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Practical Guidance on Merger Conditions from *Williams v. Energy Transfer Equity*

Attorneys
Paul S. Scrivano
Sarah Young

The Delaware Supreme Court's recent 4-1 decision in *The Williams Cos., Inc. v. Energy Transfer Equity, L.P., et al.*, which affirmed the Delaware Court of Chancery's decision to allow a public company merger to be terminated over the inability to satisfy a condition requiring the delivery of a tax opinion, highlights the sometimes perilous nature of closing conditions, and how they can potentially be invoked by one party for a purpose that is beyond the original intent of the parties, as well as the differing views on what conduct is required to comply with and establish a breach of commercially reasonable efforts covenants in acquisition agreements.

The case involved the proposed acquisition by Energy Transfer Equity (ETE) of The Williams Companies (Williams). As a condition to the closing of the transaction, the merger agreement required ETE's outside tax counsel to deliver an opinion to each of Williams and ETE that a portion of the transaction "should" be treated as a tax-free exchange. Between signing and closing, the energy market declined precipitously, and it became clear that ETE no longer wanted to complete the transaction. During the interim period prior to Closing, ETE's head of tax learned that the number of shares of stock to be offered in the transaction was fixed, which created a risk that tax authorities could attribute certain excess cash to another portion of the transaction and render ETE's counsel unable to deliver its tax opinion. After discussions internally, with ETE and other counsel, ETE's tax counsel concluded that it was likely unable to render the tax opinion, which position was disclosed by ETE in the merger proxy. Williams' counsel disagreed, but nonetheless proposed two potential alternative solutions, neither of which ETE's tax counsel determined would permit it to deliver its opinion. Williams then sued, and alleged, among other things, that ETE was in breach of the merger agreement by failing to use commercially reasonable efforts to obtain the tax opinion, and insinuated that ETE's tax counsel reached its conclusion "for reasons other than its best legal judgment." Following expedited discovery and a trial, Vice Chancellor Sam Glasscock concluded that (i) ETE's tax counsel in good faith determined that the tax opinion was not deliverable and (ii) ETE was not in material breach of the covenant. The Chancery Court further determined that if the opinion could not be delivered by the outside date, ETE was under no obligation to close the transaction due to the failure of the negotiated condition precedent. The Delaware Supreme Court affirmed the Court of Chancery's decision, concluding that ETE was not estopped from terminating the merger agreement and that ETE's tax counsel's determination was made in good faith, but disagreed with the Chancery Court's "unduly narrow view of the obligations imposed by the [merger agreement] covenants."

This decision illustrates the risks of closing conditions that are almost completely in the discretion of one party. The tax opinion condition in the ETE/Williams deal, as is the case in many public company stock transactions, simply required that each party receive the opinion of its outside counsel as to the tax status of the transaction at closing. As suggested by Williams in the litigation, there exists a risk that if a transaction is no longer in a party's best interest, that party could engineer a failure of such condition—potentially by raising concerns with its outside counsel—for reasons different than the original intent of the condition. A range of alternatives may be available to the parties to contractually minimize risks arising from this conditionality. For example, if either party's counsel fails to deliver a tax opinion that prevents the satisfaction of a closing condition, the contract could provide that the condition would be satisfied by delivery of an opinion from the other party's counsel, another nationally recognized firm or a firm jointly appointed by the parties. Alternatively, the opinion condition could be eliminated entirely and the possibility of a taxable transaction to each party's stockholders could be disclosed. More generally, the merger agreement could specify exactly what actions or conduct will or will not be required to satisfy the covenant obligation, which may include an obligation for the parties to restructure or use a pre-agreed alternative approach. Parties to a transaction should consider the optimal approach in light of each party's position and facts and circumstances related to the structure, identified risks and overall transaction dynamics.

Parties should be wary of and avoid other conditions in merger agreements that similarly provide a party with too much discretion in determining whether the condition has been fully satisfied. For example, each party and its counsel could have a different opinion on what approvals are required or desirable to satisfy a condition that all required or desirable foreign antitrust approvals or clearances be obtained prior to closing, particularly in light of each counsel's view of the nexus with the foreign jurisdiction or the need vs. desirability for the regulatory clearance. It is advisable that instead, the parties agree on narrow and precise list of conditions that can be objectively satisfied, including, in this instance, a list of specific jurisdictions where foreign clearances are required.

Also of note is the Supreme Court's disagreement with the Chancery Court's analysis of Williams' covenant breach claim. The Chancery Court's analysis of whether ETE had violated its obligation to use commercially reasonable efforts to secure the tax opinion hinged on Williams identifying commercially reasonable efforts that ETE "could have taken" that were available to it, despite ETE's motivations, or facts that evidenced ETE manipulating, withholding or misrepresenting information that caused its counsel to be unable to render its opinion. The Supreme Court disagreed with the Chancery Court's analysis, and in particular, the burden of proof placed on Williams to identify actions not taken in support of its covenant breach claim. Instead, the Supreme Court concluded that the covenant placed an affirmative obligation on the parties to take all reasonable actions to obtain the requisite tax opinion and close the transaction. The Supreme Court's disagreement with the Chancery Court's analysis of the covenant breach claim and the Chancery Court's statement that "commercially reasonable efforts" is not "addressed with particular coherence in [Delaware] case law" indicate that the covenant standards often used in merger agreements may not create as strong of an obligation as M&A practitioners have sometimes viewed such standards to be.