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No Magic Words, but It Matters Who is Saying Them—the Delaware Chancery Court Analyzes Anti-Reliance Clauses in Acquisition Agreements

by Kenneth A. Gerasimovich and Jennifer Brady

In the last few months, the Delaware Court of Chancery has issued two opinions addressing fraud claims in connection with private M&A transactions based upon representations and statements made by sellers outside the four corners of the acquisition agreement, with quite different results for the allegedly defrauded buyers.

In *Prairie Capital III, L.P. v. Double E Holding Corp.*[1] (*Prairie Capital*), decided in November 2015, the Court granted a motion to dismiss fraud claims brought by the buyer in the purchase of a private business to the extent that the claims were grounded on false representations made outside of the purchase agreement. The Court found that the extra-contractual fraud claims were barred by an "exclusive representation clause" in which the buyer affirmatively acknowledged that it relied only on the representations and warranties in the purchase agreement.

In the second case, *FdG Logistics LLC v. A&R Logistics Holdings, Inc.*[2] (*FdG Logistics*), decided a few months later, the Court allowed fraud claims based on statements and omissions in a confidential information memorandum, a management presentation, and other due diligence materials, despite the fact that the merger agreement governing the transaction contained a clear disclaimer from the sellers stating that the sellers were not making any

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representation or warranty outside of the merger agreement. In the court's view a disclaimer from the sellers was not sufficient. The buyer, as the aggrieved party, must acknowledge its non-reliance on information provided outside the scope of the agreement to preclude fraud claims for extra-contractual statements.

Prairie Capital III, L.P. v. Double E Holding Corp.
Prairie involved the sale of Double E Parent LLC (Double E) to Double E Holding Corp. (the Double E Buyer), an acquisition vehicle owned by a private equity firm, Incline Equity Partners, III L.P. (the Incline Fund). The principal sellers were two private equity funds that owned a controlling interest in Double E (the Double E Sellers), which were sponsored by Prairie Capital Partners (Prairie Capital). The sale was made pursuant to a stock purchase agreement, which was signed April 4, 2012 (the Stock Purchase Agreement), and the transaction was completed the same day. One of Prairie Capital's affiliated funds served as the representative of the Double E Sellers under the Stock Purchase Agreement (the Seller's Representative). The parties agreed that a portion of the purchase price would be held in escrow until June 30, 2013, to cover potential indemnity claims brought by the Double E Buyer.

Two days before the escrowed funds were scheduled to be released; the Double E Buyer submitted an indemnification claim notice asserting, among other claims, that Double E and its management had engaged in fraud with respect to financial statements that the Double E Buyer had relied on in its decision to pursue the transaction.

In September 2014, the Sellers' Representative sued the Double E Buyer to compel the release of the escrowed funds. The Double E Buyer and the Incline Fund asserted counterclaims against Prairie Capital and two former officers of Double E for fraud, aiding and abetting fraud, and conspiracy to commit fraud, as well as contractual claims for indemnification under the Stock Purchase Agreement.

The counterclaims brought by the Double E Buyer and the Incline Fund alleged that the fraudulent actions began in the summer of 2011 at the time Double E was first being marketed for sale, when Double E's management, under pressure to support a growth story being pitched to potential buyers, began to falsify Double E's financial statements.

In its analysis of the counterclaims brought by the Double E Buyer and the Incline Fund, the Court noted that to plead fraud, a plaintiff must identify a false representation. The counterclaims relied on four allegedly false representations made in the Stock Purchase Agreement, as well as on purportedly false representations made in writing and orally during the sale process and due diligence that did not appear in the Stock Purchase Agreement.

The Court found that the Stock Purchase Agreement foreclosed fraud claims based on misrepresentations made outside of the agreement. The Stock Purchase Agreement contained the following "Exclusive Representations Clause":

"The Buyer acknowledges that it has conducted to its satisfaction an independent investigation of the financial condition, operations, assets, liabilities and properties of the Double E Companies. In making its determination to proceed with the Transaction, the Buyer has relied on (a) the results of its own independent investigation and (b) the representations and warranties of the Double E Parties expressly

and specifically set forth in this Agreement, including the Schedules. SUCH REPRESENTATIONS AND WARRANTIES BY THE DOUBLE E PARTIES CONSTITUTE THE SOLE AND EXCLUSIVE REPRESENTATIONS AND WARRANTIES OF THE DOUBLE E PARTIES TO THE BUYER IN CONNECTION WITH THE TRANSACTION, AND THE BUYER UNDERSTANDS, ACKNOWLEDGES, AND AGREES THAT ALL OTHER REPRESENTATIONS AND WARRANTIES OF ANY KIND OR NATURE EXPRESS OR IMPLIED (INCLUDING, BUT NOT LIMITED TO, ANY RELATING TO THE FUTURE OR HISTORICAL FINANCIAL CONDITION, RESULTS OF OPERATIONS, ASSETS OR LIABILITIES OR PROSPECTS OF DOUBLE E AND THE SUBSIDIARIES) ARE SPECIFICALLY DISCLAIMED BY THE DOUBLE E PARTIES."[3]

The Stock Purchase Agreement also included a standard integration clause stating that the agreement set forth the entire understanding of the parties with respect to the transaction and that it superseded all prior discussions of the parties.

The Incline Fund argued that the Stock Purchase Agreement should not foreclose its extra-contractual fraud claims, because it failed to specifically state that the Double E Buyer did not rely on representations other than those made in the Stock Purchase Agreement. The Incline Fund looked to Delaware case law requiring that anti-reliance representations must be explicit and clear.

