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April 7, 2009

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NEWSLETTER OF THE **MERGERS & ACQUISITIONS** PRACTICE GROUP OF MANATT, PHELPS & PHILLIPS, LLP

Delaware Court Respects Plain Meaning of Merger Agreement; Allows Private Equity Sponsor to Avoid Reverse Termination Fee

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The recent Delaware Chancery Court decision in *Alliance Data Systems Corp. v. Blackstone Capital Partners V, L.P. and Aladdin Solutions, Inc.* provides a strong pronouncement on the effectiveness of private equity deal structures. The deal structure at issue involved the formation of a separate "shell" acquisition subsidiary and the private equity sponsor of the buyer agreeing to provide a reverse termination fee payable to the target. This type of structure is intended to ensure that the private equity sponsor is not itself held contractually liable for obligations (including those of the acquisition subsidiary) under the merger agreement, other than for the obligation to guarantee payment of the reverse termination fee.

As discussed below, the court determined that the target could not recover the $170 million reverse termination fee. The target had argued that the fee was payable as a result of the refusal by the buyer's parent (the private equity sponsor) to agree to conditions required by a regulator to approve the transaction. The court found that the parent's decision not to agree to the conditions was not a basis for the termination fee to be payable. The decision confirms the orthodox position of the Delaware courts to apply and enforce the plain language of merger agreements, to not readily impute obligations into the merger agreement, and to not impose obligations on non–parties.

BACKGROUND TO THE LITIGATION

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The case stems from the May 2007 merger agreement executed by Alliance Data Systems ("Alliance"), and Aladdin Solutions, Inc. and Aladdin Merger Sub, Inc. (together, "Aladdin"), two shell companies formed by Blackstone Capital Partners ("Blackstone") for the sole purpose of acquiring Alliance. Under the merger agreement, a business interruption fee of $170 million was payable by Aladdin if it breached the merger agreement. The fee was separately guaranteed by Blackstone, who was not a party to the merger agreement.

Prior to the closing of the merger, the Office of the Comptroller of the Currency (the "OCC"), which had regulatory authority over a subsidiary of Alliance, refused to provide its approval of the transaction unless Blackstone agreed to provide financial support for the banking subsidiary of Alliance, which Blackstone refused to provide. After the expiration of the termination date in the merger agreement, Alliance terminated the agreement and sued Blackstone and Aladdin for the $170 million business interruption fee.

CHANCERY COURT'S ANALYSIS

Alliance's claims against Aladdin and Blackstone were based on the following three principal arguments:

1. *Aladdin and Blackstone Failed to Comply with the Covenant Requiring Their Reasonable Best Efforts.*

   Alliance first argued that Aladdin breached the general covenant to use reasonable best efforts to close the transaction because of Blackstone's failure to agree to the regulator's conditions to approval. This covenant included a requirement that the parties to the merger agreement use such efforts in connection with obtaining third-party approvals and consents and to avoid an action by governmental entities, including banking regulators.

   In its review of the merger agreement, the court noted that the reasonable best efforts covenant only bound Aladdin, not Blackstone, and stated that Alliance should have negotiated the language in the agreement to expressly cover the efforts of Blackstone towards completing the transaction if it had such an expectation. Towards this end, the court noted how the target had in fact negotiated such language with respect to a provision dealing with anti-trust matters where Aladdin had agreed to cause Blackstone to take certain actions, including divesting holdings. However, the covenant that applied to OCC approval did not contain equivalent language. Because the court found that Alliance's claim laid solely with the actions of Blackstone (who was not subject to the covenant) and not those of Aladdin, it held that Alliance had not established any breach of the agreement.

2. *Aladdin and Blackstone Violated the Covenant Against Taking Action to Prevent or Delay the Merger.*

   The second argument brought by Alliance was that Aladdin failed to comply with a covenant in the merger agreement not to take any action that could impair or delay the merger, including causing Blackstone not to take any such action.

   In its review of Alliance's arguments, the court stated that Alliance had failed to identify any affirmative step that Blackstone took that impeded the merger in any way. Specifically, the court noted that Alliance's claim was based solely on Blackstone's refusal to agree to the regulator's demands. On this basis the court determined that Blackstone's decision not to accept or accede to the requirements of the regulator did not constitute affirmative steps to impede the merger and in fact noted that Blackstone had no obligation to engage with the regulator at all.

3. *Aladdin Misrepresented to Alliance that it Controlled Blackstone.*

   Lastly, Alliance put forth an argument based on a standard representation made by Aladdin in the merger agreement. Specifically, Alliance argued that Aladdin represented that it had the power and authority to execute and deliver the merger agreement and consummate the transaction and, therefore, that it implicitly had the power to direct its parent, Blackstone, towards closing the transaction. This argument was based on Aladdin having made certain agreements related to the actions of Blackstone.

   The court rejected this argument noting that it "distorts the plain meaning of a common term in acquisition agreements," and limited its interpretation of the representation to a narrow reading; specifically, that Aladdin had only represented that Aladdin itself had the power and authority to do what Aladdin itself had agreed to do, consistent with the fact that Blackstone itself was not a party to the merger agreement. The court refused to interpret the power and authority representation to act as a broad guarantee by Aladdin that it could control its parent, when the court saw that the parties had so carefully drafted the merger agreement to strike a bargain otherwise.

In dismissing these arguments, the court noted that there was no viable claim against Blackstone because it was not a signatory to the merger agreement. Alliance's claim was therefore limited to establishing (which Alliance failed to do) that Aladdin was somehow liable under the merger agreement for something its parent, Blackstone, had failed to do. The court also dismissed a fall-back argument of Alliance that the defendants had breached the implied covenant of good faith and fair dealing.

Alliance had argued that during negotiations both parties knew that the OCC may require Blackstone to meet certain conditions before issuing its approval. The court responded that if the necessity of such commitments was so obvious, then Alliance should have insisted that Aladdin be held responsible in the event Blackstone failed to use its best efforts to gain regulatory approval. Instead, the merger agreement had been negotiated otherwise. Accordingly, the court decided that the reverse termination fee was not payable.

TAKE-AWAYS

The court's deference to the plain language in the merger agreement underlines the importance of careful drafting of acquisition agreements. If a target has a real expectation of relying on a parent or sponsoring entity to take certain action or perform in a certain manner, then the target should address the central issue of who should be a party to the merger agreement and the scope of covenants within the merger agreement. Conversely, the decision of the court provides comfort to private equity-type sponsors and acquirers relying on a plain reading of the negotiated terms and the refusal of the Delaware courts to "read–in" obligations to acquisition agreements.

back to top

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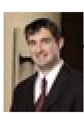

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