice-of-forum clauses.” Davidoff, *supra* note 8, at 514. In the author’s experience, the specific performance remedy was included in a provision in the miscellaneous section of the acquisition agreement, and there was little, if any, discussion or negotiation of this section in practice.

103. See Bartlett, *supra* note 87, at 1980–82 (discussing trend of private-equity takeovers).

values of these transactions became increasingly large.¹⁰⁴ Even the leading public companies considered going private.¹⁰⁵

Out of this wave of going-private transactions arose a new set of deal terms that differed significantly from traditional LBO terms. Starting in 2005, RTF provisions proliferated in an environment in which seller boards were much more likely to agree to a deal with a private equity suitor than with a strategic buyer.¹⁰⁶ An early study of seventy-nine acquisition agreements in private equity buyouts of U.S. publicly traded companies during 2005 and 2006 showed that nearly half of the deals required the buyer to pay an RTF for breach or failure to obtain financing.¹⁰⁷ A more recent estimate found that by 2007, over eighty percent of private equity acquisitions of public companies used an RTF structure.¹⁰⁸ The use of RTFs significantly transformed the traditional structure of private equity transactions. As I argue in Part III, critical provisions addressing risk allocation in these transactions have migrated into strategic transactions.

The increasing use of RTFs in private equity transactions was tied to the leveraged financing structure of private equity buyouts of public companies and the particularly unusual period of easy access to credit, as well as to the structure of acquisition agreements in these deals. Given the easier access to credit, deal terms such as “financing outs” that had been used to shield private equity buyers from the risks involved in obtaining financing were largely abandoned.¹⁰⁹

104. See, e.g., David Cho, *Firms Go Private in Search of Deeper Pockets*, WASH. POST, Jan. 31, 2007, at A1 (discussing trend of private-equity takeovers); Jason Singer & Henny Sender, *Growing Funds Fuel Buyout Boom: Already Biggest Blackstone Pool Will Raise Additional \$4.4 Billion as Firms Seek Larger Targets*, WALL ST. J., Oct. 26, 2006, at C1 (same); *The Top 10 Buyouts*, N.Y. TIMES DEALBOOK BLOG, Feb. 26, 2007, <http://dealbook.blogs.nytimes.com/2007/02/26/the-top-10-buyouts> (same). For example, in the first eight months of 2007, the number of leveraged buyout deals was greater than for the total in each of the prior ten years. Demiroglu and James, *supra* note 99, at 9.

105. Matt Krantz, *First Data Deal Shows Big Private Equity Clout: Any Public Company Could Become a Target*, USA TODAY, Apr. 3, 2007, at B1; see also Steve Rosenbush, *Deals of the Year, in a Year of Deals*, BUSINESSWEEK, Dec. 19, 2006 (quoting Goldman Sachs media banker Joe Ravitch in observing that after 2004, “[s]trategic buyers [had] a hard time competing against private equity firms”).

106. See, e.g., *In re Netsmart Tech., Inc. S’holders Litig.*, 924 A.2d 171, 198 (Del. Ch. 2007) (“Strategic buyers might sense that CEOs are more interested in doing private equity deals that leave them as CEOs than strategic deals that may . . . not.”).

107. See 2007 ABA DEAL POINTS STUDY, *supra* note 44, at 52 (finding that forty-six percent of the surveyed transactions included RTFs).

108. Davidoff, *supra* note 8, at 497.

109. According to a 2007 ABA study of key deal points in financial sponsor-backed acquisitions of publicly traded companies announced in 2005 and 2006, more than three-fourths of the 2006 acquisition agreements in the study did not contain a financing condition. 2007 ABA DEAL POINTS STUDY, *supra* note 44, at 25.

Instead of relying on “financing outs,” this new breed of LBO agreements typically provided that buyers could refuse to close an acquisition subject to payment of an RTF. In most agreements, the RTF provision was structured as a liquidated damages clause and was typically coupled with a bar on specific performance. In addition, similar to the amount of the STF, most agreements provided for RTFs that ranged around three percent of a transaction’s equity value.¹¹⁰ This meant that in the event that private equity buyers refused to close the transaction for any reason, the seller’s sole and exclusive remedy was limited to the RTF. In some contracts, the RTF even served as a cap on damages that would have needed to be proven in litigation.

Selling companies agreed to the RTF provision with an expectation that private equity buyers would likely not walk away from the transaction because of reputational forces, or that they would at least receive a hefty fee in exchange if buyers nonetheless walked away from the acquisition. In fact, many commentators initially argued that RTF provisions were “seller friendly” and that private equity buyers agreed to the provision in order to make their offers more appealing to sellers.¹¹¹ These arguments were based on the conclusion that RTF provisions were less risky for sellers than “financing out” provisions.¹¹²

The view that the RTF structure was less risky was tied to concerns about the uncertainty involved in an acquisition agreement with a “financing out” and a specific performance remedy enforceable only against a shell buyer. Boards were particularly concerned about the structure of private equity agreements, given that they generally had full recourse against the assets of a strategic buyer in the event of a breach of the agreement, as well as the ability to seek specific performance.¹¹³ Sellers and their lawyers argued that a contract with

110. See, e.g., Michael Weisser & Matthew Cammack, *Shepherding the Deal*, DEAL, Mar. 30, 2007, available at <http://www.weil.com/files/Publication/99f01d73-e17c-47cb-9b9f-6968a8ec71d4/Presentation/PublicationAttachment/a3448fee-921f-41f9-ab1b-715f5cf1893a/Shepherding%20the%20deal.pdf> (noting range of breakup fees); see also HOULIHAN LOKEY, *supra* note 67, at 7 (same).

111. See Choi & Triantis, *supra* note 1, at 869 (observing that practitioners refer to low-optionality as seller-friendly, and to broader, cheaper optionality as buyer-friendly).

112. See, e.g., Paul S. Bird & Jonathan E. Levitsky, *Deals Redefined*, DEAL, Dec. 18, 2007 (“Conventional wisdom suggested that private equity firms had been forced to accept a number of seller-favorable terms, including the disappearance of financing conditions.”); Graham & Vaiana, *supra* note 92 (“Ironically, this proliferation of mega-deals has also been accompanied by an erosion of deal terms that traditionally served to protect private equity sponsors from the risk of obtaining financing.”).

113. See Davidoff, *supra* note 8, at 520 (discussing acquisition-related Board considerations).

an RTF provision provided a potentially more favorable remedy than the traditional structure of private equity acquisition agreements.¹¹⁴ In fact, even after the advent of the broken deals of 2007 and 2008, lawyers for target companies continued to assert that not only were boards aware of the optionality of the RTF structure, but that these structures “were improvements upon the pre-2005 model, which simply specified a financing condition.”¹¹⁵

2. From Boom to Bust

The days of relatively easy courtships between sellers and private equity buyers came to a sudden halt in mid-2007.¹¹⁶ As the credit crisis crystallized in 2007 and 2008, an unprecedented number of private equity firms did the unexpected—they attempted to terminate deals for which they could not obtain financing, and, in some cases, deals were terminated even when financing was available.¹¹⁷

Not surprisingly, litigation ensued when private equity buyers attempted to terminate acquisition agreements.¹¹⁸ Some private equity buyers countered that a MAC with respect to the seller had occurred so that they could walk away without penalty.¹¹⁹ Others

114. *Id.* at 517–18. The removal of the financing condition presented another benefit for seller boards in that they could tout to the public and their shareholders that they had entered into an acquisition transaction that was not subject to financing.

115. Steven M. Davidoff, *Where Do Breakup Fees Go From Here?*, N.Y. TIMES DEALBOOK BLOG, Apr. 7, 2008, <http://dealbook.blogs.nytimes.com/2008/04/07/where-do-breakup-fees-go-from-here/>.

116. Two of the earliest articles that signaled that private equity buyers would not necessarily stay committed to signed acquisition agreements mentioned that private equity buyers had in the past walked away from deals to buy public companies. See Andrew Ross Sorkin, *Can Private Equity Firms Get Out of Buyouts?*, N.Y. TIMES, Aug. 21, 2007, at C1; Dennis K. Berman, *Over-Rated! Why Walking Away from LBO Deals Isn't So Bad*, WALL ST. J. DEAL J., Aug. 20, 2007, <http://blogs.wsj.com/deals/2007/08/20/over-rated-why-walking-away-from-lbo-deals-isnt-so-bad/>.

117. See Nowicki, *supra* note 40, at 4 (discussing private-equity buyers' use of reverse termination fee provisions).

118. See *Alliance Data Sys. Corp. v. Blackstone Capital Partners V L.P.*, 963 A.2d 746, 750 (Del. Ch. 2009) (regarding a dispute over private equity buyer's termination of acquisition agreement); *Hexion Specialty Chem., Inc. v. Huntsman Corp.*, 965 A.2d 715, 748–49 (Del. Ch. 2008) (same); *United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810, 816–28 (Del. Ch. 2007) (same); see also Dennis K. Berman, *Buyout Group Balks at Sallie Mae*, WALL ST. J., Sept. 27, 2007, at A3 (discussing particular buyer's backout of acquisition deal); Bird & Levitsky, *supra* note 112 (stating that in October 2007, “two private equity firms walked away from a \$3 billion deal to buy Acxiom Corp. by paying a \$65 million reverse termination fee”).

119. See, e.g., Transcript of Scheduling Conference at 22–23, *SLM Corp. v. J.C. Flowers II L.P.*, No. 3279-VCS (Del. Ch. Oct. 22, 2007), available at <http://lawprofessors.typepad.com>

argued that because the agreement provided for an RTF, they had contracted for what amounted to an option to pay a fee and refused to close the transaction.¹²⁰ The MAC maneuver was not a new one; almost all acquisition agreements have long provided that the buyer can refuse to close the transaction if a MAC occurs with respect to the selling company. The utilization of the RTF, on the other hand, was a new beast altogether.

These broken deals led to heated disputes between buyers and sellers that played out in the press and in the Delaware courts. Many sellers claimed that the RTF provision was not what they had bargained for and expressed shock that it would be exercised like an option.¹²¹ Private equity buyers, on the other hand, insisted that the optionality was exactly what they had bargained for. “For buyers, compared to a market with no available liquidity, an inability to syndicate transaction debt, and resulting immediate writedowns often in the billions, the loss of even hundreds of millions was seen as potentially acceptable or, occasionally, preferable.”¹²² In a number of prominent disputes, the RTF structure thus permitted the buyer to walk away from the transaction pursuant to the terms of the contract. Sellers were thus “left at the altar” with stock prices that “languish[ed] below their pre-bid levels.”¹²³

/mergers/files/slm_delaware_chancery_transcript.pdf (documenting parties’ dispute over interpretation of clauses and buyer’s attempt to walk away from transaction without penalty).

120. See, e.g., William Regner et. al., *The “Downturn” Roadmap: Parsing the Shift in Deal Terms*, DEAL LAW., Sept.–Oct. 2007, at 2 (“Some agreements made it clear that the [reverse] termination fee really is the only remedy and that the acquisition agreement is nothing more than an option.”); Megan Davies & Michael Flaherty, *DEALTALK—As Deals Crumble, Break-up Fees in Spotlight*, REUTERS (Nov. 29, 2007), <http://reuters.com/article/idUSN2961067320071129> (“ ‘What am I missing? This is an option’ to back out, one private equity investor told Reuters, referring to when he first came upon reverse break-up fee clauses.”).

121. “An option is a contract that gives its owner the right to buy or to sell an asset at a prespecified price. . . . An option to buy the specified items at a fixed price is a call option.” AZI BODIE & ROBERT MERTON, FINANCE 384 (2000). One can think of the acquisition agreement with an RTF provision as a call option being sold to the buyer if one thinks of it in the following way: the fee is the option price (C); the strike price is the deal price minus the fee (S). In this way, the seller always obtains C. The buyer purchases the selling firm if the value of the selling (V) is above the strike price at the time of closing. Thus, the payoff to the buyer, after taking into account the option price is $\max\{0, V-S\}$. There has been little analysis of how to determine the option value of reverse termination fees. See Vijay Sekhon, *Valuation of Reverse Termination Options in Mergers and Acquisitions*, 7 BERKELEY BUS. L.J. (forthcoming 2010) (manuscript at 2) (proposing a modified version of the Black-Scholes option pricing formula to estimate the value of the RTF option).

122. Gregory V. Varallo and Blake Rohrbacher, *Lessons from the Meltdown: Reverse Termination Fees*, DEAL LAW., Nov.–Dec. 2008, at 2.

123. Nowicki, *supra* note 40, at 5.

Once it became clear that the RTF structure could be used like an option to refuse to close a deal, criticism of the provision abounded.¹²⁴ Many commentators believed that the provision would largely disappear from acquisition agreements—that sellers, in particular public companies, would likely negotiate for greater certainty in acquisition agreements.¹²⁵ At the very least, commentators hoped that sellers would bargain for higher RTFs and make deliberate decisions about the risks attached to such provisions.¹²⁶

The prediction that RTFs would be abandoned has so far proven premature. Although deal-making has fallen significantly from the heights of early 2007,¹²⁷ RTFs are enduring in private equity buyouts. The continuing use of RTFs in these transactions, including the option-style structure, was noted in a survey of thirty-nine private equity acquisitions of private companies announced from January 1, 2008 to December 31, 2008.¹²⁸ The study found that in twenty-three

124. See, e.g., Davidoff, *supra* note 115 (noting that lawyers and boards under-assessed risk involved in these provisions, did not investigate how fees could work with MAC clauses, and failed to account for incentives that these provisions create for private equity firms “seeking an escape hatch”).

125. See Steven M. Davidoff, *Tough Time for Sellers’ Lawyers as Buyers Play Hardball on Deals*, N.Y. TIMES DEALBOOK BLOG, Oct. 6, 2008, <http://dealbook.blogs.nytimes.com/2008/10/06/tough-times-for-sellers-lawyers-as-buyers-play-hardball-on-deals/> (noting that some believed that reverse termination fee provisions would disappear); David Marcus, *Desperately Seeking Certainty*, DEAL, July 18, 2008, available at <http://www.thedeal.com/newsweekly/features/desperately-seeking-certainty.php> (“The run of collapsed deals has led some observers to predict that sellers would demand greater contractual certainty from PE shops in merger agreements, but so far that hasn’t happened.”); Vipal Monga, *Seller Beware*, DEAL, Aug. 8, 2008, available at <http://www.thedeal.com/newsweekly/features/seller-beware.php> (“Last year, when the first financial sponsor-backed deals began to implode, conventional wisdom argued that boards of selling corporations would react by demanding more certainty in deals. . . . The conventional wisdom was wrong.”).

126. See Davidoff, *supra* note 115 (expressing the hope that directors in competitive bid situations would begin to push for deal certainty).

127. Jessica Hall, *Global M&A Falls in 2008*, REUTERS, Dec. 22, 2008, available at <http://www.reuters.com/article/businessNews/idUSTRE4BL36B20081222>; Michael J. de la Merced, *Anemic Recovery for Mergers and Acquisitions*, N.Y. TIMES, Mar. 25, 2009, available at <http://www.nytimes.com/2009/03/26/business/26merge.html>.