The Court, however, noted that "Delaware law does not require magic words."[4] Rather than stating that the Double E Buyer did not rely on representations *outside* of the agreement, the Stock Purchase Agreement stated that the Double E Buyer *only relied* on the representations and warranties *in* the Stock Purchase Agreement. The Court stated: "If a party represents that it only relied on particular information, then that statement establishes the universe of information on which that party relied. . . . In this case, the Exclusive Representations Clause and the Integration Clause combine to mean that the [Double E] Buyer did not rely on other information. They add up to a clear anti-reliance clause."[5]

The court dismissed the fraud counterclaims to the extent based on extra-contractual representations, but it found that the counterclaims adequately plead that three of the representations in the Stock Purchase Agreement were false when made.

FdG Logistics LLC v. A&R Logistics Holdings, Inc.

This case arose out of the acquisition of a trucking company, A&R Logistics Holdings, Inc. (A&R) in 2012. A&R was acquired by Mason Wells, a private equity fund, through a merger transaction in which a subsidiary of Mason Wells was merged into A&R, with A&R as the surviving entity. (A&R as the surviving entity is referred to in the opinion as the Buyer). Prior to the merger, FdG Associates LP, a New York private equity firm, (FdG) owned 62.15 percent of A&R's outstanding shares. (FdG and its affiliates and A&R's other shareholders prior to the merger are referred to in the opinion as Securityholders).

In 2012, A&R's board began an auction process to sell the company and engaged an investment company and a financial advisor to assist with the sale. A lengthy confidential information memorandum describing A&R's business was prepared, which touted A&R's market leadership and the quality of its fleet of trucks. During the sale process, the Buyer's representatives met with A&R's management and received a power point presentation, which also emphasized the quality of A&R's trucks and equipment. In addition, prior to the merger, the Buyer's team had access to an online data room with due diligence information about A&R. Once the Buyer's representatives and A&R signed a letter of intent, the parties

began preparing definitive documents for the transaction. The acquisition was completed pursuant to a merger agreement (the Merger Agreement) on Dec. 18, 2012.

Within six months after the merger closed, the Buyer began asserting indemnification claims against the Securityholders. The Securityholders' representative brought an action in the Delaware Chancery Court to recover a pre-closing tax refund. The Buyer asserted counterclaims alleging that A&R had engaged in illegal and improper activities that were concealed from the Buyer during the due diligence process, such as falsifying driver records, breaching environmental laws, improperly recording expenses, fraudulently charging customers for services that were not performed and hiring aliens who were not authorized to work in the U.S. The Buyer's fraud claims were based, in part, on documents provided to the Buyer during the due diligence process, including the confidential information memorandum and the management power point presentation.

The Securityholders argued that the Buyer could not establish as a matter of law that it justifiably relied on any representations in any pre-merger materials because the Merger Agreement contained an anti-reliance clause. In the article of the Merger Agreement with A&R's representations and warranties, the agreement contained the following statement from A&R:

"EXCEPT AS EXPRESSLY SET FORTH IN THIS ARTICLE 5, THE COMPANY MAKES NO REPRESENTATION OR WARRANTY, EXPRESS OR IMPLIED, AT LAW OR IN EQUITY AND ANY SUCH OTHER REPRESENTATIONS OR WARRANTIES ARE HEREBY EXPRESSLY DISCLAIMED INCLUDING ANY IMPLIED REPRESENTATION OR WARRANTY AS TO CONDITION, MERCHANTABILITY, SUITABILITY OR FITNESS FOR A PARTICULAR PURPOSE. NOTWITHSTANDING ANYTHING TO THE CONTRARY, (A) THE COMPANY SHALL NOT BE DEEMED TO MAKE TO BUYER ANY REPRESENTATION OR WARRANTY OTHER THAN AS EXPRESSLY MADE BY THE COMPANY IN THIS AGREEMENT AND (B) THE COMPANY MAKES NO REPRESENTATION OR WARRANTY TO BUYER WITH RESPECT TO (I) ANY PROJECTIONS, ESTIMATES OR BUDGETS HERETOFORE DELIVERED TO OR MADE AVAILABLE TO BUYER OR ITS COUNSEL, ACCOUNTANTS OR ADVISORS OF FUTURE REVENUES, EXPENSES OR EXPENDITURES OR FUTURE FINANCIAL RESULTS OF OPERATIONS OF THE COMPANY UNLESS ALSO EXPRESSLY INCLUDED IN THE REPRESENTATIONS AND WARRANTIES CONTAINED IN THIS ARTICLE 5, OR (II) EXCEPT AS EXPRESSLY COVERED BY A REPRESENTATION AND WARRANTY CONTAINED IN THIS ARTICLE 5, ANY OTHER INFORMATION OR DOCUMENTS (FINANCIAL OR OTHERWISE) MADE AVAILABLE TO BUYER OR ITS COUNSEL, ACCOUNTANTS OR ADVISORS WITH RESPECT TO THE COMPANY."[6]

The Merger Agreement also included a standard integration clause that provided that the Merger Agreement contained the entire agreement of the parties and superseded any prior understandings, agreements, or representations of the parties.

The Court noted that Delaware law enforces anti-reliance clauses and discussed the seminal case on the matter, *Abry Partners V, L.P. v. F & W Acquisition LLC*[7], in which then Vice Chancellor Strine "carefully considered the need to strike an appropriate balance between holding sophisticated parties to the terms of their contracts and simultaneously protecting against the abuses of fraud."[8] The Court then reviewed recent case law in the area, including the *Prairie* decision, focusing on one key difference between the anti-reliance clause in *Prairie* and the clause in the A&R Merger Agreement. In *Prairie*, the allegedly defrauded party had specifically represented that it was relying only on the representations in the

agreement. In *FdG Logistics,* on the other hand, the Securityholders, the parties who were accused of the fraudulent actions, had disclaimed any representations made outside of the Merger Agreement, but the Buyer had not specifically stated that it was relying only on representations made in the Merger Agreement, or disclaimed reliance on representations made outside the Merger Agreement. The Court acknowledged that this subtle difference "between a disclaimer from the point of view of a party accused of fraud and from the point of view of a counterparty who believes it has been defrauded may seem inconsequential, like two sides of the same coin. The difference is critical, however, because of the strong public policy against fraud."[9] Asserting that an affirmative disclaimer from the point of view of the Buyer was the missing piece in this case, the Court denied the Securityholders' motion to dismiss the Buyer's fraud claims.[10]

