Recent Developments in M&A Practice: Key Takeaways

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Agenda

The "Fraud Exception"

- *Great Hill Equity Partners v. SIG Growth Equity Fund*
- *ChyronHego Corporation, et al., v. Cliff Wight and CFX Holdings, Inc.*

Evergreen Danger: Deadlines and Notices

- *Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.*

Texas Legislative Developments

- Texas Citizens Participation Act: Time to reset?
- TBOC Amendments: Facilitating Two-Step Tender Offers

Areas to Watch

- SEC Proposes Amendments to M&A Financial Disclosures
- Evolution of #MeToo in M&A

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RECENT LESSONS FOR M&A PRACTITIONERS: "FRAUD EXCEPTION" CASES

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Great Hill Equity Partners v. SIG Growth Equity Fund

- Buyer purchased a company that facilitated, as a reseller, transactions between online vendors of digital goods and persons purchasing those goods with their credit cards.
- As part of that business, the company had relationships with various payment processors, who processed the credit card payments.
- Buyer made numerous claims of fraud, based on both the contractual representations and certain purported extra-contractual statements and omissions.

Great Hill Equity Partners, continued

- Only one claim stuck (a claim that the company's CEO, a significant selling shareholder, knowingly misrepresented by causing the company to make a contractual representation in the merger agreement that he allegedly knew to be false).
- Buyer claimed that the CEO's alleged fraud resulted in uncapped indemnification liability for ***all selling shareholders***, including:
  - an innocent private equity seller and its co-investors; and
  - two charities, who had received a gift of the company's stock from the private equity seller.

Great Hill Equity Partners, continued

- Claim was based upon an undefined fraud carve-out in the exclusive remedy provision of the merger agreement.
- Indemnification was limited to each selling shareholders' pro rata share of an escrow fund, which effectively capped liability at approximately 8% of the purchase price.
- However, the exclusive remedy provision stated, in relevant part:
  - Following the Closing, *except (a) in the case of fraud or intentional misrepresentation (for which no limitations set forth herein shall be applicable)* , …, the sole and exclusive remedies of the parties hereto for monetary damages arising out of, relating to or resulting from any claim for breach of any covenant, agreement, representation or warranty set forth in this Agreement, the Disclosure Schedule, or any certificate delivered by a party with respect hereto will be limited to those contained in this Article 10.

Great Hill Equity Partners, continued

- In 2017's *EMSI Acquisition, Inc. v. Contrarian Funds, LLC*, the Delaware Court of Chancery found that an undefined fraud carve-out could be construed:
  - as allowing an indemnification claim against all selling shareholders, including those ignorant of the alleged fraud, based upon the fraud of the management of the portfolio company being sold; or
  - to mean that the selling shareholders had simply excepted, from the contractual indemnification caps, tort claims against the individuals involved in the fraudulent activity.
- The Court declared the clause ambiguous and requested extrinsic evidence in connection with its interpretation of the language.
  - The case was settled before extrinsic evidence could be introduced.

Great Hill Equity Partners, continued

- In *Great Hill Equity Partners*, court determined that extrinsic evidence of intent was not required because:
  - The clause at issue did not permit unlimited indemnification claims against all selling shareholders if there was a fraudulent misrepresentation made by one selling shareholder.
  - Rather, *the carve-out allowed only tort claims (not indemnification claims)* based upon an alleged fraudulent misrepresentation, and such claims could only be pursued against those actually committing fraud.
- Regardless of the outcome in *Great Hill Equity Partners*, undefined fraud carve-outs are fraught with potential ambiguity.
  - Though the court ultimately found the *Great Hill Equity* clause to be unambiguous, in an earlier decision the court said its meaning "would be helpfully illuminated by evidence of the parties' intent."

Key Takeaways from Great Hill Equity Partners

- Be specific about what types of fraud are actually being carved out.
- Be specific about whether the carve-out covers fraud with respect to any statement made in the course of negotiation, or only with respect to those statements that the parties agreed were the bargained-for factual reasons for the deal and therefore important enough to incorporate into the written acquisition agreement.
- Define fraud carve-outs so that only intentional misrepresentation by a particular selling party with respect to the specific representations and warranties set forth in the agreement is actually carved out from the liability caps.

ChyronHego Corporation, et al., v. Cliff Wight and CFX Holdings, Inc.