128. See WEIL, GOTSHAL & MANGES LLP, SPONSOR-BACKED GOING PRIVATE TRANSACTIONS 17 (2009), available at http://www.weil.com/files/upload/Going_Private_Survey_March_09.pdf (finding the reverse termination in eighty-seven percent of all surveyed transactions); see also Steven Davidoff, *A New Approach to Deal Uncertainty*, N.Y. TIMES DEALBOOK BLOG, Apr. 27, 2009, <http://dealbook.blogs.nytimes.com/2009/04/27/a-new-approach-to-deal-uncertainty/> (“The few private equity deals commenced [since April 2008] have largely hewed to the pure form of reverse termination fee structure. These permit the private equity buyers to walk for any reason, with their liability capped at about three percent of the transaction price.”). While the private equity deals of 2008 appeared to hew closely to the model used in the 2005–2007 period, there did appear to be some movement in the structure in several transactions that were announced in

percent of the surveyed transactions, sellers negotiated for monetary remedies in addition to the RTF, typically in “circumstances where the buyer intentionally breached its obligations to consummate the transaction despite the availability of financing.”¹²⁹ In addition, in over ninety percent of surveyed transactions, the seller was not permitted to seek specific performance and its contractual remedy was limited to the RTF or monetary damages.¹³⁰

Furthermore, the empirical study undertaken by this Article demonstrates that there is an emerging trend in strategic deals in which strategic buyers are utilizing the RTF structure used in private equity deals.

II. AN EMPIRICAL STUDY OF REVERSE TERMINATION FEES IN STRATEGIC TRANSACTIONS

This Article’s empirical study of acquisition agreements in strategic transactions announced between January 1, 2003 and December 31, 2004, and between January 1, 2008 and June 30, 2009, examines the use of RTFs to allocate a subset of deal risks faced by the parties to the transaction. Section A below sets forth the results of a contract-by-contract review of agreements in 102 strategic transactions announced during the 2003–2004 period. Section B provides the results of this review from seventy-five strategic transactions during the 2008–2009 period and provides a comparison with the results from the 2003–2004 period. An extensive contractual examination of transactions that included RTFs was undertaken as part of the empirical study in order to determine the circumstances that gave rise to the buyer’s ability to terminate the agreement and pay the RTF. Appendix A provides details of the methodology used to identify strategic transactions and the RTF triggers. Appendix B includes sample RTF and remedy provisions from the two periods included in the empirical study.¹³¹

the second and third quarter of 2009. See Steven M. Davidoff, *Bankrate: A New Model for Private Equity Deals*, N.Y. TIMES DEALBOOK BLOG, July 24, 2009, <http://dealbook.blogs.nytimes.com/2009/07/24/bankrate-a-new-model-for-private-equity-deals/> (stating that targets are now demanding less optional deals).

129. WEIL, GOTSHAL & MANGES LLP, *supra* note 128, at 18.

130. *Id.* at 20.

131. See also *infra* notes 151–69 and accompanying text for an analysis of the various types of RTF and remedy provisions.

A. The Limited Use of Reverse Termination Fees in Strategic Transactions in 2003 and 2004

Between January 1, 2003 and December 31, 2004, 102 of the 542 strategic transactions reviewed, or approximately 18.8 percent, included an RTF.¹³² An analysis of each of these agreements demonstrates that parties predominantly used RTF provisions to allocate similar risks to those allocated by STFs, such as the risk that the buyer would terminate the agreement due to a superior proposal for the buyer. Furthermore, in a substantial majority of the reviewed agreements, the RTF was equal to the STF. However, the vast majority of these agreements continued to include the remedy of specific performance in lieu of the RTF provision.

1. Reverse Termination Fee Triggers

While STFs are generally triggered by some combination of a termination and a competing acquisition proposal for the seller from a third party, RTF triggers are somewhat more varied in the 2003–2004 study. Table 1 summarizes the frequency of the most common RTF triggers in the 102 contracts reviewed for the 2003–2004 period. The most common RTF triggers in the 2003–2004 strategic deals were, in order of frequency: (1) termination in connection with a competing transaction for the buyer,¹³³ (2) changes in the buyer's board recommendation (not related to a competing offer), (3) buyer's incurable breach of representations and warranties or covenants (not

132. This finding is somewhat surprising given the rare use of RTFs in acquisition transactions demonstrated by earlier studies. This discrepancy could be explained by the fact that the empirical study in this Article did not limit transaction size. Earlier studies only reviewed transactions where the size of the deal was over a certain dollar amount. *See supra* note 12 (discussing earlier empirical studies); *see also* Nowicki, *supra* note 12, at 6 (finding that approximately twenty-three percent of observed transactions had RTF provisions). None of the earlier studies differentiated between private equity and strategic acquisitions.

133. In a significant number of transactions, an RTF is triggered when the buyer elects to terminate the acquisition because of one or more of the following scenarios, each related to a *competing transaction for the buyer*:

- (i) the buyer board elects to terminate the acquisition agreement in order to accept a competing offer for the buyer; or
- (ii) the buyer board changes its recommendation in connection with a competing offer for the buyer; or
- (iii) the transaction fails for some other specified reason, such as being voted down by the shareholders, the passing of a drop dead date, or a breach of representation and warranties after a competing proposal has been announced and is agreed to or closed within a specified period of time (typically six to twelve months); or
- (iv) buyer's violation of the no-solicitation clause.

related to a competing offer), (4) failure to obtain shareholder approval or hold a shareholder meeting (not related to a competing offer), (5) failure to obtain regulatory approval, (6) merger not consummated (for any reason), or (7) failure to obtain financing. The data show that parties generally used RTF provisions to allocate the risk that the buyer would terminate the agreement due to a superior proposal for the buyer or the risk that the buyer's board or shareholders would not approve the transaction.

In the 2003–2004 period, RTFs were often used in transactions where the merger consideration consisted of stock. For example, as demonstrated by Table 1, in the vast majority of transactions where the RTF was in connection with a competing transaction for the buyer or an adverse change in recommendation by the buyer's board, the transaction consideration was stock. Overall, Table 3 demonstrates that more than half of all transactions included in the 2003–2004 period were either stock or cash/stock deals. The use of an RTF in transactions where the consideration consists primarily of stock appears rational since specific performance may not be a wholly appropriate remedy if the transaction consideration is cash.¹³⁴

Given the more limited use of cash as merger consideration, financing, or the lack thereof, does not appear to be a significant component of the 2003–2004 transactions. Only 5.9 percent of transactions included payment of the RTF upon a failure of the buyer to obtain financing, and only 16.7 percent of the deals required the buyer to obtain new financing.

Table 2 presents a summary of the relationship between the RTF and the STF with respect to each trigger. Overall, in a majority of transactions the amount of the RTF was equal to the STF. The fact that RTFs were set at the same amount as STFs appears to be an expected consequence of the fact that the triggering conditions for the two fees appear to be symmetrical.¹³⁵ This reflects the high degree of path dependency¹³⁶ in these extremely sophisticated agreements

134. See *supra* notes 55–66 and accompanying text (discussing specific performance remedy).

135. See Quinn, *supra* note 49, at 35–39 (arguing that buyer fiduciary termination right is not symmetrical to seller fiduciary termination right).

136. Path dependence theory explains that “the consequence of small events and chance circumstances can determine solutions that, once they prevail, lead one to a particular path.” See DOUGLASS C. NORTH, INSTITUTION, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 93–94 (1990) (discussing path dependence and the role of history in institutional change); see also Stephen E. Margolis & S.J. Liebowitz, *Path Dependence*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 17 (1998) (summarizing claims regarding path dependence as amounting to “some version of ‘history matters’ ”). For a more extensive explanation of path dependency and its detractors, see Paul A. David, *Path Dependence, Its Critics and the Quest for*

where parties should be aware that there is no fiduciary limit on the buyer termination fee.¹³⁷

The data also demonstrate that the RTF was generally higher than the STF only in transactions where the buyer was given significant flexibility to terminate the transaction—in other words, when the RTF was triggered in the event the merger was not consummated for any reason. This appears to indicate that in transactions where the parties recognize that the RTF and STF provisions are allocating different risks, they are attempting to price the buyer's option at a higher amount.

2. Remedies

In seventy-nine out of the 102 transactions, or approximately 77.5 percent, the contract gave both parties a variety of remedies, including the ability to press for damages or specific performance. Because these deals included both RTFs and the availability of contract damages or specific performance, under such contracts a breaching buyer could not simply terminate the transaction and pay a fee. Furthermore, in some contracts the RTF was only payable if the seller, as the non-breaching party, terminated the agreement. Hence, in the event of a buyer's willful breach of any covenants, the seller could elect to sue for specific performance or terminate the agreement and collect the fee.

Johnson & Johnson's attempted acquisition of Guidant Corporation in December 2004 exemplifies such an arrangement.¹³⁸ In

"Historical Economics," in EVOLUTION AND PATH DEPENDENCE IN ECONOMIC IDEAS 15 (Pierre Garrouste & Stavros Ioannides eds., 2001). *But see* STAN J. LEIBOWITZ, RE-THINKING THE NETWORK ECONOMY 31–34 (2002).

137. Path-dependency theory with respect to contracts argues that the initial structure of agreements set forth by parties may limit their bargaining so that certain terms or contractual positions may become locked-in or boilerplate terms due to network effects, informational deficits, and signaling effects. *See* Davidoff, *supra* note 8, at 527–29 (discussing path dependency with respect to private equity structure); *see also* Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347, 353–55 (1996) (discussing path dependency with respect to drafting of contracts).

138. The merger of Johnson & Johnson and Guidant was ultimately terminated because a third-party acquirer, Boston Scientific, made a bid for Guidant after Johnson & Johnson alleged that a MAC had occurred and renegotiated a lower purchase price for Guidant. A bidding war ensued between Johnson & Johnson and Boston Scientific, with the latter ultimately prevailing. There was no news or commentary on the RTF and it appears that Johnson & Johnson's waffling on the original deal was primarily aimed at lowering the purchase price because of a variety of legal issues with Guidant's defibrillators and pacemakers. Kerry Dooley Young, *Johnson & Johnson's Second-Qtr Profit Rises on Medical Devices*, BLOOMBERG NEWS, July 19, 2005,

this transaction, the RTF trigger was conditioned on the non-breaching seller terminating the acquisition agreement in the event the merger was not consummated by a given date. The contract provided that either Johnson & Johnson or Guidant could terminate the deal and pay the termination fee:

[I]f the Merger shall not have been consummated on or before February 28, 2006; provided, however, that the right to terminate this Agreement . . . shall not be available to any party whose willful breach of a representation or warranty in this Agreement or whose other action or failure to act has been a principal cause of or resulted in the failure of the Merger to be consummated on or before such date[.]¹³⁹

Thus, if Johnson & Johnson tried to abandon the deal through some willful breach of its representations or warranties or covenants, it would not have been allowed to simply terminate the agreement and pay the RTF. Guidant would have had the option to terminate the agreement, whereupon it could demand the RTF from Johnson & Johnson, or, alternatively, attempt to force Johnson & Johnson to consummate the agreement by suing for specific performance.

A number of agreements in the 2003–2004 period were narrowly tailored contracts that provided that the RTF was the seller’s sole and exclusive remedy in the event the fee was triggered but that limited the means through which a buyer could engineer triggering of the fee. For example, in the \$78 million cash acquisition by Psychiatric Solutions, a Tennessee operator of mental health centers, of Ramsay Youth Services, a Florida provider of mental health services in residential and non-residential settings,¹⁴⁰ the contract provided that the RTF would be triggered in the event that the buyer failed to obtain financing for the transaction.¹⁴¹

The contract in this deal established a narrow set of walk rights for the buyer. Psychiatric Solutions would have to fail to obtain financing for the transaction before the RTF would be triggered. However, this walk right was considerably narrowed by contractual language that compelled Psychiatric Solutions to use its “best efforts promptly to obtain and deliver to [Ramsay] a binding commitment

available at <http://www.bloomberg.com/apps/news?pid=10000103&sid=aQY0BlkbuqB8&refer=us>.

139. Agreement and Plan of Merger, Johnson & Johnson, Shelby Merger Sub, Inc. and Guidant Corporation § 7.01(b)(i) (Dec. 15, 2004).

140. Press Release, Psychiatric Solutions, Inc., Psychiatric Solutions Signs Definitive Agreement to Acquire Ramsay Youth Services in \$78 Million Transaction (Apr. 9, 2003), *available at* <http://www.sec.gov/Archives/edgar/data/829608/000095014403004763/g81928exv99w1.txt>.

141. Agreement and Plan of Merger, Ramsay Youth Servs., Inc., Psychiatric Solutions, Inc., and PSI Acquisition Sub, Inc. § 8.02 (Apr. 8, 2003).

letter from a nationally recognized financial institution to provide the Financing.”¹⁴² As such, it would have been difficult for Psychiatric Solutions to engineer a financing failure for the purposes of abandoning the transaction without violating the express terms of the contract. Moreover, to trigger payment of the RTF, Ramsay would have had to terminate the agreement due to the financing failure.¹⁴³ In such an event, the contractual language in Section 8.02(f) provided that “if this Agreement shall have been terminated pursuant to Section 8.01(f) [failure to obtain debt commitment letter] or (h) [failure to consummate financing], then the Purchaser shall pay the Company an amount equal to the [RTF].”¹⁴⁴ The contract further provided that “the payment of any Break-up Fee and/or expenses [pursuant to 8.02(f)] shall be full compensation for the loss suffered by . . . the Company . . . as a result of the failure of the Merger to be consummated.”¹⁴⁵ Thus, Ramsay Youth arguably could not sue for specific performance upon the triggering and payment of the reverse termination fee.¹⁴⁶ However, the seller in this transaction had license to determine the appropriateness of the financing condition and thereby retained control over the buyer’s ability to walk away from the deal.

The option-style RTF structure was seldom used in the 2003–2004 period. Only eight, or approximately 7.8 percent, of the contracts reviewed could arguably be interpreted as option-style deals whereby the RTF was the seller’s sole and exclusive remedy in the event that the transaction failed to close due to a breach by the buyer.¹⁴⁷ In these

142. *Id.* § 6.07.

143. *Id.* § 8.01(f), (h).

144. *Id.* § 8.02(f).

145. *Id.* § 8.02(g).

146. I use the word “arguably” because the drafting of the contract is less than clear. For example, while section 8.02(g) states that the payment of the fee is full compensation for losses suffered by the seller, section 9.06 provides for the remedy of specific enforcement. *Id.* §§ 8.02(g), 9.06.

147. Of these transactions, only two of the agreements gave buyers generous room to engineer a breach for the purposes of terminating the deal and walking away from the transaction upon payment of the RTF. *See* Agreement and Plan of Merger, TXU Gas Company and LSG Acquisition Corporation § 10.02 (June 17, 2004) (on file with SEC as Exhibit 2.1 to Form 8–K). In the Atmos/TXU transaction, based on the contractual language, if the buyer decided to terminate the agreement, it would have to do no more than simply wait for the drop dead date to lapse, pay the termination fee and walk away from the acquisition and the seller would have no additional recourse against the buyer. *See id.* (“Upon payment by [Atmos] of such amount, [Atmos] will be fully released and discharged from any liability or obligation resulting for its failure to close the transactions contemplated by this Agreement.”); *see also* Agreement and Plan of Merger, D&K Healthcare Resources, Inc., D&K Acquisition Corp., and Walsh

agreements, the RTF triggers included events that the buyer could control. For example, the most common triggers included: (1) a breach of the buyer's representations and warranties or covenants under the agreement or (2) a failure to close by the "drop dead" date after all conditions to the closing are satisfied. While the option-style structure was rarely used in strategic deals in the 2003–2004 period, Part II.B demonstrates that it has become more prevalent in the 2008–mid 2009 period.

B. The Transformation of Reverse Termination Fees in Strategic Transactions in 2008 Through mid-2009

This Article's empirical study of acquisition agreements in strategic transactions announced between January 1, 2008 and June 30, 2009 demonstrates an increase in the use of RTF provisions by parties to allocate a variety of deal risks. Of the 292 strategic transactions reviewed for this period, seventy-five agreements, or approximately 25.7 percent, included an RTF provision. This is a demonstrable increase from 18.8 percent of transactions in the 2003–2004 period.¹⁴⁸ The data also show that while in some transactions RTFs continue to be set at an equal amount to STFs, parties have also become more creative by using hybrid and liability cap approaches in their use of the provision. In addition, in a significant number of transactions, the parties have drastically limited the seller's ability to seek specific performance of the contract.