Anti-Reliance Clauses You Can Rely On

It is not surprising that sellers want to limit their exposure for information provided to potential buyers during the sale process. Sellers and their advisors seek to put their best foot forward in presentations to potential buyers and may be prone to puffery and exaggeration at times. Senior managers, seeking to please their future bosses, may be motivated to stretch the truth regarding their performance. In the interest of disclosure and sometimes just the sheer rush and exhaustion of closing a deal, documents are dumped into online data rooms, occasionally without careful checking of the content. Without an anti-reliance clause, a misstatement in a management presentation or in sales figures buried in a sub-folder of the data room could come back to haunt sellers who had no intention of committing fraud. On the other hand, as a practical matter, buyers often rely on these materials for their decision making far more than the disclosure schedules attached to the acquisition agreement, which are often delegated to a junior legal associate, with the buyer's team giving them a once over just before closing. One way to address this is to specifically identify key information on which the buyer is relying and attach this to the acquisition agreement. This is usually the case with financial statements, but other materials, such as interim sales figures, environmental assessments or management reports, can also be specifically referenced in the representations or attached to the agreement if they contain information that is key to the Buyer's purchase decision. Once the relevant information is specifically identified, sellers should include an *express anti-reliance clause* in the sale agreement. As noted in *Prairie,* this clause does not need to contain any magic words, but it should be express and specific and, critically, it should come from the buyer. As the Court noted in *Abry Partners*, the subtle difference between disclaimer clauses can make all the difference in a fraud action.

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[1] *Prairie Capital III, L.P. v. Double E Holding Corp.,* Del. Ch., C.A. No. 1012, Laster, V.C. (Nov. 24, 2015).
[2] *FdG Logistics LLC v. A&R Logistics Holdings, Inc.*, Del. Ch., C.A. No. 9706, Bouchard, V.C. (Feb. 23, 2016).

[3] *Prairie*, C.A. No. 10127 at 15.
[4] *Id.* at 17.
[5] *Id.*
[6] *FdG Logistics*, C.A. No. 9706 at 24.
[7] *Abry Partners V, L.P. v. F & W Acquisition LLC,* 891 A.2d 1032 (Del. Ch. 2006).
[8] *FdG Logistics,* C.A. No. 9706 at 25
[9] *Id.*
[10] *Id.* at 30.

Omnicare Applied to Audit Reports by the Second Circuit

By Karl G. Dial

On Friday, May 20, 2016, the Second Circuit issued the first opinion by a Circuit Court applying the Supreme Court's *Omnicare* decision to audit reports under Section 11 of the Securities Act of 1933. The Second Circuit's Summary Order, issued in *In re Puda Coal Securities, Inc. Litigation*, Case No. 15-2100, slip op. at 5–6 (2d Cir. May 20, 2016) (*Puda Coal*), held that audit reports are statements of opinion and subject to the *Omnicare* standard for Section 11 claims.

In *Omnicare, Inc., v. Laborers Dist. Council Constr. Ind. Pension Fund*, 135 S. Ct. 1318 (2015) (*Omnicare*), the United States Supreme Court held that statements of opinion are only actionable under Section 11 of the Securities Act if: (1) the defendant did not honestly hold the opinion issued, or (2) material facts are omitted about the basis of the opinion making the opinion statement at issue "misleading to a reasonable person reading the statement fairly and in context." *Id.* at 1332. To read about the *Omnicare* decision in more detail, please see our previous *GT Newsletter*.

Historically, investors have asserted claims under Section 11 against accountants (as well as engineers, appraisers or other professionals) who "certified" any portion of a registration statement (such as the financial statements). 15 U.S.C. § 77k(a)(4). Before Friday, investors argued that *Omnicare* did not apply to auditors' reports under Section 11 because the reports contained "certifications" of the financial statements of the issuer. *See, e.g., Miller v. Global Geophysical Svcs., Inc.*, No. 14-cv-0708, ECF. No. 100–1 (S.D. Tex. 2015).

An auditors' report, however, does not contain the word "certify" or "certification." Instead, the auditors' standard unqualified report states that (i) the audit has been conducted in accordance with certain auditing standards, and (ii) in the auditor's "opinion," the financial statements taken as a whole are "present[ed] fairly." The auditing standards allow for a significant amount of subjective judgment to be exercised by the auditor in performing the audit, in assessing the audit evidence, and in reaching the ultimate opinion on the fair presentation of the financial statements taken as a whole.

The Second Circuit's decision in *Puda Coal* now makes clear that investors cannot sue accountants under Section 11 for their audit "opinions" unless they have evidence that the auditors did not honestly hold the opinion or omitted material facts from the audit report causing the opinion to be misleading to a reasonable person.

Karl G. Dial is a board certified civil trial specialist and CPA with over 30 years' experience trying complex civil cases. He focuses his practice on commercial litigation including bet-the-company cases involving securities litigation, claims against directors and officers, professional malpractice, trade secrets, energy litigation, intellectual property litigation and class actions. Karl has extensive experience litigating throughout the United States and has tried more than 40 complex civil cases.