- Buyer entered into an agreement to purchase Sound & Video Creations, LLC (the "Company") from CFX Holdings, Inc. and the other selling stockholders.
- Prior to the acquisition, the owner and president of the Company, and the Company, provided due diligence materials Buyer in a data room and separately provided requested financial information in connection with a QoE report prepared by ChyronHego and its advisors.
- In the year following the acquisition, the Company performed poorly, and Buyer alleged that the owner/president and CFX committed fraud and breached the purchase agreement by fraudulently misrepresenting the actual financial condition and value of the Company.

ChyronHego, continued

- The purchase agreement contained an explicit anti-reliance clause disclaiming Buyer's reliance on extra-contractual representations, which dictates what representations (or misrepresentations) may form the basis for a fraud claim.
- The anti-reliance clause stated that Buyer agreed that the Company and the selling stockholders made no representations or warranties other than those contained in the purchase agreement, including with respect to any financial projections or budgets, and contained a carve-out that such provision would "not preclude Buyer from asserting claims for Fraud."
- The Court also examined the exclusive remedies provision, the integration provision, and the fact that "Fraud" was excluded from the limitations and procedures applicable to claims under the indemnification provision, and found none of those provisions operated to preserve a right by buyer to sue for fraud based on extra-contractual statements.

ChyronHego, continued

- The Court dismissed Buyer's fraud claim based on misleading due diligence materials.
- The Court provided the following guidance:
  - An effective "holistic" anti-reliance clause should include a combination of:
    - a standard integration clause;
    - an exclusive remedies provision;
    - a definition of excluded liabilities in an indemnification provision; and
    - an explicit anti-reliance provision stating that the seller shall not be deemed to have made any representation, warranty, covenant or agreement, express or implied, about the target company or its business (including any financial projections or budgets), other than those explicitly set forth in the purchase agreement.

Key Takeaways from ChyronHego

- Delaware law allows parties to identify the specific information on which a party has relied and forecloses reliance on other information.
- For an anti-reliance provision to be effective, it must be unequivocally clear.
  - By contrast, "Standard Integration Clauses" without explicit anti-reliance representations, will not relieve a party of its oral and extra-contractual fraudulent representations.
- For anti-reliance language to be enforceable, the contract must contain language that, when read together, can be said to add up to a clear anti-reliance clause by which the buyer has contractually promised that it did not rely upon statements outside the contract's four corners in deciding to sign the contract.

Key Takeaways from ChyronHego, cont.

- Delaware courts will not condone an anti-reliance provision that one attempts to use to: (1) protect a seller from liability for making false representations in a contract; or (2) avoid liability for knowledge that representations in a contract are false.

- What about in Texas?

EVERGREEN DANGER: DEADLINES AND NOTICES

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Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.

- Vintage agreed to acquire Rent-A-Center in June 2018.
- The deal required antitrust clearance from the U.S. Federal Trade Commission.
- Under the merger agreement, each party had the unilateral right to extend the outside date past December 17, 2018, in order to obtain antitrust clearance by giving the other party written notice.
- If neither party elected to extend the end date, then the parties would still be bound by the merger agreement, but either party could terminate the merger agreement by delivering a written notice to the other party.
- The merger agreement provided in these circumstances that, upon termination, Vintage would be obligated to pay to Rent-A-Center a reverse breakup fee of $126.5 million.

Vintage Rodeo Parent, continued

- In light of the prolonged FTC approval process, it was clear to each party that the merger would not be completed by December 17, 2018.
- The Rent-A-Center board determined that it would not unilaterally extend the end date.
- While Rent-A-Center anticipated that Vintage would elect to extend, to Rent-A-Center's surprise, Vintage did not extend the end date by the prescribed deadline.
- On the morning of December 18, 2018 (only a few hours after the deadline had passed), Rent-A-Center delivered a termination notice to Vintage and demanded that Vintage pay the $126.5 million breakup fee.

Vintage Rodeo Parent, continued

- Vintage argued that an extension notice was constructively delivered or waived because the parties were actively working together towards closing, including to obtain antitrust approval.
- The Delaware Court of Chancery believed that Vintage "simply forgot" to deliver the extension notice and found that Rent-A-Center's termination was valid and effective.
- On April 22, 2019, Rent-A-Center announced that it had agreed to settle all litigation with Vintage relating to the Rent-A-Center's termination of the merger agreement.
- Vintage agreed to pay Rent-A-Center $92,500,000 in cash.