1. Reverse Termination Fee Triggers

Table 1 summarizes the frequency of the most common RTF triggers in the seventy-five contracts reviewed for the 2008–2009 period. The most common RTF triggers were, in order of frequency: (1) incurable breach of representations and warranties or covenants of the buyer (not related to a competing offer), (2) termination in

HealthCare Solutions, Inc. § 8.6 (Oct. 21, 2003) (on file with SEC as Exhibit 2.1 to Form 8–K) (providing for exclusive remedies).

148. *But see* Quinn, *supra* note 49, at 28–31 (study of 2003–2008 transactions did not demonstrate an increase in use of RTFs). There are a number of reasons for these differing results. First, the Quinn study only included transactions with a dollar value over \$100 million. In the empirical study undertaken by this Article, twenty-four of the seventy-five observed transactions had transaction values that were clearly below \$100 million. Second, the Quinn study did not include transactions entered into during the first half of 2009. In the empirical study undertaken by this Article, fifteen of the seventy-five observed transactions were entered into in the first half of 2009.

connection with a competing transaction for the buyer, (3) changes in the buyer's board recommendation (not related to a competing offer), (4) merger not consummated (for any reason), (5) failure to obtain financing, (6) failure to obtain shareholder approval or hold a shareholder meeting (not related to a competing offer), and (7) failure to obtain regulatory approval.

A comparison of the findings from the 2003–2004 period to the 2008–2009 period demonstrates that strategic buyers used RTFs to allocate deal risk beyond just the risk of non-consummation due to a competing offer for the buyer or circumstances related to a change in buyer board recommendation or shareholder approval. In a significant percentage of transactions, the fee was triggered in circumstances that were unrelated to a competing transaction for the buyer, such as in the event of the buyer's incurable breach of its representations and covenants, if the merger was not consummated for any reason, or in the event that the buyer was unable to obtain financing.

A comparison of the use of each of the seven identified triggers demonstrates that in the 2008–2009 period buyers used RTF triggers more often than in 2003–2004 in order to (1) walk away from the transaction for any reason, or (2) terminate the transaction due to a failure to obtain financing. This finding corresponds to the deal consideration used by the parties. Table 1 demonstrates that in 2008–2009, parties used RTFs in cash transactions more often than in 2003–2004. This is in line with the findings reported in Table 3 that show that 33.3 percent of deals with RTFs were solely cash deals. In addition, in 34.7 percent of all deals with RTFs the buyer was required to obtain new financing in order to complete the transaction.

RTF amounts in 2008–2009 were also significantly different from those in 2003–2004. Table 2 shows the relationship between the RTF and the STF with respect to each trigger. In the 2003–2004 period, RTFs generally mirrored STFs, equal to roughly one to four percent of the transaction value. In 2008–2009, parties continued to set RTFs as equal to STFs, but less often than they had in the earlier period. For example, Table 2 demonstrates in 2008–2009, even when the RTF was triggered by the buyer's failure to obtain financing, sixty percent of such transactions included identical termination fees. As in the private equity era, it may be that parties are agreeing to identical fees without an analysis of the value of the option to the buyer or the potential damages to the seller.¹⁴⁹

149. See *infra* notes 225–36 and accompanying text (discussing pricing issues related to RTF structure).

Notwithstanding the general trend in the size of the RTF, in the 2008–2009 period a significant number of transactions had RTFs that were higher than the STFs, particularly in cases where the fee was triggered by the failure to obtain regulatory approval or financing, or when the transaction was not consummated for any reason. Moreover, as discussed further below, a number of transactions used a two-tiered RTF structure that gave the buyer a pure walk right if it paid the higher fee. This suggests that these parties had a greater awareness of the optionality involved in an agreement where, in the event of a breach of the contract by the buyer, the seller's remedy was limited to the RTF. In addition, in these contracts, the RTF was significantly higher than the STF amount usually found acceptable in Delaware cases.¹⁵⁰

2. Remedies

In thirty-two of the seventy-five transactions, or 42.7 percent, the RTF was the seller's sole and exclusive remedy in the event that the deal failed to close due to one of the triggers listed above. Eleven of these thirty-two agreements feature RTF provisions which serve as the seller's sole remedy if the deal is terminated for certain narrowly prescribed events, such as a failure to obtain regulatory approval, but permit the seller to seek the remedy of specific performance for termination under other circumstances.¹⁵¹

One of the most significant changes when comparing the results from 2008–2009 to those from 2003–2004 is the significant increase in option-style transactions. While only 7.8 percent of transactions in the 2003–2004 period could be deemed option-style transactions, in 2008–2009, twenty-one transactions, or approximately twenty-eight percent, used the option-style RTF structure which either permitted the buyer to walk for any reason or gave the buyer broad latitude to arrange triggering of the RTF as its sole obligation. The language in these contracts closely resembles that found in private equity transactions during 2005–2007. In these deals, specific performance was expressly prohibited as a seller's remedy in the event of payment of the RTF.¹⁵² Some agreements went even further and

150. *See supra* notes 70–73 and accompanying text (discussing STF provisions).

151. *See, e.g.*, Agreement and Plan of Merger, by and among Excel Technology, Inc., GSI Group, Inc., and Eagle Acquisition Corporation (July 9, 2008) (featuring an RTF provision but permitting seller to seek specific performance under certain circumstances).

152. As in the contract at the heart of the URI/Cerberus litigation, *see* United Rentals, Inc. v. RAM Holdings, Inc., 937 A.2d 810, 816–18 (Del. Ch. 2007), in a few agreements, the termination

explicitly defined the RTF as liquidated damages intended to be the sole remedy of the seller.¹⁵³

The discussion below describes in greater detail the three most common types of RTF and remedy arrangements. Appendix B provides sample language for each of these types of RTF provisions.

a. Option-Style Reverse Termination Fees

Pure option-style RTFs give the buyer a walk right for any reason upon payment of the fee. The seller is not entitled to seek specific performance of the contract if the buyer fails to close the transaction for any reason, such as a breach of its covenants under the agreement. Under this approach, any damages suffered by the seller as a result of the buyer's breach are limited to the RTF.

The \$23 billion acquisition of Wrigley by Mars was one of the most highlighted strategic transactions that used the private equity LBO structure. The agreement provided Mars with a walk right for any reason, at any time, with the \$1 billion RTF as the only penalty for doing so.¹⁵⁴ At the time of the Mars-Wrigley deal in early 2008, commentators wondered whether other strategic buyers would adjust their acquisition structure to mirror the Mars-Wrigley transaction.¹⁵⁵ Some went so far as to claim that the Mars-Wrigley transaction had

provision conflicted with the enforcement provision included in the miscellaneous section of the acquisition contract. In other agreements, the contract was unclear about when the buyer could walk away by paying the reverse termination fee, but appeared to provide broad latitude to the buyer. *See, e.g.*, Agreement and Plan of Merger, UST, Inc., Altria Group, Inc. and Armchair Merger Sub, Inc. (Sept. 7, 2008) (providing one such example). These contracts were designated as option-style agreements, although the convoluted language of these contracts certainly leaves some room for doubt. *See* Steven M. Davidoff, *Smoke Gets in Your Eyes*, N.Y. TIMES DEALBOOK BLOG, Sept. 10, 2008, <http://dealbook.blogs.nytimes.com/2008/09/10/smoke-gets-in-your-eyes/> (discussing UST/Altria agreement).

153. The Brocade/Foundry deal incorporates an example of typical contract language which establishes the RTF as liquidated damages and a liability cap, providing in Section 8.3(f) as follows:

Upon payment by Parent of the Reverse Termination Fee . . . neither Parent nor any of its Related Persons shall have any further liability . . . relating to or arising out of this Agreement. . . . The parties agree that the Reverse Termination Fee and the agreements contained in this Section 8.3(f) are an integral part of the Merger and the other transactions contemplated by this Agreement and that the Reverse Termination Fee constitutes liquidated damages and not a penalty.

Agreement and Plan of Merger, Brocade Communications Systems, Inc., Falcon Acquisition Sub, Inc. and Foundry Networks, Inc. § 8.3(f) (July 21, 2008) [hereinafter Brocade/Foundry Agreement]. This agreement also expressly prohibits specific performance as a seller remedy if the RTF is paid. *Id.* § 9.12.

154. Steven M. Davidoff, *Wrigley and the Future of M&A*, N.Y. TIMES DEALBOOK BLOG, May 1, 2008, <http://dealbook.blogs.nytimes.com/2008/05/01/wrigley-and-the-future-of-ma>.

155. *See id.*

become a “model for others in which an industry player has agreed to buy a rival.”¹⁵⁶ However, given that the transaction took place earlier in the credit crunch when buyers faced significant risks that financing of a deal would fall through, two other types of RTF provisions have emerged.

b. Reverse Termination Fees with Specific Performance—the Hybrid Approach

Parties in other transactions appear to have carefully negotiated the RTF provisions and the triggers for the buyer’s payment of such fees. These deals appear to be similar to the hybrid structure that was utilized in a few of the private equity buyouts in the 2005–2007 period.¹⁵⁷ Under this approach, the use of the RTF as the buyer’s sole liability only arises under certain circumstances—for example, if financing is unavailable to the buyer despite the buyer’s efforts to cause the lenders to fund the acquisition. However, if the buyer wants to walk away from the deal despite the availability of financing, or the buyer breaches the merger agreement in a way that would cause the debt financing to be unavailable, then the seller’s remedies are not limited to the RTF and the seller is entitled to seek specific performance.¹⁵⁸

For example, the \$68 billion acquisition of Wyeth by Pfizer conditioned the payment of the RTF on a financing failure. However, in acknowledgement of marketplace uncertainty, Wyeth narrowed the contract language that gave Pfizer a walk right, and included specific performance as its alternate remedy. The Pfizer-Wyeth transaction limited the circumstances under which a financing failure could be claimed. The financing failure as an RTF trigger occurred only if Pfizer’s lenders withheld financing because Pfizer suffered a credit ratings downgrade.¹⁵⁹

156. David Marcus, *Exit Papers*, DEAL, Feb. 20, 2009, available at <http://www.thedeal.com/newsweekly/features/exit-papers.php>.

157. The heavily litigated \$10.6 billion takeover of Huntsman Corporation by Hexion Specialty Chemicals (which is owned by the private equity firm Apollo Management) arguably involved this hybrid structure. See *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008).

158. Landau et al., *supra* note 102, at 3.

159. Steven M. Davidoff, *Pfizer’s New Deal Model*, N.Y. TIMES DEALBOOK BLOG, Jan. 30, 2009, <http://dealbook.blogs.nytimes.com/2009/01/30/wyeths-deal-contract-shows-a-new-path> (explaining that financing conditions applied only “if [Pfizer’s] lenders refuse to finance the transaction and they do so primarily because Pfizer does not have one of: (i) an unsecured long-term obligations rating of at least ‘A2’ (with stable (or better) outlook) and a commercial paper credit rating of at least ‘P-1’ (which rating shall be affirmed) from Moody’s Investors Services,

Thus, if Pfizer was unable to claim a financing failure, then Wyeth could either sue for specific performance or terminate the agreement and collect the RTF. It is also noteworthy that even if Pfizer was experiencing financing problems, it “[would] not be put in the position of having to close without financing if it [could not] find an alternative.”¹⁶⁰ Rather, Pfizer could be compelled to seek alternate financing until the termination date, upon which it could either close the deal or abandon it and pay the RTF. The significance of this provision is that the risk for Wyeth is mitigated to provide the company with adequate closing assurance, unlike in the option-style structure. This is not to say that the approach followed in the Pfizer-Wyeth transaction would not allow Pfizer “to arrange a financing failure,” through some social or financial manipulation.¹⁶¹ However, Pfizer would be subject to a massive \$4.5 billion RTF that is approximately 7.25 percent of the deal value and *half* the deal premium. Thus, this RTF was not a lenient out for Pfizer and could serve as a strong motivator to consummate the deal.

c. The Two-Tiered Approach

A number of transactions in the 2008–2009 period used a two-tiered approach (or liability cap) with respect to remedies.¹⁶² This approach had also been used in a few private equity acquisitions during the 2005–2007 period.¹⁶³ Under the two-tiered approach, the

Inc. and (ii) a long-term issuer credit rating of at least ‘A’ (with stable (or better) outlook) and a short-term issuer credit rating of at least ‘A-1’ (which rating shall be affirmed) from Standard & Poor’s Ratings Group”).

160. *Id.*

161. *Id.*

162. *See* Aiello et al., *supra* note 86; Ginsberg et al., *supra* note 86, at 3 (referring to this approach as debt receipt failure fee approach). In addition to the capped approach, some transactions used the no-fee/capped-damages approach. Under this version of the structure, instead of a contractually provided RTF coupled with a liability cap, the contract permitted damages up to a certain amount but in order for the seller to recover any money it would need “to prove actual damages suffered as a result” of the buyer’s breach of its obligations under the acquisition agreement. *See, e.g.*, Wyndham Int’l Inc., Definitive Proxy Statement (Schedule 14A), at 43–44 (Aug. 11, 2005) (stating that seller “cannot seek specific performance to require the parent or the merger sub to complete the Blackstone merger, and our exclusive remedy for the failure of the parent or the merger sub to complete the Blackstone merger is to seek damages up to the amount of the \$275 million guarantee”).

163. *See, e.g.*, Neiman Marcus Group, Inc. Definitive Proxy Statement (Schedule 14A), at 67–68 (July 18, 2005). The Neiman Marcus acquisition agreement provided that an RTF of \$140.3 million, approximately 2.8 percent of the equity value of the transaction, would be payable by the buyer to the seller in the event the closing did not occur due to the failure to receive debt financing proceeds (when other closing conditions were satisfied) or due to another breach of the acquisition agreement by the buyer. The agreement also provided that, in some circumstances,

buyer agrees to pay one RTF conditioned upon one set of triggers, and a second, higher RTF conditioned upon another set of broader triggers. Thus, the buyer is allowed a walk right only upon payment of the higher RTF. In some agreements, the seller also retains a limited right to seek specific performance of the agreement in the case of a willful breach.

The Merck-Schering deal utilized this two-tiered structure, which has been dubbed the “new middle-of-the-road approach” in comparison to the pure option structure and the Pfizer-Wyeth structure.¹⁶⁴ Like Pfizer, Merck would only have a pure walk right if there was a financing failure and Merck paid Schering-Plough the higher RTF of \$2.5 billion.¹⁶⁵ This RTF was approximately six percent of the deal’s \$41 billion value and slightly less onerous than Pfizer’s 7.25 percent of deal value penalty.¹⁶⁶ The conditions under which Merck could claim a financing failure are fairly broad, given that a financing failure occurs when “the proceeds of the Financing are not then available to [Merck] in full pursuant to the Commitment Letter.”¹⁶⁷ If Merck were to exercise its financing out, Schering’s only recourse would be to terminate the deal and collect the RTF. That said, Merck still had a powerful incentive to consummate the agreement, considering that it would have suffered a \$2.5 billion RTF if it arranged a financing failure.

The presence of a lower first tier termination fee also distinguishes the Merck-Schering deal from all of the prior deals discussed. Here, a lower RTF of \$1.25 billion could be triggered if Merck failed to obtain its shareholders’ approval of the transaction or if it entered into a competing transaction with a third party. Under

the \$140.3 million RTF constituted complete and liquidated damages and therefore was the limit of the buyer’s liability. However, the buyer also could be liable for additional seller damages up to \$500 million in the aggregate, approximately 9.8 percent of the equity value of the transaction, if the failure of the closing to occur did not result solely from the failure to obtain financing but from some other breach by the buyer. See Ginsberg et al., *supra* note 86, at 4. There is some indication that the two-tiered approach is being used more often in private equity LBOs following the credit crisis. See Erik Krusch, *M&A Terms: Optionality Stays, but PE Pays*, WESTLAW BUS., Sept. 17, 2010, <http://currents.westlawbusiness.com/Article.aspx?id=acee3e8c-16d5-4f6f-9e54-4657cf3ad945&cid=&src=&sp=>.

