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M&A Escape Clauses In Light Of The Terrorist Attacks

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In the weeks since the terrorist attacks of Sept. 11, parties to a number of public acquisition transactions have announced their intention to walk away from deals based upon developments arising out of the attacks. Examples include:

- the decision by USA Networks, Inc. to terminate its merger agreement with National Leisure Group
- the announcement by WPP Group that it will seek permission from British regulators to terminate its $600 million tender for the shares of Tempus Group, notwithstanding that the bid had become "unconditional" under U.K. takeover rules
- the decision of Berkshire Hathaway not to proceed with the purchase of as much as $500 million of Finova Group notes.

Because of the high visibility of major M&A transactions, making the determination to walk away from a signed deal creates risks of litigation, damage to business operations, and damage to reputation for both parties. Directors should be prepared to consider how the recent terrorist incidents, and the country's response to those incidents, may impact the certainty of closing current or future deals.

Typically, a party who seeks to terminate a transaction based upon negative developments will do so in reliance upon a material adverse change (MAC) clause in the acquisition agreement. (Because of differences in U.S. and U.K. takeover rules, WPP Group is seeking a declaration from the U.K. takeover panel that a material adverse change in the Tempus Group occurred). This clause permits a party to terminate an acquisition agreement where there has been (or where there is likely to be) a material negative change in the business, financial position or prospects of the other party during the period between the execution of the agreement and the closing of the transaction.

The MAC clause is a general escape hatch, but what constitutes an adverse change and whether it is material, is not always clear. However, since the practice in acquisition transactions often has been to avoid elaborate termination provisions based upon specific aspects of a company's operations, the MAC clause is the starting, and often ending, point for parties looking to exit a deal because of adverse developments.

Historically, most parties to mergers were concerned about whether developments specific to a company's business – loss of a key client, a major environmental spill, the filing of a significant lawsuit – could trigger the MAC clause. More recently, as parties became aware that broad economic developments could, by virtue of their impact on the specific parties' businesses, also trigger a MAC, they have sought to explicitly exclude the impact of general developments. Thus, it is not uncommon for merger agreements to now exclude changes in conditions generally affecting the U.S. or world economy as a

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whole as well as changes in industry conditions, unless the change affects one party disproportionately.

Exclusions such as these arguably could mean that even if a company's business had been materially adversely affected by developments such as the terrorist attacks, such events may not trigger the MAC clause if they resulted from an impact on the overall economy or industry segment rather than a unique impact on the company in question.

While such a result may be what the parties to the agreement intended, it is also quite possible that the companies did not focus on exactly what their expectations would be upon the occurrence of an event as unprecedented as the terrorist attacks. For agreements signed before September 11, it will likely fall to the courts to sort out what the parties' obligations are where one side invokes a MAC clause to terminate a transaction which the other side seeks to complete.

For agreements to be entered into post-Sept. 11 however, it is incumbent on companies to carefully consider how such extraordinary events should be addressed in acquisition agreements. Indeed, there is some evidence that these matters are being directly addressed in newly signed acquisition agreements. For example, in the September 26 merger agreement between Reliant Resources and Orion Power, the parties have specifically addressed the issue of how acts of terrorism affect the MAC clause. In that agreement, changes in the financial or securities markets or the economy in general which result in a material adverse effect on Orion's business do not constitute a MAC, "except to the extent caused by a material worsening of current conditions caused by acts of terrorism or war."

Some questions that should be asked as companies consider MAC provisions in the post-Sept. 11 world include:

- should changes in conditions generally affecting the U.S. or global economy or the particular industry segment be excluded from determining whether a MAC has occurred
- if such broad-based changes are excluded, should certain extraordinary events, such as terrorism and its effects, be included
- should new, more specific provisions, which could serve as a proxy for a MAC, be included? Examples could include a significant decline in the stock indexes, the closing of financial markets, or matters specific to the company's business or operations
- should a right to terminate the agreement flow only from an existing adverse effect on the company, or is an adverse effect on its future prospects sufficient
- If events occur which trigger a MAC, should there be a recovery or cure period to see if circumstances improve before a party can walk away?
- Finally, to the extent a company seeks to broaden its ability to walk from a transaction, will it be required to give the same flexibility to its merger partner?
- Update: At press time, the U.K. regulators had refused to permit WPP Group to terminate its bid for Tempus and USA Networks, and National Leisure Group had

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agreed to terminate their merger agreement in connection with USA Networks' $20 million investment in National Leisure.

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