View from Amsterdam: The Dutch Defense/ Flexible Anti-Takeover Mechanisms in the Netherlands

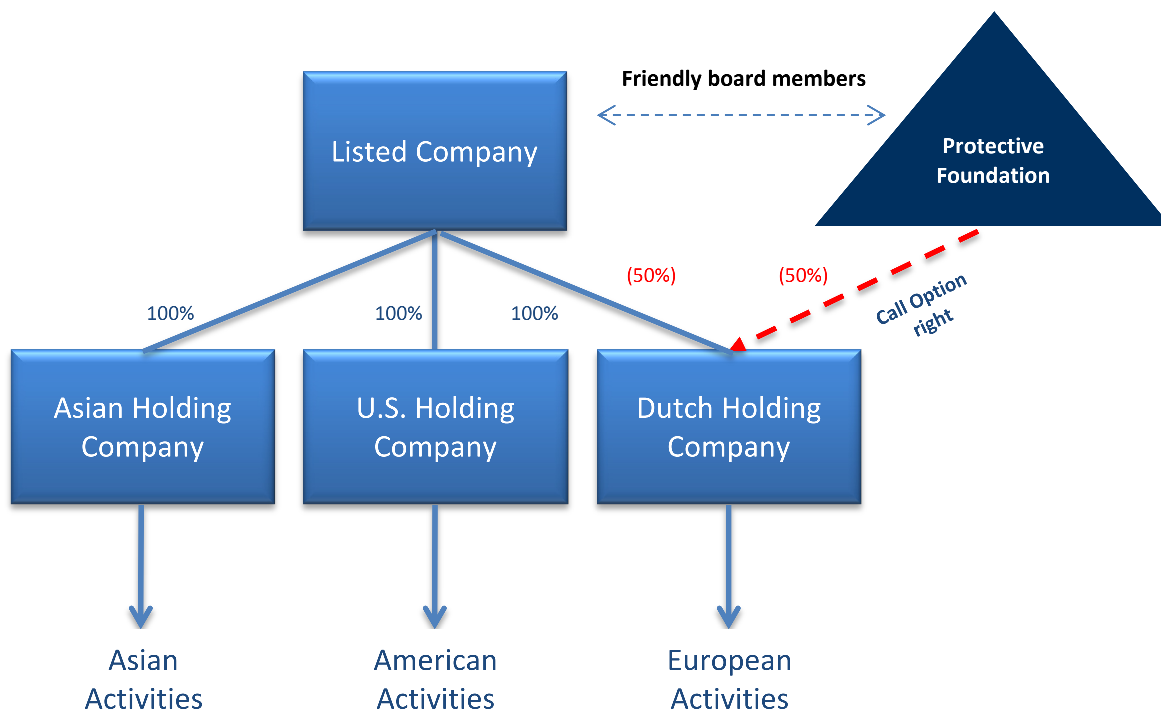
By Greenberg Traurig's Amsterdam Corporate Department

Anti-takeover mechanisms aim to prevent a publically listed company from being taken over by a hostile bidder or an activist shareholder. For many years, flexible anti-takeover mechanisms have been established under Dutch corporate law, the most common of which is based on the issuance of preference shares to a Protective Foundation (*stichting beschermingsprefs*) which has as sole purpose to safeguard the continuity, independence and identity of the publically listed company it seeks to protect.

The Issuance of Preference Shares to a Foundation

The most common Dutch defense mechanism against a hostile bidder or shareholder aiming to seize control over a publically listed company is structured around a call option right, which is granted by the listed company for the issuance of preference shares to a target-friendly Protective Foundation. The Protective Foundation can call for the issuance of shares at its discretion and at nominal value, which is substantially lower than the value for which the shares are traded at the stock exchange. The articles of association of the foundation typically stipulate that the purpose of the foundation is to protect the continuity of the listed company and to safeguard its interests. After exercising the call option, the equity interest of all other shareholders dilutes to such extent that the foundation holds up to 50 percent of the voting rights (a blocking stake) whereas the dilution of the economic position of the other shareholders is minimal. Due to its effectiveness and flexibility, this construction is very popular amongst Dutch public companies listed on the Dutch Stock Exchange. Currently, more than 40 percent of the Dutch companies listed on the Dutch Stock Exchange have this – or a comparable – anti-takeover mechanism in place.

The same defense mechanism may also be incorporated at sub holding levels in international group structures. Typically, a top holding company, located outside the Netherlands and listed on a foreign stock exchange, has a Dutch sub holding company (often for tax purposes) heading its European group. In such a structure, the call option for the issuance of preference shares is in the Dutch holding. This structure is very straight forward and can be set up in the course of few weeks where both the general meeting and management of Dutch sub holding are controlled by the ultimate parent. If there is a threat of a hostile takeover bid on the shares of the listed top holding company, the call option can be exercised, allowing the Protective Foundation to obtain a blocking stake in the European activities of the group. This results in the bidder's inability to exercise control over the European activities and provides leverage for the management board of the listed entity to enter into negotiations with the bidder on, for example, a higher bid price. The Protective Foundation typically has a board of directors that consists of the individuals friendly to the board of directors of the listed company. This can be demonstrated as follows:



Variations of this structure are, of course, conceivable.

Dutch case law has established that an anti-takeover mechanism is permissible if it is necessary to protect the continuity of the company and the interests of all stakeholders concerned. If the company is part of a group, the group interest will be taken into account. The test is whether or not the mechanism is 'adequate and proportionate' in light of the threat of a hostile takeover. The meaning and scope of this open norm has been established and clarified over the years in case law. In general, anti-takeover mechanisms may not exceed their purpose and should therefore not extend in scope and/or time beyond what is reasonably necessary in view of the threat and circumstances.

The following are proven examples of how Dutch anti-takeover mechanisms thwarted a hostile bidder:

(i) Public Bid on the Outstanding Shares of a Dutch Listed Telecom Provider Thwarted

A Dutch Listed Telecom Company (DLC) successfully used its anti-takeover defense mechanism to repel the unsolicited approach of a Large Foreign Telecom Corporation (LFC). The LFC acquired a 29.8 percent stake in the DLC through a partial offer of € 8 per share in 2012. This offer was not supported by the board of directors of the DLC because the board considered the offer too low and the motive of LFC was unclear. On Aug. 9, 2013, the LFC launched a full offer on all the shares of the DLC to reinforce its European presence. The Protective Foundation of the DLC exercised its call option and subsequently issued preference shares to the foundation. This course of affairs forced the LFC to enter into negotiations with the board of directors of the DLC. After failing to agree to the conditions of a potential acquisition, the Protective Foundation upheld its defense and the LFC withdrew its offer on Oct. 16, 2013,

and has since reduced its stake in the DLC. Subsequently, when the threat of a hostile takeover ceased to exist, the Protective Foundation requested that the DLC cancel the issued preference shares and thereby reverse the defense mechanism to allow it to be used again in the future.