164. Steven M. Davidoff, *Merck and Schering-Plough’s Extreme Engineering*, N.Y. TIMES DEALBOOK BLOG, Mar. 11, 2009, <http://dealbook.blogs.nytimes.com/2009/03/11/merck-and-schering-ploughs-extreme-engineering>.

165. See Agreement and Plan of Merger, Merck & Co., Inc., Schering-Plough Corporation, Blue, Inc., and Purple, Inc. § 8.3 (Mar. 8, 2009) [hereinafter Merck/Schering Agreement].

166. David Marcus, *Merck, Schering Play Follow the Pharma*, DEAL, Mar. 20, 2009, available at <http://www.thedeal.com/newsweekly/dealmakers/merck,-schering-play-follow-the-pharma.php>.

167. Merck/Schering Agreement, *supra* note 165, at § 8.1(b)(ii).

such circumstances, Schering could sue Merck for specific performance if financing had been obtained in full and all of the closing conditions had been fulfilled or waived, or it could collect the \$1.25 billion and up to \$150 million in reimbursed expenses.¹⁶⁸

In sum, as demonstrated by the empirical study set forth in this Part, RTFs are on the rise in strategic transactions. Parties in strategic deals used three different varieties of RTF structures during the 2008–2009 period, many of which were primarily adapted from earlier private equity models. This adaptation flies in the face of predictions that, as a result of the broken deals of late 2007 and early 2008, RTF provisions would disappear from merger agreements as sellers pushed for greater certainty by negotiating for more onerous remedies, in particular specific performance.¹⁶⁹ The deals of 2008–2009 were significant not only because of the number of deals where RTF provisions were employed, but also because of the license that buyers were given to abandon the deal. Many deals in the 2008–2009 period recognized the uncertainty of the credit markets and buyers contracted accordingly for walk rights upon a financing failure. In other deals, the buyers were able to use the private equity model to obtain broad walk rights with their exposure to damages limited to the RTF.

III. ASSESSING THE EVOLUTION OF REVERSE TERMINATION FEES

This Part examines why strategic buyers and sellers have turned to RTFs to allocate deal risks in acquisition agreements. In some respects it is hard to categorize the motivations of parties in strategic deals using RTFs, in part because of the variety of structures that are being used, and in part because many of these transactions occurred during a period of extreme economic uncertainty. However, this Part identifies a number of both deal-specific and market-related reasons for the increasing use of RTF in strategic deals. These reasons are derived from a review of the contractual language of acquisition agreements in which RTF provisions have been used and from an understanding of the contexts in which these agreements were made. In addition, this Part challenges the conventional wisdom against RTFs and argues that RTF provisions can provide benefits for both buyers and sellers in strategic acquisitions.

168. See Schering-Plough Corp., Registration Statement (Form S-4) 115, 118 (May 20, 2009).

169. See Monga, *supra* note 125.

A. The Role of Economic and Financing Uncertainty

While there were a number of motivations for strategic buyers to bargain for RTFs in 2008–2009, similar to private equity firms, strategic buyers have primarily advocated for RTFs to address uncertainty of financing in the marketplace, as well as to mitigate risks that may arise in a difficult economic environment. First, buyers could limit their liability to the amount of the fee in the event of deal breakdowns outside of their control if, for example, financing became unavailable. Second, a buyer would still be able to escape paying the fee in the event that it could reasonably argue that the seller had suffered a MAC or had failed to comply with its obligations under the merger agreement. Third, buyers could use the RTF structure as an after-signing option payment if they then decided to walk away from the transaction in the event of further economic deterioration. That sellers are agreeing to RTFs despite the economic meltdown and pervasive uncertainty in the marketplace suggests that “sellers . . . acknowledg[e] the difficulty of the credit markets.”¹⁷⁰

In 2008, given the financial crisis, financing was uncertain for any buyer, whether strategic or private equity. While “[t]he availability of financing was rarely an issue for strategic [buyers] prior to the debt market meltdown,” in an era of tight credit markets there is less certainty that strategic buyers will be able to obtain loans to complete their acquisitions on favorable terms.¹⁷¹ Thus, in an era with greater risk to strategic buyers that financing will be unavailable, it seems rational for buyers in transactions with a financing component to insist on an RTF structure without any provision for specific performance.

The problem of the availability of financing is compounded by the terms of such financing. Stricter lending standards have caused lenders to treat strategic acquirers like private equity buyers, such

170. *Id.*

171. Avram Davis, *(Reverse) Breaking Up is Easy To Do Long a Mainstay in LBOs, Reverse Breakup Fees Increasingly Find Their Way into Corporate Deals*, INVESTMENT DEALER'S DIG., Mar. 2, 2009, at 8. A survey of failed transactions in 2008 appears to reinforce that buyers were rational in concerns about the risk that financing would be unavailable. See Gibson, Dunn & Crutcher, LLP, *Deal-Breakers*, DAILY J., May 14, 2009, at 7, available at <http://www.gibsondunn.com/Publications/Pages/Deal-Breakers.aspx> (“According to Thomson Reuters’ data, 70 U.S. deals were ‘withdrawn’ in 2008 Of these 70 reported deals . . . [t]he largest single factor was the buyer’s inability to obtain financing. In most of these deals, the buyer lacked a financing ‘out,’ was subject to a ‘reverse termination fee’ provision and ultimately paid an amount that matched such provision. In the few cases in which a financing ‘out’ existed, it functioned as intended, and the buyer escaped the transaction without penalty.”).

that “even highly-rated borrowers are facing historically high margins and stricter terms, including pricing structures, covenants and conditionality typically associated with [LBOs] rather than strategic mergers by investment grade companies.”¹⁷² It appears that the market conditions that have forced lenders to equate strategic buyers with private equity buyers have similarly forced strategic buyers to structure their deals like private equity acquisitions. A strategic buyer that negotiates for an RTF therefore effectively requests that the seller assume some of the risks that the deal might fall through due to the uncertain economic climate and the harsher borrowing terms that it undertakes for the transaction.

As had been earlier noted by Chancellor Strine in the *In re Topps* decision, there had been a long-standing disparity in the use of financing outs and RTFs to address financing risks in private equity deals and the assumption of risk by buyers in strategic deals. While private equity acquisitions provided an express out for buyers in the event that financing fell through, strategic transactions “historically . . . were structured without a financing condition and with an express provision entitling both parties to specific performance.”¹⁷³ In describing this disparity Chancellor Strine stated in the *In re Topps* decision:

Apparently, financial buyers argue with a straight face that they should, because of reputational factors, be considered as presenting a lower risk of consummation for lack of financing than strategic buyers. Thus, in the past, financial buyers always argued for a financing out. Now, they say that they will agree to no out but only if their liability is capped at the amount of a reverse break-up fee. Meanwhile, strategic buyers continue to be asked to accept full liability for damages caused if they fail to close, even if the reason for not closing is based on financing, not a risk unique to a strategic buyer. This is an interesting asymmetry, and the factors driving it seem to include both economically rational ones and ones that are less rational.¹⁷⁴

The assumption of at least some of the financing risk by sellers in strategic deals in the 2008–2009 period thus narrows the distinction between the structure of such deals and private equity deals.

172. Danek A. Freeman, *Recent Trends in the US Investment Grade M&A Loan Market*, FIN. DIG., May 12, 2009, at 1, available at http://www.weil.com/files/upload/Finance_Digest_May_12_2009.pdf.

173. Finley, *supra* note 93, at 2.

174. *In re Topps Co. S'holders Litig.*, 926 A.2d 58, 72 n.11 (Del. Ch. 2007).

B. The Increasing Leverage of Buyers

Strategic buyers have also been able to shift risks to sellers in part because they may be the only option that sellers currently have. In other words, sellers appear to be agreeing to RTFs because it is “a function of deals happening where there are few other logical buyers.”¹⁷⁵ The dearth of buyers may be attributed to the sidelining of private equity buyers or, such as in Mars’s \$23 billion acquisition of Wrigley, the absence of other buyers large enough to acquire the seller.¹⁷⁶

There is some support for the proposition that strategic buyers have actually replaced private equity buyers in the mergers and acquisition marketplace. The credit crunch has significantly curtailed the availability of financing for private equity buyers.¹⁷⁷ The lack of availability has reduced competition for transactions.¹⁷⁸ In addition, while private equity firms are suffering from the availability of financing, “corporate buyers have the cash and profitability to continue to do deals.”¹⁷⁹ Essentially, as private equity firms have scaled back their purchases, “[s]trategic players [have stepped] into the void, buoyed by their voluminous cash holdings and unhindered by competing private equity firms.”¹⁸⁰

The downturn in the economy, coupled with a lack of competition from private equity buyers, has also meant that strategic buyers faced reasonable valuation multiples and would be able to complete acquisitions at prices where there was less risk that they would be overpaying for the seller.¹⁸¹ A buyer’s bargaining leverage is heightened in light of the economic meltdown. As a result of economic conditions and a lack of adequate financing, sellers were no longer courted by multiple suitors. In addition, potential buyers often demanded more extensive closing conditions and attempted to

175. Monga, *supra* note 125.

176. *Id.*

177. See Jeff Gell, et al., *The Return of the Strategist*, BCG REP., May 2008, at 7, available at http://www.bcg.com/impact_expertise/publications/files/MA_Return_of_the_Strategist_May_08.pdf.

178. *Id.*

179. *Id.* at 1.

180. Andrew Ross Sorkin, *After the Deluge: A Good Time to Buy?*, N.Y. TIMES DEALBOOK BLOG, May 19, 2008, <http://dealbook.blogs.nytimes.com/2008/05/19/after-the-deluge-a-good-time-to-buy/>.

181. Gell, *supra* note 177, at 9.

structure contracts so as to limit their post-closing risks.¹⁸² While RTFs were less common in the 2003–2004 period when sellers had better bargaining leverage, as a result of the economic crisis and a tough business environment, buyers began to use RTFs in order to retain “maximum flexibility and . . . to ensure that ultimately, they are not stuck in a bad deal.”¹⁸³ According to one commentator, “none of the potential buyers of [a] company would sign without the conditional put.”¹⁸⁴ These circumstances suggest that RTFs may persist. Strategic buyers may use this shift in structure to continually request RTFs in order to maintain flexibility to walk away from a transaction prior to closing.

The economic downturn has depressed some sellers’ positions such that they must sell the company.¹⁸⁵ The Employers Holding-AmCOMP deal on January 10, 2008 suggests such motivations for the sale of the company. AmCOMP is an insurance holding company headquartered in North Palm Beach, Florida that provided workers’ compensation insurance to small- to mid-sized employers in eighteen states. In 2007, it was the subject of a Florida Office of Insurance Regulation investigation that required AmCOMP and its subsidiaries to repay \$8.4 million in excessive profits realized from 2003 to 2006.¹⁸⁶ Further, AmCOMP appeared to be experiencing business problems, as indicated in its proxy disclosure that stated “the current weakness in the overall economy . . . was having an adverse effect on many of [AmCOMP’s] customers and resulting in declining payrolls and a corresponding reduction in the workers’ compensation premium revenue received from these customers.”¹⁸⁷ Although there is no

182. Michael J. Delaney, *Role Reversal*, DEAL, Nov. 21, 2008, available at <http://www.thedeal.com/newsweekly/community/role-reversal.php>.

183. *Id.*

184. Vipal Monga, *Turning the Tide*, DEAL, Aug. 29, 2008, available at <http://www.thedeal.com/newsweekly/features/turning-the-tide.php>.

185. According to a recent Thomson Reuters study, bankruptcy-related mergers and acquisitions have “hit their highest level globally . . . and are set to keep rising as more companies are forced into distressed sales.” Brooke Masters & Julie MacIntosh, *Bankruptcy-Related M&A Has ‘Only Just Begun’*, FIN. TIMES, Apr. 12, 2009, available at http://www.ft.com/cms/s/0/05234d00-2788-11de-9b77-00144feabdc0.html?dbk&nlick_check=1. It bears mention that the “target corporation in dire straits” argument is a limited one. Despite weak economic conditions, a vast majority of the strategic deals analyzed featured financially-healthy targets. These include the Altria/UST Inc. deal on September 2, 2008 and the Pfizer/Wyeth deal on January 25, 2009.

186. See Press Release, Fla. Office of Ins. Regulation, Florida Insurance Commissioner Approves AmCOMP Merger, Also Requires Company to Refund \$8.4 Million in Excess Profits (Sept. 2, 2008), available at <http://www.flair.com/PressReleases/viewmediarelease.aspx?ID=3008>.

187. AmCOMP, Inc., Definitive Proxy Statement, at 24.

concrete evidence that AmCOMP was in a position where it had to sell itself, these problems collectively suggest that AmCOMP was in such a situation because Employers Holding successfully negotiated a lower purchase price eight months after the initial agreement.¹⁸⁸ Because AmCOMP was in a poor bargaining position, it may have easily acceded to the RTF in the interest of consummating the deal.

C. The Potential for Greater Certainty?

Commentators have noted that one of reasons that sellers are amenable to RTFs is that with strategic buyers, the “risk of deals blowing up for financing reasons is relatively low.”¹⁸⁹ To be sure, buyers could demand an RTF before signing a deal, and the presence of a large fee could deter buyers from abandoning a transaction.¹⁹⁰ Nevertheless, as evidenced by the Brocade-Foundry transaction discussed below, these are not particularly prudent reasons for sellers to agree to RTF provisions.

Some sellers that have recognized the risks of an option-style RTF structure have entered into agreements where the RTF is significantly higher than the STF in order to promote certainty of closing. For example, in the aforementioned acquisition of Wrigley by Mars, the acquisition agreement allowed Mars to walk away from the deal if closing “[had not] occurred on or before . . . the Termination Date,”¹⁹¹ or if Wrigley terminated the deal in the event of a representations and warranties breach by Mars, or “if all the conditions [to closing were satisfied] and [Mars] failed to consummate

188. See AmCOMP, Inc., Form 8-K, Aug. 29, 2008.

189. Similarly, during the heyday of the private equity boom, many sellers viewed the RTF as a sort of insurance policy that could provide “protection for [selling] companies against the risk of non-consummation.” John Mark Zeberkiewicz & Blake Rohrbacher, *The Price of Remorse: Paying Reverse Termination Fees to Excuse Performance*, INSIGHTS, Oct. 2007, at 22. The Delaware Chancery Court in cases connected to private equity acquisitions also framed the fee as providing this type of protection. See *In re Lear Corp. S’holder Litig.*, 926 A.2d 94, 108 (Del. Ch. 2007) (“Lear was also protected in the event that AREP breached the Merger Agreement’s terms by a reverse termination fee of \$250 million. That fee would be triggered if AREP failed to satisfy the closing conditions in the Merger Agreement, was unable to secure financing for the \$4.1 billion transaction, or otherwise breached the Agreement. But AREP’s liability to Lear was limited to its right to receive this fee.”); see also *In re Topps Co. S’holders Litig.*, 926 A.2d 58, 65 (Del. Ch. 2007) (framing RTF as seller’s only remedy for buyer’s failure to close transaction).

190. See Marcus, *supra* note 156 (“Mars said that it would only agree to the acquisition if the [seller] assented to a merger agreement that allowed Mars to walk for any reason on payment of a reverse breakup fee and explicitly barred specific performance.”).

