


Andrew Bettwy *Glen Lim*

Special Considerations in Acquisition Financings and SunGard Conditionality

by Andrew Bettwy and Glen Lim, Proskauer Rose LLP

Limited Conditionality

Conditionality is of paramount concern to borrowers in the acquisition financing context. The borrower, who is also the buyer, enters into an acquisition agreement and agrees to pay the full purchase price to acquire the target company once certain conditions are met. The buyer often does not have, or is not willing to part with, enough capital to pay the purchase price on its own, and will be relying on the availability of financing to consummate the acquisition. In some acquisition agreements, the buyer will have a "financing out" which will excuse the buyer from performing its obligations under the acquisition agreement if adequate financing is unavailable. However, financing conditions in acquisition agreements largely fell out of favor in recent years as sellers increasingly refused to assume financing risk. As a result, buyers turned their attention to financing commitment conditionality with laserlike focus, and applied increasing pressure on their financing sources to limit the level of conditionality in their commitment papers.

SunGard Conditionality

The watershed moment came with the 2005 leveraged financing of SunGard Data Systems. The SunGard commitment papers curtailed conditionality in a way that limited the amount of "daylight" between the acquisition agreement conditions and the commitment letter conditions, thus minimizing the borrower's risk of being forced to close an acquisition without access to adequate sources of funds. Bolstered by the exuberant financial market conditions of 2005-2007, "SunGard conditionality" quickly became the norm in acquisition financing commitment papers. The precise terms have evolved over time and vary depending on the transaction, but SunGard conditionality remains standard fare in acquisition financings when the buyer does not have the benefit of a financing condition in the underlying acquisition agreement.

The main elements of SunGard-style limited conditionality are:

- The "Company MAC" tracks exactly the material adverse change definition in the acquisition agreement, including using the governing law of the acquisition agreement when interpreting whether a Company MAC has occurred. Accordingly, the Company MAC will only refer to the target and its subsidiaries, and will include any carve-outs to that definition negotiated by the seller in the acquisition agreement. The arranger may comment on the wording of this definition if it is too favorable to seller (for example, if there is a carve-out for adverse events regardless of whether such events materially and disproportionately affect the target as compared to other companies in the same industry).
- Documentary conditions are limited such that only certain key representations and warranties will apply as a condition to the initial funding of the loans on the closing date. This subset of representations varies, but typically includes (i) representations by the target company in the acquisition agreement that are material to the interests of the lenders and with respect to which the borrower has the right to terminate the acquisition agreement if such representations are untrue, and (ii) certain "specified representations" in the credit documentation, such as power and authority, due execution and delivery and enforceability of the credit documentation; no conflicts with

organizational documents or applicable laws; compliance with Federal Reserve margin rules, Investment Company Act, Patriot Act and other regulatory requirements; solvency; and the validity, perfection and priority of the security interests granted by the borrower and any guarantors in favor of the lenders. Other specified representations may be included such as status of the credit facilities as senior debt, accuracy of financial reports, or others that are specific to the financing and are not otherwise adequately covered by the material acquisition agreement representations. If the buyer is an operating company with real assets and liabilities, in some deals the buyer may be required to give the full array of representations and only the target has the benefit of the specified representations. However, the seller may balk at this as it forces the seller to effectively take the risk of buyer being able to make all of the credit agreement representations.

As a practice tip, one important nuance of SunGard conditionality negotiations is the effect of a breach of the credit agreement representations other than the specified representations (that is, the "non-specified representations"). Both borrowers and arrangers will agree that if SunGard conditionality applies, the breach of a non-specified representation in the credit agreement will not give the commitment parties the right to refuse to fund. However, some sponsors and borrowers argue further that a breach of a non-specified representation on the closing date should also not result in an event of default; in other words, it should be as if the non-specified representations were never made at all on the closing date. Arrangers may argue this goes further than necessary as the spirit of SunGard is to ensure certainty of funding, not to give the borrower a free pass on a breached closing date representation. This is also known as the "making vs. accuracy" debate: borrowers prefer that the non-specified reps at closing do not have to be "made," while arrangers prefer that they do not have to be "accurate" solely for purposes of funding the loans, but are still made for purposes of triggering an event of default. If both parties are intractable on the point, one way to resolve the issue is to give the borrower an agreed grace period or cleanup period following the closing during which the borrower can take necessary actions to resolve the issue that gave rise to the breach of the non-specified representation (assuming such resolution is possible).