(ii) $40 Billion Hostile Takeover Bid Thwarted

On Feb. 27, 2015, a U.S. based pharmaceutical company converted into a Dutch public limited liability company (*naamloze vennootschap*) in order to successfully thwart a hostile $40 billion takeover bid by a multinational pharmaceutical corporation. After conversion, a Protective Foundation was created on April 3, 2015, which was granted a call option for preference shares. When it was rumored that the multinational corporation planned to make a $40 billion hostile bid during the summer of 2015, the Protective Foundation exercised its call option and gained a 50 percent interest in the U.S. based company. Four days after the Protective Foundation exercised its call option, the multinational corporation withdrew its offer and dropped its pursuit of the U.S. based pharmaceutical company.

Conclusion

Dutch corporate case law provides anti-takeover defense mechanisms which are not only highly effective, but flexible as well. These defense mechanisms put a board of directors in a position to resist hostile bidders and activist shareholders, and can also position them to be able to negotiate a higher offer price or specific demands.

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View from Israel: A Guide to Understanding Anti-Assignment Clauses

By Aaron R. Katz

Introduction

With the increasing trend of globalization in the business world, Israeli companies and investors are commonly entering into agreements with U.S.-based entities. One of the most frequently found clauses in U.S. commercial agreements is an anti-assignment provision that prevents either or both of the parties from assigning the agreement to a third party prior to receiving the consent of the non-assigning party. Many transactions will also require the due diligence review of a large number of U.S. commercial agreements that the target has entered into. The following post will provide an overview and general guidance on the proper analysis of anti-assignment clauses.

Silent Provision and Change of Control Provision

In the event that an agreement does not contain an anti-assignment provision, a contract is generally assignable without the consent of the non-assigning party. See *Peterson v. District of Columbia Lottery and Charitable Games Control Board*, 673 A.2d 664 (D.C. 1996) ("The right to assign is presumed, based upon principles of unhampered transferability of property rights and of business convenience.") Exceptions include where the assignment affects the duties of the other party to the contract, where the contract is considered to be a personal contract and when the assignment violates public policy (i.e. tort liability).

On the other hand, many contracts contain provisions that not only prevent the assignment of the contract, but also state that a change of control of the target is deemed an assignment or the contract contains a separate clause requiring consent in the event of a change of control. This type of provision will often be triggered in transactions in which a buyer is acquiring the target company. A careful review of change of control clauses is thus especially imperative and often very fact specific to the deal at hand.

Deal Structures

One of the commonly used anti-assignment provisions reads as follows: "No party may assign any of its rights under this Agreement, by operation of law or otherwise, to a third party without the prior written consent of the non-assigning party." In the situation where the target has entered into agreements that contain this clause, whether or not an assignment is considered to have taken place in the event of the acquisition of the target will largely depend on the specific deal structure of the transaction.

The commonly used deal structures are an asset acquisition, a stock acquisition and a merger.

- **Asset Acquisition:** In an asset acquisition the buyer only acquires those assets and liabilities of a target that are specifically listed in the Asset Purchase Agreement. Any agreement that has an anti-assignment clause will be triggered in the event of an asset acquisition. Indeed, one of the disadvantages of structuring a corporate acquisition as an asset acquisition is that contracts that will be transferred must be assigned.

- **Stock Acquisition:** In a stock acquisition, a buyer acquires a target's stock directly from the selling shareholders. After the closing of the Stock Purchase Agreement, the target will continue as it existed prior to the acquisition with respect to its ownership of asset and liabilities. Thus, in essence, the anti-assignment clause was never triggered in the first place. See *Baxter Pharm. v. ESI Lederle*, 1999 WL 160148 (Del. Ch. 1999).

- **Mergers:** Mergers differ from both asset acquisitions and stock acquisitions in that a merger is considered a creature of law, and the specific type of merger that is used will have a direct impact on whether the anti-assignment clause is triggered.

  1. A direct merger occurs when the target merges with and into the buyer, and the buyer continues as the surviving entity. In a similar fashion to an asset acquisition, this type of merger will trigger the anti-assignment clause.

  2. A forward triangular merger occurs when the target merges with and into the buyer's merger subsidiary, with the merger subsidiary surviving the merger. This type of merger will trigger the anti-assignment clause. See *Tenneco Automotive Inc. v. El Paso Corporation*, 2002 WL 45930 (Del. Ch. 2002) and *Star Cellular Telephone Company, Inc. v. Baton Rouge CGSA, Inc.*, 19 Del. J. Corp. L. 875 (Del. Ch. 1993).

  3. A reverse triangular merger occurs when the buyer's subsidiary merges with and into the target, with the target surviving as a wholly owned subsidiary of the buyer. In effect, the target continues to exist after the closing. The Delaware Chancery Court in *Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH*, 2013 WL 655021 (Del. Ch. Feb. 22, 2013) held that the acquisition of a target in a reverse triangular merger did not violate an existing agreement of the target that prohibited assignments by operation of law. The court noted that generally, mergers do not result in an assignment by operation of law of assets that began as property of the surviving entity and continued to be such after the merger. Thus there is a significant difference between a reverse triangular merger and both a direct merger and forward triangular merger, as in those cases the target was not the surviving company of the merger. Note, however, that the matter is not uniformly resolved. In *SQL Solutions, Inc. v. Oracle Corp.* (N.D. Cal. 1991), a United States District Court in the Northern District of California applied California law and federal IP principles to hold that a reverse triangular merger constitutes an assignment by operation of law.