191. Agreement and Plan of Merger, Wm. Wrigley Jr. Company, Mars, Incorporated, New UNO Holdings Corporation and New Uno Acquisition Corporation § 8.1(c) (Apr. 28, 2008).

the merger.”¹⁹² Under the agreement, Wrigley’s sole remedy was the RTF and it was clearly prohibited from seeking specific performance of the contract. The Mars-Wrigley agreement is significant because the buyer’s broad walk rights are mitigated by the \$1 billion RTF, which is approximately forty-five percent higher than the \$690 million STF that Wrigley would have to pay if it abandoned the deal. The disparity between the two fees is indicative of Wrigley’s recognition that without a right to seek specific performance, its risk can only be mitigated by demanding a higher RTF. In fact, Wrigley’s proxy disclosure indicated that William Wrigley himself, the company’s executive chairman, negotiated the \$1 billion RTF.¹⁹³ The proxy disclosure, however, does not indicate how the parties arrived at the specific number.

Not all sellers encountered Wrigley’s experience. Similar to the breakdown of private equity transactions in 2007, the use of the option-style RTF caused significant problems for some sellers. For example, Foundry Networks Inc. found itself in a precarious position when its \$3 billion deal to be acquired by Brocade Communications almost fell apart because of the broad financing out and nominal RTF to which the parties had originally agreed. The agreement provided for an \$85 million RTF triggered by a financing failure. Three months later, amid difficulty in obtaining \$400 million in financing, Brocade considered abandoning the deal for its \$85 million RTF.¹⁹⁴ The problem arose firstly because “Financing Failure” as defined in the agreement was very broad:

a refusal or other failure, for any reason, on the part of any Person that has executed the Debt Commitment Letter . . . or on the part of any other Person obligated or expected at any time to provide a portion of the Debt Financing, to provide a portion of such Debt Financing.¹⁹⁵

There was no further restriction on the amount of debt financing that had to be refused, or the amount that Brocade would have to fail to obtain before the “Financing Failure” was met. Then, there was “a difference of interpretation between Bank of America and Morgan Stanley, the banks that agreed to finance this transaction, and Brocade on the interest rate provisions . . . of the \$400 million in bridge financing,” upon which Brocade considered exercising its

192. *Id.* at § 8.1(d).

193. *See* Wm. Wrigley Jr. Company, Preliminary Proxy Statement (Schedule 14A), at 22 (May 23, 2008).

194. *See Foundry Shareholders Willing to Take Price Cut to Save Brocade Deal*, DEALSCAPE, Oct. 28, 2008.

195. Brocade/Foundry Agreement, *supra* note 153, at Exhibit A, Certain Definitions, A-6.

financing out.¹⁹⁶ Additionally, as the RTF was the seller's sole remedy, Foundry would have had no other recourse against Brocade.

Since the RTF amounted to only about 2.8 percent of the deal value, and the \$85 million loss paled in comparison to the \$400 million the buyer was unable to secure, Brocade was able to use the situation as a leveraging tool to renegotiate the purchase price. Indeed, “[a] simple cost of capital issue allowed Brocade to engineer the removal of its equity component in the deal and an additional \$250 million cash price adjustment.”¹⁹⁷ Brocade managed to reduce the deal value by \$400 million, or essentially shifted the \$400 million in financing to Foundry's shareholders. For its part, Foundry was happy to “take the haircut and take a complete deal.”¹⁹⁸

D. Sell-Side Value Creation

Many of the above explanations reveal why RTFs have been attractive to buyers and palatable to sellers. However, there are a number of ways that RTF structures can benefit sellers. This is especially true when parties use the hybrid RTF structure.

Sellers may enter into acquisitions agreements with RTF provisions, even though the contract may result in less certainty, because of potential value creation in relation to the purchase price. The flexibility an RTF provision provides to a buyer may induce a buyer to enter into a contract with a higher purchase price. In lieu of an RTF provision, a buyer may simply look to discount the likelihood of a problem and reflect that in a reduced purchase price. While it is hard to determine whether such value creation has occurred in the deals of 2008–2009, it is certainly a possibility.

Some have argued that RTFs can also provide a so-called “insurance” benefit to sellers.¹⁹⁹ In an early paper that examined RTFs in deals from 1989 through 1998, Thomas W. Bates and Michael L. Lemmon posited that RTFs “are valuable to target shareholders because they lock in a portion of the expected gains of a still uncertain

196. Steven M. Davidoff, *Brocade's Financing Problems in Foundry Deal*, N.Y. TIMES DEALBOOK BLOG, Nov. 17, 2008, <http://dealbook.blogs.nytimes.com/2008/11/17/brocades-financing-problems-in-foundry-deal>.

197. *Id.*

198. *Id.*

199. See Bates & Lemmon, *supra* note 12, at 471; Utz Weitzel & Stephanie Rosenkranz, *Bargaining in Mergers: The Role of Outside Options and Termination Provisions*, 4–5 (Utrecht Sch. of Econ. Tjalling C. Koopmans Research Inst. Discussion Paper Series, No. 05-32, 2005), available at <http://www.uu.nl/uupublish/content/07-062.pdf>.

deal.”²⁰⁰ Accordingly, the presence of RTFs should be higher in transactions with higher costs of bid failure or higher than expected negotiation costs. However, the analysis of the 2008–2009 data does not necessarily provide conclusive support for this hypothesis. While the presence of RTFs may provide some insurance for sellers, the remedy limitation in these contracts, namely the bar on specific performance, may offset this insurance by providing a stronger termination option to buyers.

In the case of the hybrid structure, sellers have also used the combined threat of the RTF with specific performance to force reluctant buyers to complete a transaction. The contentious \$18.8 billion acquisition of Rohm and Haas by Dow Chemical in 2008 is an apt example of how sellers can use the hybrid RTF structure to their benefit.²⁰¹ Following the announcement of the transaction in July 2008, the transaction appeared set to close on January 27, 2009 after the conditions to closing, including regulatory approval, were fulfilled. However, on January 26, Dow issued a press release stating that it would not close on the Rohm acquisition as planned. Dow’s chairman and CEO characterized the closing as “untenable at this time,” and attributed Dow’s decision to “the continued crisis in global financial and credit markets combined with the dramatic and stunning failure of . . . the formation of the K-Dow joint venture in late December 2008.”²⁰² Indeed, Dow had received word from a joint venture partner, Petrochemical Industries Company (“PIC”), on December 28, 2008 that the Kuwait Supreme Petroleum Council had decided to “reverse its prior approval of the agreement between Dow and PIC to enter into K-Dow Petrochemicals.”²⁰³ However, commentators have recognized that the credit market conditions and the failure of the K-Dow joint

200. Bates & Lemmon, *supra* note 12, at 475.

201. See Ely Razin, *Forcing M&A: Courts, Can Dow Walk From Rohm?*, WESTLAW BUS., Feb. 5, 2009, http://currents.westlawbusiness.com/Articles/2009/11/20091113_0017.aspx?cid=&src=WBSignon; see also Ashkan Tehrani, *Lessons of the Dow/Rohm Saga*, INT’L FIN. L. REV., May 21, 2009, <http://www.iflr.com/Article/2208074/Lessons-of-the-DowRohm-saga.html> (explaining that Dow planned to rely on three financing sources: approximately \$9 billion in cash from K-Dow Petrochemicals, a joint venture with Kuwait’s national petrochemical company, Petrochemical Industries Company; \$4 billion in cash proceeds from Berkshire Hathaway and Kuwait Investment Authority’s purchase of Dow’s convertible preferred stock; and a \$13 billion term facility with nineteen banks).

202. Press Release, Dow Chem. Co., Dow Chemical Confirms Rohm and Haas Acquisition Will Not Close On or Before January 27, 2009 (Jan. 26, 2009), *available at* <http://www.sec.gov/Archives/edgar/data/29915/000002991509000006/eightk.htm>.

203. Press Release, Dow Chemical Co., Dow Chemical Receives Notification of Kuwait Decision to Cancel K-Dow Partnership (Dec. 28, 2008), *available at* http://www.sec.gov/Archives/edgar/data/29915/000094787108000660/ss54352_ex9901.htm.

venture were but two factors that led to Dow's attempt to backpedal from its agreement with Rohm. A third factor was likely that Rohm's share price was trading at approximately a thirty-six percent discount to the price offered by Dow in the acquisition, and this "put Dow and its new equity investors . . . in an uncomfortable position."²⁰⁴

In response to Dow's failure to close, Rohm immediately filed suit in the Delaware Court of Chancery alleging Dow intentionally breached the acquisition agreement. Further, Rohm sought specific performance as provided for under the agreement. Rohm premised its suit on Dow's refusal to close despite all conditions to closing having been satisfied. Rohm also observed that Dow's reliance on deteriorating market conditions was weak because the deal was negotiated at a time when the credit markets were already in distress and it had "stressed to Dow that . . . there be certainty that the deal would close because it had other interested acquirers."²⁰⁵ Most compellingly, Rohm pointed to express provisions in the merger agreement that reflected the measures negotiated to provide Rohm with the certainty of closure that it demanded.

Indeed, the acquisition provided little wiggle room for Dow. Despite the fact that Dow planned to rely on billions of dollars of outside financing, Dow represented in the agreement that it would have the necessary funds for the merger consideration and a financing out was notably absent from the agreements.²⁰⁶ The hybrid-style acquisition agreement explicitly provided for both an RTF and the seller's entitlement to specific performance to enforce the agreement.²⁰⁷ Section 7.2(d) of the agreement stipulated a \$750 million RTF in the event of Dow's failure to consummate the merger by drop dead date or if there existed a final non-appealable injunction arising in connection with any regulatory law. This provision further indicated that the RTF would be payable upon the termination of the agreement "if all of the conditions to closing . . . [had] been satisfied. . . other than the [antitrust] conditions set forth in Section 6.1."²⁰⁸ As such, Dow would have been liable for payment of the RTF because of its failure to consummate the merger and the satisfaction of all the conditions to closing. Dow thereupon attempted to sidestep payment of

204. Tehrani, *supra* note 201.

205. Razin, *supra* note 201.

206. See Steven M. Davidoff, *Dow's Surprise*, N.Y. TIMES DEALBOOK BLOG, Jul. 11, 2008, <http://dealbook.blogs.nytimes.com/2008/07/11/dows-surprise>.

207. See Agreement and Plan of Merger, The Dow Chemical Company, Ramses Acquisition Corp. and Rohm and Haas Company § 8.5(a) (July 10, 2008) [hereinafter Dow/Rohm Agreement].

208. See *id.* § 7.2(d).

the RTF via a defensive claim that not all the conditions to closing had been satisfied because the Federal Trade Commission clearance was not finalized. However, this attempt would have been a long shot even if its antitrust defense had any traction.

Furthermore, it soon became evident that Dow's failure to contract for a financing condition, even when "the potential problem of financing was a known quantity,"²⁰⁹ jeopardized its existing covenants in its short-term debt financing. At the risk of "triggering cross-defaults in its other funded debt,"²¹⁰ Dow was cornered into choosing between endangering its investment-grade status and wrangling its way around the merger.²¹¹

The cumulative effect of the above provisions, including the lack of a financing out, forced Dow into acceding to the acquisition. On the eve of the trial in the Delaware Chancery Court, Dow and Rohm reached a settlement under which Dow was to complete the deal on amended terms. After months of mounting costs, the transaction finally closed on April 1, 2009.²¹²

E. The Conundrum of Specific Performance vs. Damages

RTFs not only mitigate risk for sellers through sell-side value creation, they also provide sellers with some protection and recourse against the buyer if the deal is stopped or if it simply falls through. This is in part because, while courts have granted specific performance in the past, it is not clear that they will continue to do so or that it is an appropriate remedy in an all-cash acquisition of a company.²¹³ Furthermore, a 2005 decision in the Second Circuit in a suit arising out of a failed acquisition transaction has led to

209. Steven M. Davidoff, *A Hard Look at Dow's Answer to Rohm*, N.Y. TIMES DEALBOOK BLOG, Feb. 3, 2009, <http://dealbook.blogs.nytimes.com/2009/02/03/a-hard-look-at-dows-answer-to-rohm>.

210. Jim Fotenos, *Rohm and Haas Company v. The Dow Chemical Company*, M&A LITIG. COMMENT., Feb. 9, 2009, <http://mandalitagationcommentary.blogspot.com/2009/02/rohm-and-haas-company-v-dow-chemical.html>.

211. Another element of the merger agreement that bound Dow to the merger was the definition of a MAC in the contract. The MAC provision was drafted in favor of the seller and included numerous carve-outs from the definition of a MAC, including events generally affecting the economy or the financial, debt, credit or securities markets, and any decline in the stock price of Rohm. *See Dow/Rohm Agreement*, *supra* note 207, § 3.1. Dow was therefore not in a position to assert a MAC for the abandonment or delay of the merger. Moreover, even if a MAC claim was possible, its futility is underscored by the chancery court's history of never having found a MAC in an acquisition transaction. *See supra* note 45.

212. *See* Tehrani, *supra* note 201.

213. *See supra* notes 55–58 and accompanying text.

considerable debate about the damages that would be recoverable in a breach of contract suit in such transactions.

The Second Circuit's decision in *Consolidated Edison v. Northeast Utilities* has caused some sellers to argue that providing for an RTF as liquidated damages could potentially provide greater compensation than the amount that the seller would be able to obtain in a breach of contract suit for money damages. After agreeing to buy the stock of electric utility company Northeast Utilities for the market price plus a fifty percent premium, Consolidated Edison decided that Northeast Utilities' business had undergone a MAC. It therefore refused to close and instead offered to negotiate a lower price. Both parties sued, with Northeast Utilities demanding the original premium for its stockholders.

The Second Circuit, applying New York law, held that Northeast Utilities and its shareholders were not entitled to recover the lost merger premium as damages—over \$1 billion—after the buyer, Consolidated Edison, walked away from the transaction.²¹⁴ Relying on the precise language of the acquisition agreement, the court held that to create a third-party right to enforce a contract “the language of the contract must clearly evidence an intent to permit enforcement by the third party.”²¹⁵ Soon after the court's decision, practitioners generally argued that the Second Circuit's holding in *Consolidated Edison* meant that “absent clear contractual language to the contrary, neither the shareholders of a target company nor the target company itself (on behalf of its shareholders) [can] collect lost shareholder premium as damages for a breach of a merger agreement.”²¹⁶

There is some disagreement, however, about whether the Second Circuit's holding in *Consolidated Edison* can be applied broadly to preclude the seller from ever recovering merger premium damages when a buyer fails to complete an acquisition. In a recent article, Ryan Thomas and Russell Stair argue that if such sweeping

214. *Consol. Edison, Inc. v. Ne. Utils.*, 426 F.3d 524, 531 (2d Cir. 2005).

215. Similar to most other public company acquisition agreements, the acquisition agreement at issue in *Consolidated Edison* did not provide the seller's shareholder with third-party beneficiary rights prior to closing. See Ryan D. Thomas & Russell E. Stair, *Revisiting Consolidated Edison*, 64 BUS. LAW. 329, 330 (Feb. 2009).