Vintage Rodeo Parent, continued

- Key Takeaways:
  - Delaware courts generally will strictly enforce the clear and unambiguous terms of a merger agreement.
  - Reasonable efforts do not require reminding a counterparty of its contractual rights.
- Practice Pointers:
  - Always set a calendar reminder for important deadlines in transaction documents.
  - Memorialize the parties' agreement, even if you think everyone is on the same page.

TEXAS STATUTORY DEVELOPMENTS: TCPA AND TBOC AMENDMENTS

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Texas Citizens Participation Act

- What is the TCPA?
- Why are companies so exercised about it?
- What is changing about it?

What is the TCPA?

- Texas's anti-SLAPP law – passed in 2011
- "SLAPP" = Strategic Lawsuits Against Public Participation
  - legally meritless lawsuits that target truthful speech, lawful petitioning, and legal association
  - designed to chill First Amendment activities by subjecting those who exercise constitutional rights to the intimidation and expense of litigation
- Amendments taking effect September 1 – let's hope they help

Existing Law: When does the TCPA apply?

- "If a ***legal action*** is ***based on, relates to,*** or ***is in response to*** a party's exercise of the right of ***free speech,*** right to ***petition,*** or ***right of association***, that party may file a motion to dismiss the legal action."

Existing Law: TCPA defines these concepts very broadly

- "Legal action" means a lawsuit, cause of action, petition, complaint, cross-claim, or counterclaim or any other judicial pleading or filing that requests legal or equitable relief.

- "Relates to" has been interpreted very broadly

- "Based on" has essentially been interpreted to mean "after"

- In the words of one court of appeals justice, "It seems that any skilled litigator could figure out a way to file a motion to dismiss under the TCPA in nearly every case."

Existing Law: Procedural Impacts

- As a result, the TCPA has had significant consequences for civil litigation in Texas.

- When it applies, the act requires plaintiffs, at the very beginning of a lawsuit, to present clear and specific evidence establishing a prima facie case for every element of their claims.

- Failure to do so results in dismissal and a mandatory award of attorney's fees and sanctions against the plaintiff.

- If a court denies a TCPA motion to dismiss, the moving party can seek an immediate interlocutory appeal that stays the entirety of the underlying case until the appeal is finally decided.

Some surprising uses of the TCPA

- "Speech right" cases
  - Trade secret misappropriation claims
  - Breach of contract claims
  - Fraud claims
  - Tortious interference claims
  - Private employment disputes

- "Associational rights" cases
  - Violations of noncompete agreements
  - Violations of confidentiality obligations and fiduciary duties
  - Civil conspiracy claims

Goals of Amendments: Reduce Scope and Impact of TCPA

- Adds to the definition of "right of association" the requirement that the collective activity "relat[e] to a *governmental proceeding or a matter of public concern*"

- Redefine "legal action" to, among others, exclude alternative dispute resolution proceedings

- Limit the definition of a "matter of public concern" to "a statement or activity regarding" a public official or person, a matter of political, social, or other interest to the community, or "a subject of concern to the public," and to remove broad "related to" language

Goals of Amendments: Reduce Scope and Impact of TCPA, cont.

- Exempt certain types of cases, including employment disputes involving misappropriation of trade secrets and corporate opportunities and non-disparagement and covenant-not-to-compete claims, claims under the Deceptive Trade Practices Act, and all common-law fraud claims

- Require 21 days' notice of hearing and response to be filed seven days before hearing

- Make sanctions awards discretionary if a movant prevails on a TCPA motion to dismiss

Practice Tips: Avoiding this mess in contracts…

- Importance of arbitration and choice-of-law clauses
- Contractual waiver of rights to petition and/or assert anti-SLAPP defenses
  - Defendant agreed to limit its ability to file complaints with Railroad Commission, waived ability to claim it as TCPA-protected petitioning. *Lona Hills Ranch LLC v. Creative Oil & Gas Operating, LLC*, 549 S.W.3d 839, 848 (Tex. App.—Austin 2018, pet. filed).
  - However, mere agreement to confidentiality terms will not waive TCPA claim. *Elliott v. S & S Emergency Training Solutions*, 2017 WL 2118787 (Tex. App.—Dallas 2017), *rev'd on other grounds*, *S & S Emergency Training Sols., Inc. v. Elliott*, 564 S.W.3d 843 (Tex. 2018).
  - Consider adding to employment agreements, vendor contracts, and license agreements