Additional Considerations

Damages and Termination: Some courts have held that a contractual provision prohibiting assignment operates only to limit the parties' right to assign the contract (for which the remedy would be damages for breach of a covenant not to assign) but the provision does not limit the power to actually assign the contract (which would invalidate the assignment), unless the contract explicitly states that a non-conforming assignment shall be "void" or "invalid." See, e.g., *Bel-Ray Co v. Chemrite (Pty.) Ltd.*, 181 F. 3d 435 (3d Cir. 1999). It is also imperative to review the termination section of an agreement, as certain agreements contain a provision by which the non-assigning party has the right to terminate the agreement in the event of an assignment.

Conclusion

As described above, any review of U.S. commercial agreements is highly dependent on the structure of the deal and at times, the specific jurisdiction governing the agreement. With offices across the United States, and specifically in Delaware, New York, and California, all states with highly sophisticated and oft-invoked commercial laws, Greenberg Traurig is uniquely situated in a position to offer high value legal services to Israeli clients.

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View from Italy: New Incentive Rules for the Unfreezing of Bad Loans of the Italian Bank

By Luigi Santa Maria, Alessio Gerhart Ruvolo, Dante Campiverdi, and Andrea Zorzi

1. Introduction

After a lot of buzz, the highly anticipated "Banks Decree" ("**Decree**") setting forth urgent measures on the reform of cooperative banks, the guarantee for the securitization of non-performing loans ("**NPLs**") and the tax regime for crisis procedures and collective savings management was passed at a cabinet meeting on Feb. 10, 2016. It was published in the Official Journal of the Italian Republic on Feb. 15, under no. 18/2016, thereby officially taking effect, though the Parliament will have the last word on the Decree.[1]

The Decree was approved on the same day on which the European Commission ("**Commission**"), the body responsible for regulating State aid in the European Union, formally gave its green light to the state guarantee scheme chosen by the Italian authorities.[2] Indeed, following months of negotiations, the Commission found the Italian plans aimed at facilitating the transfer of NPLs off the balance sheets of Italian banks to be free of any State aid, provided that the State is remunerated in line with market conditions.

The Decree is part of a broader framework of legislation focused on restructuring and strengthening the Italian banking system by making it more shock-resistant, with the goal of ultimately getting credit institutions in condition to adequately fund the real economy, while complying with increasingly demanding capital requirements.[3]

Consistent with such purposes, the Decree (i) sets up a state guarantee scheme to ease the offloading/securitization of non-performing loans that impact the stability of Italian domestic banks, (ii) provides new regulation encouraging the aggregation of cooperative credit banks in order to reduce the structural weakness of the current system, and (iii) sets forth new favorable provisions on the tax regime for crisis procedures and collective savings management.

The focus of this first outline of the Decree is on the measures relating to NPLs only.[4]

2. The securitization of non-performing loans

2.1 The Italian scenario

Since the onset of the global financial crisis, in Italy the aggregate amount of NPLs as a percentage of total loans has increased from just above 5 percent in 2007 to 18.5 percent in January 2015. This rapid rise reflects, in part, the protracted recession, which has negatively impacted the creditworthiness of borrowers, particularly small and medium-sized enterprises. At the same time, the inefficient and lengthy judicial process, combined with limited incentives to write off loans, has held back the pace of NPLs resolution.[5]

Therefore, the scheme, drawn up following months of negotiations with the European Union, is designed to ease the offloading by Italy's credit institutions of at least a part of their over 200 billion Euros of bad loans into asset-backed securities (ABS) that will be offered for sale in order to clean up their balance sheets.

2.2 The new measures adopted

> *Scope of application*

The preeminent innovation brought about by the Decree is the adoption of a new State-backed guarantee (the "**Guarantee**") for securitized NPLs issued within securitization transactions pursuant to Article 1 of Law no. 130 of April 30, 1999 ("**Securitization Law**").

The scheme is designed to facilitate the assignment by domestic credit institutions of NPLs to special purpose vehicles ("**SPVs**"), by making the notes incorporating the securitized bad loans more appealing through a public guarantee granted by the State. Unless otherwise specified, references to Article(s) below refer to Article(s) of the Decree.

> *Special features of the NPLs securitization(s)*

In the framework of the general rules laid down by the Securitization Law, the Decree sets forth the features that the securitization(s) of bad loans shall have in order to benefit from the scheme:

(i) the NPLs shall be assigned to the SPV for an amount not exceeding their balance sheet net value (which is the gross net value of any adjustment/write-off – "*valore al netto delle rettifiche*");

(ii) at least two classes of notes shall be issued based on their degree of subordination in absorbing the losses: the **senior notes**, which is the only class of notes that can be backed by the state guarantee, and the junior notes;

(iii) the **junior notes**, as the most subordinated class of notes, shall not entitle the holder to receive the repayment of the principal as well as the payment of accrued interest or other remuneration until the full repayment of the principal of the senior notes;

(iv) one or more tranches of notes may be issued in addition to the senior and junior classes (s.c. **mezzanine notes**) entitling the holder to receive the interest payment following payment of the interest due on the senior notes and prior to the repayment of the principal amount of the senior tranche (*Article 4*).

Senior and mezzanine notes shall have the following features: a) floating rate(s) remuneration; b) prepayment of the principal amount before maturity contingent on the cash flows generated by the recoveries and collections on the portfolio of transferred loans, net of all relevant recovery and collection costs; and c) interest paid at the end of each interest period on a quarterly, semi-annually or yearly basis depending upon the residual nominal value of the note at the beginning of each interest period.

The remuneration of mezzanine notes may be deferred, linking it to the occurrence of specified events, or can be made conditional upon the achievement of performance targets in the recovery/collection of the transferred loans (*Article 6*).

Junior and mezzanine notes may not be subscribed by the State and other public entities.