216. Victor Lewkow & Neil Whoriskey, *Left at the Altar—Creating Meaningful Remedies for Target Companies*, M&A LAW., Oct. 2007, at 1, 1; see also Kevin Miller, *The Con Ed Decision—One Year Later: Significant Implications for Public Company Mergers Appear Largely Ignored*, M&A LAW., Oct. 2006, at 1, 1 (“[T]he Second Circuit effectively held that, under New York law, an acquirer could not be held liable for target shareholders' lost merger premium if the target shareholders were not intended third party beneficiaries entitled to such relief.”). *But see* Thomas & Stair, *supra* note 215, at 339–47.

conclusions follow from the Second Circuit's decision, then selling corporations "should be concerned that nearly every public merger transaction will be transformed, in substance, into an 'option' deal allowing the buyer to walk away with little consequence . . . [thus shifting] the balance of leverage in any renegotiation or settlement discussions firmly into the buyer's camp."²¹⁷

Thomas and Stair contend that the *Consolidated Edison* decision can be limited to its facts, since the court's reasoning relied on the exact wording of the particular agreement before the court, wording which few acquisition agreements contain. More importantly, it is unclear whether the Delaware courts would in fact follow the *Consolidated Edison* rationale. In fact, in granting specific performance in *IBP v. Tyson*, "among the considerations that the court weighed in determining to award specific performance was the potential magnitude of any damages award, clearly evidencing that the court contemplated an expectancy-based damages award for the benefit of IBP and its shareholders."²¹⁸ In addition, as noted by Thomas and Stair, in a 2008 conference, Delaware Vice Chancellor Strine confirmed the assumption that "shareholder damages may be available in the event of a breach reflects a logical and practical understanding by the parties to merger agreements and provides for an orderly dispute resolution procedure."²¹⁹

IV. THE IMPLICATIONS OF REVERSE TERMINATION FEES

The rising use of RTFs in acquisition agreements has a number of important implications for both deal-makers and corporate law scholars. This Part argues that the increasing use of the RTF provisions demonstrates that contractual innovation has taken place in the aftermath of the financial crisis. In addition, this Part posits that, notwithstanding such innovation, a number of additional problems may arise in connection with the RTF model.

217. Thomas & Stair, *supra* note 215, at 338.

218. *Id.* at 342; *IBP, Inc. v. Tyson, Inc.*, 789 A.2d 14, 83 (Del. Ch. 2001) ("In addition, the determination of a cash damages award will be very difficult in this case. And the amount of any award could be staggeringly large. No doubt the parties would haggle over huge valuation questions, which (Tyson no doubt would argue) must take into account the possibility of a further auction for IBP or other business developments. A damages award can, of course, be shaped; it simply will lack any pretense to precision. An award of specific performance will, I anticipate, entirely eliminate the need for a speculative determination of damages.").

219. Thomas & Stair, *supra* note 215, at 343.

A. Contractual Innovation and RTFs

The analysis above suggests that a transformation is taking place in the allocation of deal risk in strategic transactions. The increasing complexity in the use of RTF provisions in some of the more sophisticated contracts of the 2008–2009 period demonstrates that parties and their counsel had noted some of the lessons of the failure of the private equity structure.

The increasing use of RTFs in strategic acquisitions and the convergence of the strategic and private equity acquisition models demonstrate that buyers and sellers, as well as their advisors, are “recognizing that deal models do not exist as binary polar alternatives.”²²⁰ Strategic buyers are not only borrowing from the private equity playbook, they are also expanding upon and altering the private equity RTF structure. The types of RTFs that have been employed by strategic deals in the wake of the economic crisis have been numerous and are still evolving.²²¹ More changes to existing structures will probably continue to manifest as parties negotiate with varying amounts of leverage and strategic considerations. These evolving deal terms and the reallocation of deal risks in acquisition agreements reflect not only a more thoughtful approach to deal-making as a result of the lessons learned from deals that failed in connection with the financial crisis, but also the evolutionary nature of deal-making. While there continue to be manifestations of the same mistakes from private equity transactions in a number of strategic acquisition agreements, this Article’s empirical study and analysis of RTF structures demonstrate that acquisition agreements are beginning to reflect creativity and novel solutions to common deal risks.

It is not yet clear whether the acquisition agreements that will be entered into after this period will continue to reflect the increased use of RTFs to allocate deal risk. The deals entered into during the 2008–2009 period primarily included RTFs to provide greater flexibility to buyers. However, because RTFs can be risk mitigating for

220. David Fox & Daniel E. Wolf, *Deal Certainty: The Fallacy of a New Market*, KIRKLAND M&A UPDATE, Oct. 2, 2009, at 3, available at <http://www.kirkland.com/siteFiles/Publications/5696D46D316C86CCD29B502D2E02AF62.pdf>.

221. The evolution in these deal terms has continued since the period covered by the study in this Article. See, e.g., Steven M. Davidoff, *Fast-Food Deal on Fast Track*, N.Y. TIMES DEALBOOK BLOG, Sept. 9, 2010, <http://dealbook.blogs.nytimes.com/2010/09/09/fast-food-deal-on-a-fast-track/>; David Marcus, *Strategics Need an Out, Too*, DEAL, June 4, 2010, available at <http://www.thedeal.com/newsweekly/2010/june-7-2010/strategics-need-an-out,-too.php#bottom>.

sellers as well as buyers, there may be rational reasons for sellers to replace specific performance provisions with RTF provisions even when seller leverage increases or returns to levels more akin to those found in more stable economic conditions. Furthermore, if the experience from deals in the 2008–2009 period is repeated, then one would expect that more deals will reflect the nuanced use of RTFs that one sees in some of the high-profile transactions of the era, such as the Pfizer-Wyeth transaction.²²²

Even if the prevalence of RTFs in acquisition agreements wanes, the increasingly complex use of RTFs that has been demonstrated by the study in this Article supports the view of organizational learning theory which “suggests that we consider contracts as both inputs to learning processes and outcomes of learning.”²²³ In essence, the strategic acquisition agreements of the 2008–2009 period evidence at least some “population-level learning” from the failures of RTF structures during the private equity boom of 2005–2007.²²⁴ Of course, given the fact that a number of strategic deals continue to use the suboptimal provisions of the private equity RTF structure, it is clear that such lessons are not yet widespread.²²⁵ The next logical step is identifying the drawbacks of RTF provisions.

B. The Potential Drawbacks of the Reverse Termination Fee Structure

Despite the potential flexibility and predictability that RTFs can provide for both sides in an acquisition transaction, the option-style structure that has emerged in strategic transactions, and that was commonly agreed upon in private equity transactions, could present significant problems for sellers. Furthermore, the use of RTFs has yet to be fully examined by the Delaware courts and could potentially result in significant judicial scrutiny of a board’s decision to enter into an acquisition agreement with an RTF provision.

222. See Smith & King, *supra* note 14, at 40 (institutional theory suggests that “Mimicry of high-status organizations’ contractual elements soon leads to a diffusion of a new contractual form among organizations in an entire industry Thus, one implication of institutional theory is that adaptation of contracts over time may proceed in a fad-like fashion, with lower-status firms continually conforming to new standards set by higher-status firms.”).

223. *Id.* at 29.

224. *Id.* at 32.

225. For a discussion of suboptimal provisions in contracts, see, for example, Stephen J. Choi & G. Mitu Gulati, *Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds*, 53 EMORY L.J. 929, 937 (2004) (“Change not only takes time, but also comes in stages—as we describe it, there is first an interpretive shock, then a lengthy period of adjustment, and only then a big shift in terms.”).

1. Pricing Issues

One of the most troubling developments in the rise of the RTF structure in private equity deals was the process by which the actual amount of the fee was set. Somewhat surprisingly, in a number of transactions parties are continuing to set the RTF to be equal to the STF.²²⁶

In transactions where the RTF is equal to the STF, the amount of the RTF can significantly miscalculate the closing risks faced by sellers and their shareholders when agreeing to a contract with an option-style RTF provision. This miscalculation is evident from the failures of the private equity structure, which led to much criticism of RTFs. In fact, the frequency of RTFs in recent deals prompted a Wall Street lawyer to remark, “It’s almost like a bad virus.”²²⁷ While the RTF provision was originally agreed to by sellers in private equity transactions primarily to promote certainty of closing of the contract, the provision failed to function as intended, in part because it was agreed to as the mirror of the STF.²²⁸ Thus, it is surprising to see that in a number of strategic transactions, parties are continuing to set the RTF at amounts that are identical or nearly identical to the STF.

There is little rationale for linking the amount of the RTF to the amount of the STF. STFs are used as a deal protection device by the buyer in order to deter a third-party bidder and agreed to by sellers in order to assure a deal with a preferred buyer. As discussed previously, the size of STFs has been limited by fiduciary duty principles.²²⁹ However, RTFs are not subject to the fiduciary duty concerns assessed by the Delaware courts. As demonstrated by the broken deals of 2007 and 2008 discussed above, “the in terrorem effect of the reverse break-up fee had been mitigated by the practice of

226. See also Marcus, *supra* note 125 (“The merger agreements in the deals that have been done since the bubble burst have largely followed the reverse break fee, no-financing condition, no-specific-performance paradigm.”); Davidoff, *supra* note 196 (discussing “new strategic [acquisition] model that incorporates a reverse termination fee private-equity-type provision”).

227. Monga, *supra* note 125.

228. As discussed above, in the vast majority of private equity acquisitions of public companies, the RTF was generally set at three percent of the deal value to make it mirror the STF in an acquisition agreement; essentially this was seen as a simple cost of doing business. See Davidoff, *supra* note 8, at 515–16 (finding that from 2005 to 2007, the average size of RTFs was 2.6 percent of transaction value); see also Christopher J. Bellini, Dorsey & Whitney LLP, *Private Equity Deal Terms: The Song (Largely) Remains the Same*, PRIVATE EQUITY FOCUS, June 2008, at 3, 4 (stating that “[t]he cap was typically a reverse termination fee that mirrored the break-up fee paid by the target to the buyer in the event that it terminated the merger agreement in favor of a superior competing offer”).

229. See *supra* note 70 and accompanying text.

setting the reverse fee at the same amount as the [STF].”²³⁰ In fact it seems that the only logical reason for setting the two fees at the same amount was “simplifying negotiations and a general sense of equity in treating buyer and seller alike.”²³¹

Furthermore, even in transactions where the RTF structure provided a pure option to the buyer to walk away by paying the fee, it is not clear whether the option was calculated according to any actual methodology.²³² This suggests that some of the same mistakes made in the private equity era are being replicated in recent strategic deals. As noted by Professor Davidoff, in private equity deals:

[The RTF option] was not calculated according to any option pricing method. Nor did it appear to be calculated by reference to the damage incurred by [the seller] in the event that it was exercised by the private equity firm. The amount ultimately paid also did not deter [buyers] from exercising the option in many instances. . . . and . . . appeared to undercompensate acquirers for the losses incurred by the acquired company and its shareholders. Evidence of this came from the post-termination share trading prices of acquirers against whom these provisions were invoked. In the months after the exercise of this provision, the share prices of these companies traded significantly below the pre-offer price.²³³

From a deal risk allocation standpoint, it is clear that the RTF should be set at a higher level than the STF given that in an option-style structure in particular, the seller is taking on a significantly higher risk of deal failure in agreeing to a deal with an RTF provision than a buyer takes with respect to having a deal jumped by a third party.²³⁴ For selling companies, an acquisition transaction places immense pressure on the company’s business, including potential loss of employees and customers and disruption of the company’s ordinary business operations, along with a lengthy and time-consuming due diligence and negotiation process. This is not to say that buyers do not also have incentives to complete the transaction, but that sellers may face greater problems in the event that an announced transaction fails to close.²³⁵

230. Peter S. Golden et al., *Negotiated Cash Acquisitions of Public Companies in Uncertain Times*, M&A LAW., Feb. 2009, at 1, 1.

231. *Id.*

232. See, e.g., Sekhon, *supra* note 121, at 6 (noting that even in deals with RTF provisions, “the analyses underlying fairness opinions issued by financial advisors to target companies do not address the option value to the acquirer inherent in” the RTF option).

233. Davidoff, *supra* note 8, at 515–16.

234. Of course, one could argue that the failure of boards to properly assess the risks of RTF provisions was reasonable since private equity firms historically rarely terminated transactions. See Davidoff, *supra* note 115.

235. See Coates & Subramanian, *supra* note 3, at 359; Davidoff, *supra* note 8, at 520. Some scholars have argued that the “reputational damage” from not being able to close deals leads to

An additional problem with the RTF structure in some acquisition agreements is not just that the fee has generally been improperly priced, but that the option-style structure provides a powerful tool for a buyer to walk away from a transaction or force renegotiation of the transaction at a significantly reduced price. Other provisions in the agreement exacerbate this problem, in particular the MAC clause, which under most contracts would allow a buyer to claim that a MAC has occurred and generally not be obligated to even pay the fee.²³⁶ In a transaction with both an RTF and a MAC provision, the buyer has significant negotiating leverage—it could attempt to claim that a MAC has occurred so that it would not have to pay the fee, and even if the MAC claim fails, the buyer’s maximum liability would be capped at the RTF.²³⁷

2. Board Fiduciary Duties, Disclosure, and the Reverse Termination Fee Structure

The RTF structure also raises important questions regarding the appropriate level of review of a board of director’s decision to enter an acquisition agreement with an RTF. The ability of shareholders for either the buyer or the seller to bring RTF-related fiduciary duty and disclosure claims against boards is a matter of considerable importance. While the disclosure and fiduciary duty implications of RTFs are beyond the scope of this Article and will be addressed in a companion paper, these issues are noted here because they are one of

view as a “weak bidder” therefore increasing costs in future bidding wars and decreasing the likelihood of winning bids since more bidders will enter bidding contests. See Guhan Subramanian, *The Drivers of Market Efficiency in Revlon Transactions*, 28 J. CORP. L. 691, 701–02 (2003). On the other hand, with respect to large private equity firms, these costs are likely to be low while the costs of an incorrect acquisition for a premier private equity firm like Blackstone are far higher. In addition, private equity firms seem to operate on a “gentlemen’s agreement” to not jump each other’s deals. See *In re Lear Corp. S’holder Litig.*, 926 A.2d 94, 121 (2007) (“[T]here is not a culture of rampant topping among the larger private equity players, who have relationships with each other that might inhibit such behavior.”); Sautter, *supra* note 21, at 560.

236. Admittedly, buyers have rarely been successful in court at escaping their obligation to close a transaction by claiming that a MAC has occurred. See *supra* note 45.

237. See Nowicki, *supra* note 40, at 2 (stating that when private equity buyers of Harman International Industries informed the company in September 2007 “that they were walking away from their agreement to acquire Harman for roughly \$8 billion due to an unspecified material adverse change[,] . . . [r]ather than engage in a legal battle over the MAC clause, the parties agreed to terminate the deal, and [the buyers] agreed to purchase \$400 million in convertible debt from Harman in return for being released from the acquisition agreement’s \$225 million reverse termination fee requirement”).

the many factors that will influence how RTFs continue to evolve in strategic transactions.

In general, as in the private equity era, both buyers and sellers in strategic deals have been less than forthcoming with the shareholders in public disclosure about the role of the RTF in the transaction. Sellers have touted that they entered into a “definitive agreement” to be acquired, focusing on the value of the transaction and the premium to be received by the company’s stockholders, but rarely including much relevant information from which one could decipher whether the agreement included an option-style RTF.²³⁸ In fact, even experienced practitioners have noted that, while acquisition agreements are presented to the seller’s shareholders and the public as a committed agreement by the buyer to complete the acquisition, one can determine if the agreement actually gives the buyer an option to pay the fee and walk away from the transaction without further liabilities “only by carefully parsing the [reverse termination fee] and remedies provisions of the merger agreement”²³⁹ Buyers have been similarly circumspect in their disclosure about RTF provisions in acquisition transactions.