- Assuming the loans are secured by collateral (which is usually the case with leveraged financings), the requirement to provide the lenders with a perfected lien on collateral at closing is generally limited to property of the type that can be perfected by filing a UCC-1 financing statement, by giving the agent possession (such as a stock certificate or intercompany note) or by the filing of security agreements with the U.S. Patent and Trademark Office and Copyright Office with respect to registered intellectual property. Other methods of perfection may be included in certain secured transactions where a specific type of collateral is critical to the lenders' security package and cannot be perfected by the foregoing methods.

Further Limited Conditionality
In addition to SunGard provisions, negotiated acquisition financing commitment papers will typically have fewer and more limited conditions to closing than those described in Negotiating Conditions Precedent – Material Adverse Change, Due Diligence and Other Conditions Precedent.

Below are conditions precedent provisions that the borrower may attempt to limit in acquisition financing commitment papers:

- Limited or no conditionality regarding new information.
- No Market MAC condition.
- No due diligence condition, unless and to the extent the borrower has a "diligence out" in the acquisition agreement.
- No clear market condition, although there is usually a clear market covenant.
- Limited conditionality regarding compliance with the commitment papers to certain specified items, such as the payment of fees and adherence to any "market flex" provisions in the fee letter, and cooperation with syndication.
- Limited or no financial performance conditions.
- Providing for the post-closing delivery of certain (or in extreme cases, all) credit documentation by the target and its subsidiaries. This is often resisted by arrangers when the initial borrower is a mere acquisition vehicle because

the commitment parties would be forced to fund the loans into an empty shell before obtaining a security interest in the assets of the target. In some cases this may be a necessity, such as when the seller only provides limited cooperation to the buyer in facilitating the financing, or where practical logistics may prevent the delivery of documentation contemporaneously with the closing.

The Verizon Case Prompts a Change in Delaware Law: A 2012 decision by a U.S. district court in Texas brought further focus to this point. In U.S. Bank Nat'l Ass'n v. Verizon Commc'ns Inc., 3:10-CV-1842-G (N.D. Tex. 2012), the court, applying Delaware law, followed the 1999 Delaware Chancery Court decision of AGR Halifax Fund, Inc. v. Fiscina, 743 A.2d 1188 (Del. Ch. 1999), holding that written board resolutions are invalid if signed by a new board in advance of its actual appointment, even if delivered after the appointment of the new board. Because of this ruling, in acquisition financings the approval of the financing by the new board members could not occur until the moment of the closing. This led to a more detailed examination of the timing of certain deliverables, such as board resolutions, which often resulted in a delay in the delivery of certain closing documentation until a short time (usually a very short time) post-closing. This delay imposed additional risks on financing sources, and required the development of new protocols for the delivery of documentation, including legal opinions, that were often cumbersome and unsatisfactory to multiple parties and their counsel. The Verizon decision, and the general reaction to it in the transactional community, prompted a change to Delaware law. Effective August 1, 2014, the Delaware General Corporation Law, the Delaware Limited Liability Company Act, and the Delaware Revised Uniform Limited Partnership Act were all revised to clarify that a person may execute a consent up to 60 days in advance of the effective date of the consent, even if the person is not a director at the time the consent is executed. See 8 Del. C. § 141; 8 Del. C. § 228. In any event, and even during the brief period while Verizon held sway, for all practical purposes arrangers and their counsel typically require that all essential documentation and deliverables be "on the closing table" and ready for delivery at or immediately following the funding of the loans.

Documentation Principles and the Clear Channel Case

To provide for greater certainty and efficiency in documenting the credit agreement, the borrower may also negotiate for "documentation principles," whereby the parties agree to pre-determined guidelines regarding the definitive credit documentation. The 2008 litigation of BT Triple Crown Merger Co., Inc. v. Citigroup Global Markets, Inc., 2008 N.Y. Misc. LEXIS 2682 (N.Y. Sup. Ct. May 7, 2008) (more commonly known as the Clear Channel case) is often cited as an example of the need for documentation principles in commitment papers. One of the primary issues in the Clear Channel litigation was that the lenders refused to close a committed financing ostensibly due to the inability of the parties to negotiate the terms of the definitive documentation. But the clear implication was that the commitment parties had no desire to fund a highly leveraged loan in the midst of a singularly horrible market for syndicated loans. After Clear Channel, borrowers paid increasing attention to documentation principles in an effort to avoid the same result. Post-2008 documentation principles are often detailed and may refer to a specific precedent or series of precedent transactions to use as a guide in negotiations. This is often the case when the borrower is owned by a financial sponsor with a stable of other leveraged portfolio companies and an associated wealth of recent loan agreement precedent.