Finally, hedging agreements may be executed to reduce the risk of discrepancies between the interest rates applied, respectively, on assets and on liabilities. The use of liquidity credit facilities is also contemplated to cover possible shortfalls of the collections/recoveries in respect to the

interest payment amounts due at each payment date, so as to assure a financial flexibility consistent with the merit of credit of the senior notes (*Article 4*).

> *Investment grade and independent servicer*

In order for the Guarantee to be granted, the senior notes shall have previously obtained a rating equal to or higher than the investment grade from an ECB-approved independent rating agency (*Article 5*).

In order to avoid possible conflicts of interest, the servicer appointed to manage the NPLs shall be an entity other than the selling bank and shall not belong to the same banking group.

> *Order of priority of payments*

The proceeds generated by (a) the recoveries and the collections made on the portfolio of transferred loans, (b) the hedging agreements executed (if any) and (c) the use of liquidity credit facilities, net of the amounts due to the NPLs servicers as consideration for their activity, will be applied in making payments or provisions in the following order of priority, in each case, only to the extent that payments or provisions of a higher priority have been made in full:

(i) tax charges, if any;

(ii) amounts due to services providers,

(iii) amounts due as interest and commissions in connection with the credit facilities;

(iv) amounts due as consideration for the Guarantee backing the senior tranche;

(v) amounts due to the counterparties of the hedging agreements, where executed;

(vi) amounts due as interest on the senior notes;

(vii) amounts to be repaid to restore the availability of the credit line, where used;

(viii) amounts due as interest on the mezzanine notes, where issued;

(ix) repayment of the principal outstanding amount of the senior notes;

(x) repayment of the principal outstanding amount of the mezzanine notes;

(xi) payment of the amounts due as principal, interest (or other remuneration) on the junior notes (*Article 7*).

3. The Guarantee

> *Features*

The Guarantee is an unconditional, irrevocable and first demand guarantee.

It may only be granted to collateralize the senior tranche of the ABS issued and shall become effective solely in the event that more than 50 percent plus one of the “non-guaranteed and higher risk-bearing” junior notes have been successfully sold to private market participants (*Article 8*).

> *Timeline, validity and access to the Guarantee*

For a period of 18 months from the effective date of the Decree, the Ministry of Economy and Finance ("**MEF**") shall be entitled to grant the State's Guarantee; such period can be further extended by the MEF for 18 months or until Feb. 15, 2019.

Within three months following the approval of the scheme by the European Commission (i.e., Feb. 10, 2016), the MEF shall appoint an independent and qualified expert in charge of monitoring the compliance of the Guarantee to be granted with the provisions of the Decree and the EC decision approving the scheme (*Article 3*).

The Guarantee shall be issued on a case-by-case basis, by means of an ad hoc decree of the MEF, following the relevant application by the credit institution(s) concerned (*Article 10*).

> *Price*

The Guarantee shall be granted against a yearly consideration; namely, the fee for the Guarantee, to be determined at market conditions, shall be calculated based on three baskets of credit default swaps (CDS) prices of Italian-based companies with a rating matching those of the senior notes to be guaranteed.[6] Indeed, the fee shall reflect the level and duration of the risks taken by the State by granting the Guarantee itself and will constantly increase over time in line with the duration of the State's exposure.

The fact that the proposed Guarantee will be granted by the State acting as a "private investor," based upon a market benchmark, was decisive in leading the Commission to consider the newly established scheme to be free of any State aid and give its green light to the new legislation.[7]

The relevant ratings and calculation formulae are set forth in Article 9 and in Annex 2 to the Decree.

> *Enforcement and financial sources*

The Guarantee holder may enforce the Guarantee within nine months following the expiration of the senior notes in case of non-payment, in whole or in part, of the sums due as principal or interest. The enforcement procedure is as follows: in case of non-payment lasting for more than 60 days from the expiration of the due date, the senior note holders concerned, through the note holders' representative, shall send a request to the SPV for the payment of the unpaid amounts; after 30 days and no later than six months from the date of receipt of the request by the SPV, absent payment, the senior note holders, through the note holders' representative, are entitled to ask for the enforcement of the Guarantee. Within 30 days of receipt of the request for the enforcement of the Guarantee, the MEF will pay to the senior note holders the unpaid amounts, with no additional interest or costs (*Article 11*).

An ad hoc fund with a financial endowment of Euro 100 million for 2016 has been established by the MEF for the payments related to the possible enforcement of the Guarantee, as well as any additional costs connected thereto. The fund shall be further financed by the proceeds of the annual fees paid as consideration for the Guarantee (*Article 12*).

> *Favorable tax regime for crisis procedures*

As a part of the wider purpose underlying the Decree to facilitate the banks in enforcing their collateral (with the indirect effect of improving the transferability of bad loans and the "marketability" of the relating ABS), the Decree also contains favorable tax provisions applicable in case of crisis/insolvency procedures. In particular, the registration, mortgage and land taxes payable in connection with the

transfer of ownership of property due to foreclosures in the context of crisis/insolvency proceedings has been reduced to a fixed rate of Euro 200 (*Article 16*).[8] This should encourage potential buyers to purchase foreclosed assets, thereby facilitating the lenders/assignees of loans to recover their credit.

4. Concluding remarks

The outline above provides a summary of the main measures adopted by the Italian Government pursuant to the Decree that are particularly significant for banks and financial institutions.

These measures are subject to possible changes by the Italian Parliament.[9] Certain aspects of the measures require clarification and improvement. However, the Decree is a good starting point in the pursuit of the governmental objectives of attracting a wider range of investors and boosting bank liquidity, thereby having an impact not only on the banking sector, but also on access to credit, which, of course, is one of the main engines that makes an economy run.

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[1] A law decree ("*Decreto Legge*") - a temporary legislative enactment having the force of ordinary law adopted by the Government in "extraordinary cases of necessity and urgency" pursuant to Article 77 of the Italian Constitution - loses its effects retroactively, starting from its enactment, if it is not confirmed by the Parliament within 60 days of its publication.