The lack of effective disclosure could lead to potential liability for disclosure violations under state and federal law relating to the buyer’s or seller’s public statements about the transaction.²⁴⁰ In an economic environment filled with uncertainty, courts have been heavily focused on shareholder disclosure in connection with acquisition transactions. For example, the failure of adequate disclosure has been at the heart of the train wreck that ensued from Bank of America’s acquisition of Merrill Lynch. The Securities and Exchange Commission (“SEC”) has sought to charge Bank of America

238. See, e.g., Reddy Ice Holdings, Inc., Current Report (Form 8-K) (July 2, 2007) (neither disclosure in Item 1.01 nor the press release attached as Exhibit 99.1 mention an RTF provision, although it is clear from reading sections 8.3, 8.5, and 9.7 of Agreement and Plan of Merger attached as Exhibit 2.1 that the RTF was seller’s sole remedy in event buyer did not close transaction). The transaction, valued at approximately \$1.1 billion, was subsequently terminated by the private equity buyer in February 2008 after payment of the \$21 million RTF. See Reddy Ice Holdings, Inc., Current Report (Form 8-K) § 1.02 (Feb. 1, 2008). Similarly Blackstone’s acquisition of PHH also included an RTF option that was ultimately exercised by the buyer to terminate the transaction, PHH Corp., Current Report (Form 8-K) § 1.01 (Jan. 7, 2008), although there had been little clear disclosure about the RTF at the time of announcement of the agreement. See PHH Corp., Current Report (Form 8-K) (Mar. 14, 2007) (failing to mention RTF in either disclosure under Item 1.01 or press release attached as Exhibit 99.1).

239. Landau, et. al., *supra* note 102.

240. Disclosure-related litigation has been identified by Delaware practitioners and scholars as an emerging battle ground in fiduciary duty litigation. See Lloyd L. Drury III, *Private Equity and the Heightened Fiduciary Duty of Disclosure*, 6 N.Y.U. J. L. & BUS. 33, 35 (2009).

with failing to disclose extraordinary financial losses at Merrill Lynch prior to a shareholder vote to approve a merger between the two companies, after charging the bank with misleading investors about billions of dollars in bonuses that were being paid to Merrill executives.²⁴¹ Expressing his frustration with the lack of adequate disclosure, Judge Rakoff, in a widely heralded opinion, repeatedly labeled the disclosure failure as a “lie” and the shareholders as “victims of the lie.”²⁴² Judge Rakoff’s opinion, and the SEC’s renewed vigor in going after Bank of America, may signal a somewhat greater appetite on the part of regulators and courts to address disclosure shortcomings.

RTFs may also implicate board fiduciary duties for both the buyer and seller boards. A failed transaction resulting in the payment of a high RTF may potentially create significant cash flow problems for a buyer. Furthermore, a buyer board could arguably use an RTF provision as a form of takeover defense to prevent a hostile acquisition of the buyer by a third-party bidder. When used in this manner, the RTF is analogous to the Customer Assurance Program (“CAP”) used by PeopleSoft to deter the hostile bid from Oracle in their heated 2005 acquisition.²⁴³ The CAP, which required a significant contractual rebate to PeopleSoft customers in the event an acquirer discontinued new sales of the PeopleSoft product line or “materially reduce[d] support services” for the company’s products, has been described as a “perfect defense” that would cost a potential acquirer hundreds of million, if not billions, of dollars.²⁴⁴ Like the CAP, the RTF has two important features. First, it is a contract term embedded in an acquisition agreement that cannot be easily renegotiated and used as a bargaining chip against a third-party hostile bidder for the buyer in exchange for a higher price.²⁴⁵ Second, although the size of the RTF is dependent on arm’s length bargaining between the buyer and the seller in the initial acquisition agreement, when used as a poison pill, both the buyer and the seller would clearly prefer a higher RTF amount.

241. See SEC, Litigation Release No. 21371 (Jan. 11, 2010), available at <http://www.sec.gov/litigation/litreleases/2010/lr21371.htm>.

242. SEC v. Bank of Am. Corp., 653 F. Supp. 507, 509 (S.D.N.Y. 2009).

243. For a more detailed description of the Customer Assurance Program used by PeopleSoft, see David Millstone & Guhan Subramanian, Oracle v. PeopleSoft: A Case Study, 12 HARV. NEGOT. L. REV. 1, 12 (2007).

244. *Id.*

245. See *id.*

The Delaware courts have yet to address directly RTF provisions in acquisition agreements, and there is much uncertainty regarding the nature of such review. In general, the Delaware courts are extremely reluctant to question the substantive decisions of boards, particularly buyer boards, to enter into acquisition transaction.²⁴⁶ In fact, in a recent decision arising out of a shareholder derivative claim against the board of directors of Dow Chemical regarding its acquisition of Rohm & Haas, the court appeared unwilling not only to question the decision to enter into the transaction, but also to question substantive buy-side decisions, including how to structure the transaction and what terms to include in an acquisition agreement.²⁴⁷ However, given the growing complexities of RTF provisions, one can certainly envision RTF arrangements that would implicate board fiduciary duties.

CONCLUSION

In the wake of deals that exploded during the financial crisis, new contractual provisions to address the risk of parties escaping deals have emerged in acquisition transactions. The RTF provision is the most important new provision in acquisition agreements. The research presented in this Article provides the first systematic analysis of RTF provisions. The increasing use of RTFs and the utility of these provisions for both buyers and sellers indicate that these provisions will be a mainstay of acquisition agreements to come regardless of economic conditions. While this Article provides a number of explanations for the increasing use of these provisions to allocate deal risk, it is an early exploration into the reallocation of deal risk through innovative contractual terms. This reallocation presents a number of issues not only for the study of acquisition agreements, but also for broader questions about corporate governance and board fiduciary duties. This Article begins an examination of these issues, but more analysis and research is certainly needed on these important matters.

246. See, e.g., *Ash v. McCall*, No. 17132, 2000 WL 1370341 (Del. Ch. Sept. 15, 2000). In *Ash v. McCall*, the Delaware Court of Chancery dismissed the plaintiff's allegations that the board had breached its duties and committed waste by failing to detect accounting irregularities at the selling company during its due diligence investigation. The *Ash* court refused to second-guess the good faith business judgment of a board which approved an acquisition based on expert advice and a thorough board process. *Id.* at *8.

247. See *In Re Dow Chem. Co. Derivative Litig.*, Cons. No. 4339, 2010 WL 66769, at *9 (Del. Ch., Jan. 11, 2010) (“[S]ubstantive second-guessing of the merits of a business decision . . . is precisely the kind of inquiry that the business judgment rule prohibits.”)

Table 1. Frequency of Reverse Termination Fee Triggers

Reverse Termination Fee Triggers	1st Period:					2nd Period:				
	January 1, 2003–December 31, 2004					January 1, 2008–June 30, 2009				
	Cash Only	Stock Only	Cash & Stock	Choice	Total	Cash Only	Stock Only	Cash & Stock	Choice	Total
Termination in Connection with a Competing Transaction for Buyer	1	41	11	3	56 (54.9%)	2	19	9	1	31 (41.3%)
Change in Board Recommendation	1	37	3	2	43 (42.2%)	4	19	6	2	31 (41.3%)
Failure to Obtain a SH Vote/Hold SH Meeting	1	13	3	2	19 (18.6%)	3	7	2	1	13 (17.3%)
Buyer's Incurable Breach of R&W/Covenants/Agreements	7	21	7	4	39 (38.2%)	10	12	6	3	31 (41.3%)
Failure to Obtain Regulatory Approval	4	2	2	1	9 (8.8%)	10	1	0	0	11 (14.7%)
Financing Failure	4	0	2	0	6 (5.9%)	8	2	6	0	16 (21.3%)
Merger not Consummated (for any reason)	8	3	2	0	13 (12.7%)	13	6	2	1	22 (29.3%)

Note: Figures in parentheses are percentages for the adjacent base numbers. The total number of transactions with RTFs was 102 for the 2003–2004 period and seventy-five for the 2008–2009 period.

Table 2. Comparison of Reverse Termination Fees and Standard Termination Fees

Reverse Termination Fee Triggers	1st Period:				2nd Period:			
	January 1, 2003–December 31, 2004 ²⁴⁸				January 1, 2008–June 30, 2009			
	<u>N</u>	RTF = STF (%)	RTF < STF (%)	RTF > STF (%)	<u>N</u>	RTF = STF (%)	RTF < STF (%)	RTF > STF (%)
Termination in Connection with a Competing Transaction for Buyer	56	94.6	3.6	1.8	31	67.7	9.7	19.4
Change in Board Recommendation	43	88.4	9.3	0	31	77.4	6.5	16.1
Failure to Obtain a SH Vote/Hold SH Meeting	19	73.7	26.3	0	13	53.8	30.8	15.4
Buyer's Incurable Breach of R&W/Covenants/Agreements	39	84.6	7.7	5.1	32	64.5	12.9	22.6
Failure to Obtain Regulatory Approval	9	55.6	33.3	11.1	11	36.4	18.2	45.5
Financing Failure	6	83.3	0	16.7	16	63.0	12.5	25.0
Merger not Consummated (for any reason)	13	15.4	23.1	53.8	22	36.4	4.5	59.1

248. In one of the agreements, the amount of the RTF was not disclosed in either the acquisition agreement or the company's public disclosure. *See* Agreement and Plan of Merger, Prime Medical Services, Inc., ABC Merger, Inc. § 10.2 (Nov. 11, 2003).

Table 3. Types of Strategic Transactions with Reverse Termination Fees²⁴⁹

	1st Period:	2nd Period:
	January 1, 2003–December 31, 2004	January 1, 2008–June 30, 2009
	(%)	(%)
Transaction Consideration		
Cash Only	18.6	33.3
Stock Only	49.0	40.0
Cash & Stock	21.6	21.3
Choice	10.8	5.3
Financing		
No Financing/ Existing Revolving Credit	83.3	65.3
New Financing Obtained in Connection with Transaction	16.7	34.7

Note: The total number of transactions with RTFs was 102 for the 2003–2004 period and seventy-five for the 2008–2009 period.

249. To determine the consideration used, as well as the use of financing, we reviewed the buyer's representations and covenants in the acquisition agreement and consulted company annual and quarterly reports, news stories surrounding the transaction announcement, and proxy statements and/or prospectuses mailed to shareholders for voting approval of the transactions.

APPENDIX A – METHODOLOGY

In order to obtain a large sample of strategic deals that were announced between January 1, 2003 and December 31, 2004 as well as between January 1, 2008 and June 30, 2009, my research assistants and I reviewed all Form 8-K “current report” filings with the SEC for each of the periods that contained as exhibits contracts labeled under the term “merger” or “2.1.”²⁵⁰ A current report on Form 8-K must be filed by companies subject to the periodic reporting requirements of the Securities and Exchange Act of 1934 within four business days from the date when the company enters into a definitive material agreement, including a merger agreement.²⁵¹ In general, the reporting firm includes the actual agreement as an exhibit to the Form 8-K.²⁵² The agreements are therefore available online via the EDGAR system of the SEC.

For the 2003 to 2004 period, our results yielded a total of 1,027 filings on Form 8-K. We analyzed each such filing to determine whether it could be categorized as a business combination, including mergers, major asset acquisitions, and stock transactions. The listings were reviewed for duplicates; amendments to previously filed agreements; agreements not related to business combination transactions,²⁵³ such as a reincorporation, a recapitalization, an

250. Form 8-Ks are not the exclusive means that agreements are filed in acquisitions and can be filed on other SEC forms such as tender offer documents. For example, in a recent study of acquisition agreements from 2004–2008, the authors found that 20.3 percent were not filed on 8-Ks. See Matthew D. Cain & Steven M. Davidoff, *Delaware’s Competitive Reach: An Empirical Analysis of Public Company Merger Agreements* 28 (2009) (unpublished working paper), available at <http://ssrn.com/abstract=1431625>. Thus, our study may exclude some front-end tender offers where the acquisition agreement has not been filed on a Form 8-K.

251. For the current rules under Form 8K, see SEC, Form 8-K [blank form], <http://www.sec.gov/about/forms/form8-k.pdf> (last visited Sept. 8, 2010), Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date § 1, Item 101, Release Nos. 8400, 49424, 33-8400, 34-49424 (Mar. 16, 2004) (codified at 17 C.F.R. §§ 228, 229, 230, 239, 240, 249) (noting that “[i]tem 101 [Entry into a Definitive Material Agreement] requires disclosure of all material definitive agreements specified by the item, including business combination agreements and other agreements that relate to extraordinary corporate transactions”).

252. See Miller, *supra* note 1, at 2091; Additional Form 8-K Disclosure Requirements, *supra* note 251, § 1, Item 101 (“[W]e encourage companies to file the exhibit with the Form 8-K when feasible, particularly when no confidential treatment is requested.”). The company is required to file the agreement as an exhibit to its next periodic filing if it does not file the agreement as an exhibit to an 8-K. *Id.* The study conducted for this Article did not consider any merger agreements filed other than as exhibits to Forms 8-K.

253. Firms use the statutory merger form to accomplish non-business-combination goals such as a recapitalization or a reincorporation in order to avoid class voting or to squeeze out a

internal reorganization; and going private transactions involving an existing majority stockholder. We also excluded transactions where the buyer was a financial buyer, such as a private equity firm or a specified purpose acquisition company—in other words, a newly formed company without any business operations that has been organized with the sole purpose of going public and using the proceeds of the public offering to acquire an existing operating business.²⁵⁴ We obtained a sample of 542 strategic transactions. Because RTFs have a variety of naming conventions, we reviewed the terms of each of the 542 agreements to determine whether the agreement included an RTF provision. We found that 102 of the 542 transactions, or approximately 18.8 percent, included RTF provisions.

For the 2008–2009 period, our results yielded a total of 603 filings on Form 8-K. We followed the same methodology described above to determine whether the filing could be categorized as a business combination, including mergers, major asset acquisitions and stock transactions. We obtained a sample of 292 strategic transactions. Following a review of these 292 agreements, we found that seventy-five, or approximately 25.7 percent, included an RTF provision.

For each agreement, we examined the contractual triggers for payment of the RTF, the relationship between the amount of the STF and the RTF, whether the contract provided for monetary remedies in addition to the RTF, and whether, and under what circumstances, a specific performance remedy was available for the seller under the contract.²⁵⁵ We also examined the consideration used in the transaction and whether the deal was financed in any way. To determine the consideration used, as well as the use of financing, we reviewed the buyer's representations and covenants in the acquisition agreement and consulted company annual and quarterly reports, news stories surrounding the transaction announcement, and proxy statements and/or prospectuses mailed to shareholders for voting approval of the transactions.

minority block of shareholders. See DALE A. OESTERLE, *THE LAW OF MERGERS AND ACQUISITIONS* 5, 84–85 (3d ed. 2005).

254. See Steven M. Davidoff, *Black Market Capital*, 2008 COLUM. BUS. L. REV. 172, 224–55.

255. We did not include as RTF provisions contractual terms that solely served to reimburse the seller for expenses.

APPENDIX B – SAMPLE REVERSE TERMINATION FEE PROVISIONS

2003–2004 Sample RTF Provision²⁵⁶

SECTION 5.06(c) In the event that

(i) this Agreement is terminated pursuant to Section 7.01(b)(i) [Either party terminates due to incurable breach of R&W resulting in failure to close], 7.01(b)(ii) [Either party terminates due to final nonappealable injunction] or 7.01(c)(ii) [Buyer terminates due to regulatory restraint] and

(ii) at the time of any such termination all of the conditions set forth in Article VI [Conditions precedent to merger] have been satisfied or waived except for any of the conditions set forth in Section 6.01(b) [NYSE listing], 6.01(c) [Antitrust], 6.01(d) [No injunctions or restraints], 6.02(c) [No litigation involving government entity] or 6.02(d) [No restraint] (in the case of Sections 6.01(d), 6.02(c) and 6.02(d), only to the extent that the conditions set forth therein have not been satisfied due to a suit, action or proceeding by any national Governmental Entity or the imposition of a Restraint, in either case relating to competition, merger control, antitrust or similar Laws),

then Parent shall pay to the Company a fee equal to \$700 million (the “Company Termination Fee”) by wire transfer of same-day funds on the first business day following the date of termination of this Agreement.

.....
SECTION 8.10. Specific Enforcement.