As a practice tip, the parties and their counsel must carefully review any precedent documentation to determine any material exceptions or deal-specific changes from the precedent to be included in the term sheet, such as provisions that a particular arranger may require as an internal or regulatory matter, or changes in law or market practice since the time of the precedent transaction.

Timing Considerations

In connection with acquisition financing, it is common for consensual mergers and acquisitions to be conducted in two main stages: the signing of a definitive acquisition agreement, and the closing of the acquisition some time later when certain conditions precedent have been met, including, among other things, obtaining the necessary shareholder and third party consents and receiving all requisite governmental approvals. This delay between signing and closing of an acquisition makes the commitment letter a necessity in a leveraged acquisition, because both the buyer and the seller will rely on the availability of funds to pay the full purchase price on the closing date. Similarly, if the seller is soliciting bids from potential purchasers, the sources and certainty of financing will be taken into consideration in evaluating the strength of the bids. Accordingly, the commitment papers and the related acquisition agreement are negotiated on parallel tracks.

Due Diligence of the Target

While commitment papers and the acquisition agreement are being negotiated, the arranger and its counsel will conduct and finalize due diligence of the target company. The arranger and its counsel will also conduct due diligence of the buyer if the buyer is an operating company rather than a shell acquisition vehicle, with the goal of ultimately removing the diligence condition from the commitment letter prior to signing.

While the degree of diligence in financing transactions will vary, in many sponsor-led acquisitions arrangers will "piggy-back" off the sponsor's due diligence of the target. This involves sharing any reports prepared by the sponsor's advisors, including due diligence memoranda prepared by the sponsor's counsel and any third party tax, accounting and environmental analyses with the arranger. The arranger will usually be required to deliver a non-reliance letter to the sponsor's counsel before the diligence memos will be provided. If certain reports are unavailable, the diligence download may be conducted by phone or in meetings. In addition, the arranger and its advisors will be granted access to the target's data room, usually through an online portal, and will be given the opportunity to conduct their own business and legal due diligence for a limited time.

The Acquisition Agreement and Xerox Provisions

To further limit conditionality, sponsors will ask the arrangers to pre-approve the form of acquisition agreement and related disclosure schedules. Arranger's counsel will review the acquisition documents with a focus on provisions relating to the financing, such as timing of closing, the obligations of the target company to assist with the syndication, and the "Company MAC" definition (particularly if this definition is to be mirrored in the Company MAC condition in the commitment letter).

Xerox Provisions: In addition, arranger's counsel will negotiate for certain lender protective provisions in the acquisition agreement. These provisions were first publicly used in Xerox Corporation's 2009 merger with Affiliated Computer Services, Inc., and thereafter have been commonly known as the "Xerox provisions." The Xerox provisions were designed to ensure that the financing sources (that is, the arranger and the lenders and their affiliates) will not be the subject of litigation by the seller in the event the acquisition does not close due to the unavailability of the financing, and that any actions against the financing sources relating to the transaction (whether by seller, buyer, or others) will be brought in certain venues, typically the state and federal courts in New York County and the Southern District of New York. The Xerox provisions were a direct reaction by the lending community to tortious interference and similar claims that were brought by sellers in the wake of the 2008 financial market crisis after some arrangers refused to fund their commitments because the conditions to closing could not or would not be met (most notably in the litigation surrounding the failed merger of Hexion Specialty Chemicals, Inc. and Huntsman Corp.).

Once the commitment papers are finalized, they will be signed by the borrower, the arranger and the commitment parties at the same time the acquisition agreement is signed by the buyer and the seller. Alternatively, if the acquisition is being conducted pursuant to a competitive bid process involving multiple potential buyers, the commitment papers will be signed by the arranger and the commitment parties and delivered to the potential buyer to be submitted to the seller together with the buyer's markup of the acquisition agreement. If the fee letter is included in the bid package, it is almost always a redacted version with economic terms excluded, as arrangers consider fee information to be sensitive and confidential. In a bid situation, the commitment papers often will be delivered to the seller without being signed by the borrower/buyer; the purpose is to show the seller that the buyer has committed financing and this can be accomplished without the buyer's signature, at least until the buyer has been assured of winning the bid. Once the commitment papers and acquisition agreement are fully executed and delivered, the borrower and arrangers will move forward with a view to finalizing the financing documentation and meeting the conditions to closing the acquisition and the financing at the same time.

Andrew Bettwy and ***Glen Lim*** are Partners in the Corporate Department and members of the Finance Group of Proskauer Rose LLP.