[2] See European Commission Press Release, "*State aid: Commission approves impaired asset management measures for banks in Hungary and Italy*", IP/16/279, Feb. 10, 2016.

[3] Such framework includes (i) law no. 33 of March 24, 2015, reforming credit societies (banche popolari); (ii) Legislative Decree no. 180 of Nov. 16, 2015, implementing in Italy the Directive 2014/59/EU establishing frameworks for the recovery and the resolution of credit institutions and investment firms ("**BRRD**"); (iii) Law Decree 181 of Nov. 16, 2015 amending Legislative Decree n. 385 of Sept. 1, 1993 ("**Banking Law**") and Legislative Decree no. 58 of Feb. 24, 1998 ("**Securities Law**") and (iv) Law Decree 183 of Nov. 22, 2015 providing measures concerning the resolution of four Italian regional banks (Banca delle Marche S.p.A., Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara S.p.A., Cassa di Risparmio di Ferrara S.p.A.).

[4] Contrary to what was originally anticipated by the Government, the Decree does not include the long-promised compensation fund (along with its relevant accessibility criteria) that should have been designed to help small

investors in the four Banks rescued at the end of 2015 recover part of their losses.This measure should be contained in an ad hoc ministerial decree to be adopted later this month.

[5] See, Bank of Italy Financial Stability Report no. 1 of April, 2015, Table 3.1 and International Monetary Fund working paper no. 15/24, *The Strategy for Developing a Market for Nonperforming Loans in Italy*.

[6] According to Article 9, para. 2 of the Decree, if the senior notes obtain different ratings from different agencies, the lowest rating granted shall be the reference.

[7] On the contrary, should the State pay above market prices for the non-performing loans or accept lower guarantee fees than a private operator would, this would constitute "state aid" that, pursuant to EU State aid rules, can only be legitimately implemented if the benefiting bank is put under resolution.

[8] The Italian Government is also starting a wider reform of the regulation of company crisis and insolvency proceedings, aiming at accelerating the lengthy legal process of bankruptcy litigation in an effort to facilitate lenders and creditors recovering, in whole or in part, their outstanding loans as quickly as possible.

[9] As mentioned above, pursuant to Article 77 of the Italian Constitution, the Decree could be amended by the Parliament within 60 days from its publication and could lose its effects retroactively should it not be converted into law.

View from London: The PSC Register

By Omar Anwar and *Fiona Adams*

As of April 6, 2016, UK companies and limited liability partnerships (LLPs) are now required to hold and maintain a register of people with significant control (the PSC Register). The PSC Register is primarily aimed at identifying and listing individuals with significant control over a UK company (whether directly or indirectly) and whether those individuals are based in the UK or overseas.

The PSC Register was implemented under the Small Business, Enterprise and Employment Act 2015 (the Act) and applies to all LLPs and UK companies except: (i) UK listed companies (as they are already subject to the Financial Conduct Authority's Disclosure and Transparency Rules), and (ii) companies traded on an EEA regulated market or on specified markets in Switzerland, the USA, Japan, and Israel.

In order to be considered a person with significant control (PSC), an individual must meet one or more of the following five conditions (the Conditions):

1. The individual directly or indirectly holds more than 25 percent of the shares;
2. The individual directly or indirectly holds more than 25 percent of the voting rights;
3. The individual directly or indirectly holds the right to appoint or remove the majority of directors (defined as the directors holding the majority of the voting rights);
4. The individual otherwise has the right to exercise, or actually exercises, significant influence or control over the company (the Fourth Condition); or
5. The individual has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or firm, which itself satisfies one or more of the first four conditions.

Given that the aim of the Act is to increase transparency, the Fourth Condition serves as a "catch-all" Condition to ensure PSCs cannot avoid the requirements by structuring their interests so as to fall outside the scope of the first three Conditions. If a person does not meet one or more of the first three Conditions but has a right to exercise significant influence or control, or actually exercises significant influence or control over a company, then he or she will be a PSC in relation to that company. The Department for Business, Innovation and Skills has published statutory guidance on the meaning of "significant influence" and "control." Note: the Conditions mentioned above are slightly different for LLPs in order to reflect the way in which LLPs are structured.

A PSC is by definition an individual and not a legal entity (such as a company). Although a company cannot be a PSC, it will be entered on a PSC register if it is a "registrable relevant legal entity." A company will be deemed a "registrable relevant legal entity" if: (i) it meets one or more of the Conditions and is itself required to keep its own PSC Register; (ii) it is subject to Chapter 5 of the Disclosure and Transparency Rules; or (iii) it has voting shares admitted to trading on a regulated market in the EEA or on specified markets in Switzerland, the USA, Japan, and Israel. The net effect of these measures is that, in a corporate group structure, each UK subsidiary that is owned by a UK company will record its

immediate parent in its PSC Register, and any UK subsidiary that is not owned by a UK company will record any individuals with significant control in its PSC Register.

Under the Act, companies must take "reasonable steps" to determine whether they have a PSC. Similarly, a person who knows or ought to reasonably know that he or she is a PSC in relation to a company and is not entered as such in the company's PSC register, must inform the company of the person's status as a PSC in relation to that company. The details required to complete the PSC Register include the name, address, and country of residence, the date on which the individual became a PSC in relation to the company, and which of the Conditions the PSC satisfies. Information about a PSC must be complete and confirmed with the PSC before it is entered in the register. The PSC register makes it possible to identify not only if a company has PSCs, but also exactly who those PSCs are at any given time.

Since these measures are aimed at increasing transparency the register will be open to public inspection. Information from the register must be filed with Companies House by June 30, 2016. Overseas companies with UK subsidiaries need to be aware of the regime, as each of their UK subsidiaries will be required to keep a PSC Register.

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