The parties agree that irreparable damage would occur and that the parties would not have any adequate remedy at law in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that the parties shall be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement in the United States District Court for the Southern District of New York, this being in addition to any other remedy to which they are entitled at law or in equity.

256. Adapted from Agreement and Plan of Merger, Johnson & Johnson, Shelby Merger Sub, Inc. and Guidant Corporation (Dec. 15, 2004).

2008–2009 Sample RTF Provisions**1. Option-Style RTF²⁵⁷**

SECTION 8.2 Effect of Termination.

. . . .

(c) Reverse Termination Fee.

(i) In the event that this Agreement is terminated:

(A) by the Company pursuant to Section 8.1(d)(i) [Buyer's Incurable Breach of R&W/ Covenants/ Agreements] if at the time of such termination there is no state of facts or circumstances (other than a state of facts or circumstances caused by or arising out of a breach of Holdings' and Merger Sub's representations, warranties, covenants or other agreements set forth in this Agreement) that would reasonably be expected to cause the conditions set forth in Section 7.1 and Section 7.2 [Buyer and seller conditions to merger] not to be satisfied on or prior to the Termination Date;

(B) by the Company pursuant to Section 8.1(d)(ii) [Failure to Consummate Merger]; or

(C) by the Company or Holdings pursuant to (x) Section 8.1(c) [Failure to Close by Drop Dead Date] for the failure to satisfy the conditions set forth in Section 7.1(b), Section 7.1(c) or Section 7.2(d) [Government/Regulatory Approval] (subject to the right of Holdings to waive the condition set forth in Section 7.2(d)) due to the failure to receive any required consent or clearance under applicable Antitrust Laws from a Governmental Entity of competent jurisdiction or any action by any Governmental Entity of competent jurisdiction to prevent the Merger for antitrust reasons or (y) Section 8.1(b) due to the denial of any approval required under applicable Antitrust Laws or the taking of any other action by any antitrust or competition Governmental Entity of competent jurisdiction if, in each of clauses (x) and (y), at the time of such termination all other conditions to Closing set forth in Sections 7.1 and 7.2 (other than those conditions that by their terms are to be satisfied at the Closing but which conditions would be satisfied if the Closing Date were the date of such termination) have been satisfied,

then in the case of a termination under the circumstances described in clauses (A), (B) or (C) above, Parent shall pay

257. Adapted from Agreement and Plan of Merger, Wm. Wrigley Jr. Company, Mars, Incorporated, New UNO Holdings Corporation and New Uno Acquisition Corporation § 8.1(c) (Apr. 28, 2008).

\$1,000,000,000 (the “Reverse Termination Fee”) to, or as directed by, the Company, as promptly as reasonably practicable (and, in any event, within two business days following such termination) by wire transfer of same day funds. In no event shall the Company be entitled to the Reverse Termination Fee on more than one occasion.

(ii) The Company’s right to receive payment of the Reverse Termination Fee from Parent shall be the sole and exclusive remedy of the Company and its affiliates against Parent, Holdings, Merger Sub or any of their respective former, current or future directors, officers, employees, agents, stockholders, representatives, affiliates or assignees or any former, current or future director, officer, employee, agent, general or limited partner, manager, member, stockholder, representative, affiliate or assignee of any of the foregoing (collectively, the “Related Persons”) for any loss or damage suffered as a result of the failure of the Merger to be consummated or for a breach or failure to perform under this Agreement or otherwise and upon payment of such amount, none of Parent, Holdings, Merger Sub or any of their respective Related Persons shall have any further liability or obligation relating to or arising out of this Agreement or the transactions contemplated by this Agreement (except that Holdings shall also be obligated with respect to Section 6.4(b) [Confidentiality Agreement] and Parent shall also be obligated with respect to the penultimate sentence of Section 6.10(b) [Use of Seller’s logo in connection with debt financing], Section 6.11(d) [Indemnification of seller] and the second sentence of Section 8.2(d) [Reimbursement of Expenses]).

(iii) Notwithstanding anything herein to the contrary, the Company agrees that, to the extent it has incurred losses or damages in connection with this Agreement, (i) the maximum aggregate liability of Parent, Holdings and Merger Sub for such losses or damages shall not exceed the Liability Limitation (as defined below), provided that the sole obligations of Parent under and in respect of this Agreement and the transactions contemplated hereby shall be limited to the express payment and/or indemnification obligations of Parent to (A) pay the Reverse Termination Fee, if required, from Parent pursuant to Section 8.2(c)(i) [Incurable breach of R&W], (B) reimburse amounts or provide indemnification pursuant to the penultimate sentence of Section 6.10(b) or Section 6.11(d) and (C) reimburse amounts due from Parent pursuant to the second sentence of Section 8.2(d) (such payment and indemnification obligations, collectively, the “Parent Obligations”), (ii) in no event shall the Company or any of its affiliates seek to recover any money damages or any other recovery, judgment or damages of any kind, including

rescissory, consequential, indirect, or punitive damages, in connection with this Agreement or the transactions contemplated hereby against Parent (other than for satisfaction of the Parent Obligations) or against, individually or in the aggregate, Parent, Holdings or Merger Sub in excess of the Liability Limitation and (iii) in no event shall the Company or any of its affiliates seek to recover any money damages or any other recovery, judgment or damages of any kind, including rescissory, consequential, indirect, or punitive damages, in connection with this Agreement or the transactions contemplated hereby against any of Parent's, Holdings' or Merger Sub's respective Related Persons.

"Liability Limitation" means an amount equal to \$1,000,000,000 (inclusive of any payment of the Reverse Termination Fee) plus any amounts to be reimbursed and indemnification payments pursuant to the penultimate sentence of Section 6.10(b) or Section 6.11(d) and the second sentence of Section 8.2(d).

(iv) The Company acknowledges and agrees that it has no right of recovery against, and no personal liability shall attach to, any of Parent, Holdings, Merger Sub or their respective Related Persons, through Holdings, Merger Sub or otherwise, whether by or through attempted piercing of the corporate, limited partnership or limited liability company veil, by or through a claim by or on behalf of Holdings or Merger Sub against Parent or any of their or Parent's respective Related Persons, by the enforcement of any assessment or by any legal or equitable proceeding, by virtue of any Law or otherwise, except for its right to recover from Holdings or Merger Sub (but not any of Holding's or Merger Sub's respective Related Persons) to the extent provided in this Agreement, and its right to receive payment and/or indemnification from Parent pursuant to the Parent Obligations (as limited by the provisions herein), and subject to the Liability Limitation and the other limitations described herein. Notwithstanding anything that may be expressed or implied in this Agreement or any document or instrument delivered in connection herewith, the Company hereby agrees and acknowledges that the Company's right to receive payment and/or indemnification from Parent pursuant to the Parent Obligations (as limited by the provisions herein) shall be the sole and exclusive remedy of the Company and all of its affiliates against Parent and its Related Persons (other than Holdings and Merger Sub to the extent, and subject to the limitations, contained in this Agreement) in respect of any liabilities or obligations arising under, or in connection with, this Agreement, the Financing Commitment Letters or the transactions contemplated hereby or thereby.

....

SECTION 9.10 Specific Performance.

The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed by the Company in accordance with their specific terms or were otherwise breached by the Company. It is accordingly agreed that, prior to the termination of this Agreement pursuant to Section 8.1, Holdings and Merger Sub shall be entitled to an injunction or injunctions to prevent breaches of this Agreement by the Company and to enforce specifically the terms and provisions of this Agreement against the Company, this being in addition to any other remedy to which either such party is entitled at law or in equity. The Company acknowledges and agrees that it shall not be entitled to an injunction or injunctions to prevent any breaches of this Agreement by Parent, Holdings or Merger Sub or to enforce specifically the terms and provisions of this Agreement or otherwise to obtain any equitable relief or remedy against Parent, Holdings or Merger Sub and that the Company's sole and exclusive remedies with respect to any such breach shall be the remedies set forth in Section 8.2(c); provided, however, that the Company shall be entitled to any injunction or injunctions solely to prevent any breach by Holdings or Merger Sub of Section 6.4(b).

2. Hybrid: RTF with Specific Performance²⁵⁸**SECTION 7.2 Termination Fee.**

Notwithstanding any provision in this Agreement to the contrary, if:

....

(d) this Agreement is terminated by Parent or the Company pursuant to either Section 7.1(b) [Failure to consummate merger by drop dead] or Section 7.1(c) [Final nonappealable injunction] (in the case of Section 7.1(c) to the extent arising in connection with any Regulatory Law) and, at the time of either such termination, all of the conditions to closing, have been satisfied or waived in writing (or, if the Closing were to have taken place on the date of termination, such conditions would have been satisfied), other than the conditions set forth in Section 6.1(b) [Injunctions or restrictions to merger] (if the injunction, restraint or prohibition relates to any Regulatory Law) or Section 6.1(c) [Regulatory approval], then Parent shall pay to the

²⁵⁸ Adapted from Agreement and Plan of Merger, The Dow Chemical Company, Ramses Acquisition Corp. and Rohm and Haas Company (July 10, 2008).

Company an amount in cash equal to \$750,000,000 (the “Reverse Termination Fee”) within two (2) Business Days of such termination.

....

SECTION 8.5 Jurisdiction; Enforcement.

(a) The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached and that the parties would not have any adequate remedy at law. It is accordingly agreed that the parties shall be entitled to an injunction or injunctions to prevent breaches or threatened breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement exclusively in the Delaware Court of Chancery, or in the event (but only in the event) that such court does not have subject matter jurisdiction over such action or proceeding, in the United States District Court for the District of Delaware or another court sitting in the state of Delaware. The foregoing is in addition to any other remedy to which any party is entitled at law, in equity or otherwise.

3. The Two-Tier RTF²⁵⁹

SECTION 8.3 Expenses and Other Payments.

....

(c) If [Seller] terminates this Agreement pursuant to Section 8.1(e) [Change in Buyer board recommendation], then [Buyer] shall (x) pay [Seller] the [Tier 1] Termination Fee, in cash, by wire transfer of immediately available funds to an account designated by [Seller], no later than two (2) Business Days after such termination, and (y) reimburse [Seller], in cash, for the [Seller] Expenses by wire transfer of immediately available funds to an account designated by [Seller], no later than two (2) Business Days after receipt by [Buyer] of an invoice from [Seller] for the [Seller] Expenses.

(d) If (i) all of the conditions set forth in Sections 7.1 and 7.2 [Buyer and Seller conditions to merger] shall have been satisfied or waived (other than those conditions that by their terms are to be satisfied at the Closing, provided that such conditions shall have been capable of being satisfied as of the date of termination of this Agreement), (ii) the Mergers shall not have been consummated on or prior to the End Date, and (iii) [Seller] or [Buyer] terminates this

259. Adapted from Agreement and Plan of Merger, by and among Merck & Co., Inc., Schering-Plough Corporation, SP Merger Subsidiary One, Inc. (formerly Blue, Inc.), and SP Merger Subsidiary Two, Inc. (formerly Purple, Inc.) (Mar. 8, 2009).

Agreement pursuant to Section 8.1(b)(ii) [End Date], then [Buyer] shall (x) pay to [Seller] the [Tier 2] Termination Fee, in cash, by wire transfer of immediately available funds, to an account designated by [Seller], in the case of termination by [Seller], no later than two (2) Business Days after such termination, and in the case of termination by [Buyer], concurrently with such termination, and (y) reimburse [Seller] in cash for the [Seller] Expenses by wire transfer of immediately available funds to an account designated by [Seller], no later than two (2) Business Days after receipt by [Buyer] of an invoice from [Seller] for the [Seller] Expenses. [Seller] agrees that notwithstanding anything in this Agreement, the remedy provided for in the prior sentence shall be the sole and exclusive remedy of [Seller], its Subsidiaries, shareholders, Affiliates, officers, directors, employees or Representatives against [Buyer] or any of its Related Persons, Representatives or Affiliates for, and in no event will [Seller] or any other such Person seek to recover any other money damages or seek any other remedy based on a claim in law or equity with respect to, (A) any loss suffered as a result of the failure of the Mergers to be consummated, (B) the termination of this Agreement, (C) any liabilities or obligations arising under this Agreement, or (D) any claims or actions arising out of or relating to any breach, termination or failure of or under this Agreement, in each case, with respect to or as a result of any failure to seek or obtain the proceeds of the Financing or any alternative financing and any event related thereto.

(f) If either [Buyer] or [Seller] terminates this Agreement pursuant to Section 8.1(b)(ii) [End Date] or Section 8.1(d)(ii) [Failure to obtain Buyer shareholder vote] or [Seller] terminates this Agreement pursuant to Section 8.1(b)(iii) [Buyer's incurable breach of R&W], and, in each case, (i) in the case of a termination pursuant to Section 8.1(d)(ii), there shall have been publicly announced, disclosed or otherwise made known an Acquisition Proposal for [Buyer] on or after the date of this Agreement and prior to the [Buyer] Shareholder Meeting; or in the case of a termination pursuant to Section 8.1(b)(ii) or Section 8.1(b)(iii), an Acquisition Proposal shall have been made for [Buyer] on or after the date of this Agreement and prior to such termination, whether or not publicly announced, disclosed or otherwise made known and (ii) within twelve (12) months after such termination [Buyer] enters into a definitive agreement with respect to or consummates any Acquisition Proposal (provided, that, for purposes of this clause (ii), any reference in the definition of Acquisition Proposal to 15% shall be deemed to be a reference to 50%), then on the earliest of (A) the date of entering into such definitive agreement or (B) the closing or other consummation of such Acquisition Proposal,

[Buyer] shall pay [Seller] the Termination Fee, in cash, by wire transfer of immediately available funds to an account designated by [Seller] and, in addition, if no obligation to reimburse [Seller] Expenses has previously arisen, [Buyer] shall reimburse [Seller] in cash for the [Seller] Expenses by wire transfer of immediately available funds to an account designated by [Seller] no later than two (2) Business Days after receipt by [Buyer] of an invoice for the [Seller] Expenses.

....

SECTION 10.11 Specific Performance. The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. Each party agrees that, in the event of any breach or threatened breach by any other party of any covenant or obligation contained in this Agreement, the non-breaching party shall be entitled (in addition to any other remedy that may be available to it whether in law or equity, including monetary damages, except as limited by Section 8.3) to seek and obtain (a) a decree or order of specific performance to enforce the observance and performance of such covenant or obligation, and (b) an injunction restraining such breach or threatened breach. In circumstances where [Buyer] or [Seller] is obligated to consummate the Mergers and the Mergers have not been consummated (other than as a result of the other party's refusal to close in violation of this Agreement) each of [Seller] and [Buyer] expressly acknowledges and agrees that the other party and its shareholders shall have suffered irreparable harm, that monetary damages will be inadequate to compensate such other party and its shareholders, and that such other party on behalf of itself and its shareholders shall be entitled to enforce specifically [Buyer]'s or [Seller]'s, as the case may be, obligation to consummate the Mergers. Notwithstanding the foregoing or any other provision of this Agreement, the parties acknowledge and agree that neither [Seller] nor Merger Sub 1 or Merger Sub 2 shall be entitled to enforce specifically the obligations of [Buyer] to consummate the transactions contemplated by this Agreement unless all of the conditions set forth in Section 7.1 and Section 7.2 [Buyer and Seller conditions to merger] shall have been satisfied or waived and the proceeds of the Financing are then available in full pursuant to the Commitment Letter (or if Financing Definitive Agreements have been entered into, pursuant to such Financing Definitive Agreements). Each party further agrees that no other party or any other Person shall be required to obtain, furnish or post any bond or similar instrument in connection with or as a condition to obtaining any

remedy referred to in this Section 10.11, and each party irrevocably waives any right it may have to require the obtaining, furnishing or posting of any such bond or similar instrument.