TBOC Amendments: Facilitating Two-Step Tender Offers

- Recall two principal ways of acquiring a public company in a "friendly" transaction: one-step merger or two-step tender offer/short form merger

- Two-step tender offer/short form merger facilitates speed – no need to wait for a shareholder vote
  - Time and expense associated with proxy solicitation process and shareholder meeting

- Until 2015 in Texas, however, it effectively required holders to obtain 90% in the first step tender offer in order to be permitted to effect a short form merger (similar to DGCL §251(h))
  - Workarounds sometimes available – *e.g.*, "top-up" options to get to 90%

- New amendments take effect in September
  - TBOC §21.459 is where all this is happening…

Existing Law: How it works in Texas…

- Target must be a *public company* (shares listed on a national securities exchange or held of record by 2000+ holders prior to the Target board approving the transaction)

- Merger Agreement *expressly* provides that short-form merger is to be effected pursuant to the applicable provisions of the statute

- Tender offer must be for all shares otherwise entitled to vote on the merger

Existing Law: How it works, cont.…

- After consummating an offer (*i.e.*, irrevocably accepting for purchase) such that buyer owns sufficient shares, together with shares previously owned by the buyer, to approve the merger under the TBOC and certificate of formation
  - Recall that default rule in Texas in two-thirds (rather than majority) of outstanding to approve a merger…
- Shares not tendered are converted into the right to receive the same consideration as other shares tendered in the offer
- If you meet all of the above, you can structure your acquisition to gain the benefits of speed associated with a tender offer without the risks associated with a longer drawn-out process to approve a long-form merger…

TBOC 2019 Amendments

- Designed to further facilitate using this structure

- Buyers can now include shares owned by qualified affiliates when determining whether the threshold has been obtained
  - Parent that directly or indirectly owns 100% of buyer
  - Direct and indirect wholly owned subsidiaries of buyer

- Buyers can include "rollover" shares being exchanged for shares in the buyer pursuant to a separate written agreement in connection with the transaction
  - Useful for private equity buyers
  - Rollover shares can be excluded from the application of the best price rule

AREAS TO WATCH

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SEC Proposes Amendments to Financial Statement Disclosures

- On May 3, 2019, the U.S. Securities and Exchange Commission proposed extensive amendments to disclosure requirements for financial reporting for acquisitions and dispositions of businesses.
- The SEC intends for these changes to improve financial information about acquired and disposed businesses, facilitate more timely access to capital and reduce the complexity and cost to prepare disclosures.
- The SEC will accept comments on the proposed amendments for 60 days after the proposal is published in the Federal Register.

SEC Proposes Amendments to Financial Statement Disclosures

- The proposed amendments include:
  - updates to the investment test and the income test;
  - expansion of the use of pro forma financial information in measuring significance;
  - changes to required financial statements at various significance levels;
  - changes to the significance threshold and tests for a disposed business;
  - updates to financial statements required in carve-out transactions;
  - when financial statements not previously filed or those relating to an acquisition of major significance may be omitted;
  - changes to the treatment of individually insignificant acquisitions;
  - revisions to adjustments that may be made to pro forma financial information; and
  - codification of historical reporting practices for financial statements of oil and gas producers.

SEC Proposes Amendments to Financial Statement Disclosures

- Most notably, the proposed rules would require the financial statements of the acquired business above 50% significance to cover only the two most recent fiscal years rather than three.
- The SEC believes that two years of pre-acquisition financial statements would be sufficient to allow investors to understand the possible effects of the acquired business on the registrant.
- Older financial statements, such as the third year of Rule 3-05 financial statements, are less likely to be indicative of the current financial condition and results of operations of the acquired business.

Evolution of #MeToo in M&A

- In addition to incurring reputational harm when allegations of unlawful misconduct or discrimination become public (through a lawsuit or otherwise), an employer also faces potentially significant legal exposure when such claims are raised.
- Companies also face indirect civil liability for sexual harassment, sex-based discrimination or sexual misconduct.
- In light of these risks, investors and strategic purchasers in all sectors should give appropriate weight to #MeToo issues throughout the deal process:
  - Targeted diligence review
  - Stronger contractual protections
  - Broader background checks
  - Tailored management arrangements
  - Post-closing protections
- Sellers can conduct pre-diligence before negotiations begin to take mitigating steps and to best position sellers to respond to buyers' questions

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