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Checklist: Deal Confidentiality Pledges & Reminders

By Broc Romanek, Editor of DealLawyers.com

1. Whether to Require NDAs or Send Reminders (Or Do Nothing)—Decide whether you should get employees to sign confidentiality oaths (*i.e.*, manually-signed non-disclosure agreements) when they are "read into" an impending deal.

   In the alternative, you can distribute reminders to whomever has knowledge about the deal of the sensitivity of the information and their duty to keep it confidential. Or you can choose to do nothing in reliance upon employees' existing duties of confidentiality.

   Alternatives to obtaining deal-specific NDAs or acknowledgments make sense if the company's culture is one of trust, which assumes and expects that the directors, officers and employees will act competently and responsibly—whatever that may mean in the context of any given situation. If that trust is lacking, the director/officer/employee should not be in the role that would otherwise warrant their being brought under the tent.

2. Factors to Consider in Selecting an Approach—Factors to consider in determining what approach to take include:

   – How many deals does the company do each year? If deals are relatively frequent, the employees read in should be well aware of their confidentiality duty. And it can be bothersome to get manually signed NDAs from them each time. In fact, it likely will offend them because it may imply a lack of trust in their professionalism and integrity.

   – How many employees are involved? If some are read in, but are not used to being involved in a deal, it may be wise to get them to sign something deal-specific to further educate them by example as to the types of information required to be maintained in confidence in accordance with the company's code of ethics.

   – Consider whether you have adequate resources to send, collect and file manually signed NDAs. Do you have enough time and administrative support to handle this task effectively? To the extent that the company deems obtaining deal-specific manually signed NDAs to be beneficial, you need to be confident that you can administer the process effectively. If you don't have the bandwidth

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to track and obtain the signed agreements, you may be better off not considering this approach at the outset.

– Ensure that all employees read into the deal signed a confidentiality agreement when they joined the company. This agreement may consist of an acknowledgment of the company's ethics code that contains a duty of confidentiality and is typically acknowledged annually. If so, obtaining additional confidentiality agreements for particular projects may not provide any benefit. In fact, obtaining separate NDAs might create the impression that information was only subject to confidential treatment if there were a separate NDA.

3. <u>Content of Confidentiality Reminders</u>—Some companies opt to send "confidentiality reminders" via email and require each "read in" employee to reply and acknowledge the reminder. The reminder may state that the particular project information is subject to the company's confidentiality policy (or general confidentiality agreement), remind the employee of their obligation to not trade on material non-public information and describe information security procedures—which ordinarily differ depending on the nature of the deal—for the project. To help put things in context, the reminder may also note the company's confidentiality representations made and obligations to third parties involved in the deal, and the fact that the company is depending upon each employee in order to honor the company's commitments to these third parties.

4. <u>Treat Different Types of "Read In" Employees Differently</u>—Often, you will have two or more groups of "read in" employees. A smaller group may be aware of the entire scope of the project, the parties involved, and strategic implications—which can be called the "full disclosure" group. Another larger group may involve employees who do some work related to the project, and are generally aware that there is something unusual going on, but who do not have full visibility into the project—the "limited disclosure" group.

   Consider managing the participant lists separately. The limited disclosure participants likely are not necessarily aware of all of the other employees working on the project. The full disclosure participants likely will be informed of the identity of every employee on both lists. Your communications with each group will differ based on your knowledge of their involvement and their awareness of others' involvement in the deal.

5. <u>Steps to Take If Insider Caught Insider Trading</u>—Here are steps to consider if an employee or director is suspected of insider trading during a deal:

   – Inform suspect about suspicious trading and investigate facts behind trade quickly.

   – Consider placing employee on leave pending investigation.

   – Whether or not on leave, take employee out of information loop.

   – Have trade reversed, if possible (if the news is not out yet, it may be reversible).

   – If trading is in fact improper, notify the SEC Enforcement Staff. There is no legal requirement to do so, and doing so will almost certainly trigger an investigation, but the company will earn significant credit for its transparency.

   – In some cases, the other side of the deal should be notified—typically if it looks like there was going to be a FINRA or SEC investigation of the trading, in which case it would be courteous to give your counterparty a head's up. Otherwise, they probably don't need to know, and you'll risk waiving privilege.

   – The suspect will need their own lawyer. Depending on who it is, the company may be required (or permitted) to advance their legal fees.

   – There shouldn't be a difference for the steps above if the suspect is an officer, director or employee—but if it is an executive officer or director, it could trigger disclosure issues pursuant to Section 16 and/or 8-K.

Here is a drill down into a few of the pointers above:

– To the extent practical (*i.e.*, information on company servers and equipment), preserve emails, text messages, telephone records, and other evidence of communications sent to and from the suspected employee, starting with the date he or she was read in through at least the date the deal was publicly disclosed. Also consider imaging the hard drive of the employee's computers. Although circumstances will vary, this should ordinarily be done as soon as possible and without notice to the suspected employee.

  After evidence is preserved, question the employee about the suspected trading in a non-threatening manner and allow the employee to provide an innocent explanation or credible denial. Optimally, this should be done by in-house or outside counsel to protect privilege and work product protection, and if so, it should be preceded by so-called "Upjohn" warnings making clear that counsel represents only the company (not the individual) and that all privileges belong only to the company and might later be waived. During or after the discussion, request the employee to provide copies of relevant trade confirmations and other relevant documentation.

– If the trade remains suspicious or the employee refuses to cooperate, consider suspension, dismissal, or other appropriate discipline. Also consider suggesting that the employee retain separate counsel and, after consultation with separate counsel, consider reversing the trade, particularly if the deal has not yet been publicly disclosed. Reversing the trade or closing a potentially tainted stock position could mitigate monetary liability and demonstrate good faith, thereby reducing the risk of subsequent law enforcement action (although with hindsight enforcement authorities might later cite the reversal as acknowledgement of wrongdoing). In many cases, the employee may be entitled to have the company cover the costs of separate counsel, at least until there is ever a finding of wrongdoing.

Thanks to Russ Ryan of King & Spalding and Jay Dubow of Pepper Hamilton for help with #5 above.

Crown Jewels: Restoring the Luster to Creative Deal Lock-Ups?

By Daniel Wolf, David Feirstein and Joshua Zachariah of Kirkland & Ellis LLP

The "crown jewel" lock-up, a staple of high-stakes dealmaking technology in the 1980s M&A boom, has been showing some signs of life in the contemporary deal landscape, albeit often in creative new forms. As traditionally conceived, a crown jewel lock-up is an agreement entered into between the target and buyer that gives the buyer an option to acquire key assets of the target (its "crown jewels") separate and apart from the merger itself. In the event that the merger fails to close, including as a result of a topping bid, the original buyer retains the option to acquire those assets. By agreeing to sell some of the most valuable pieces of the target business to the initial buyer, the traditional crown jewel lock-up can serve as a significant deterrent to competing bidders and, in some circumstances, a poison pill of sorts.

Given the potentially preclusive nature of traditional crown jewel lock-ups, it is not surprising that they did not fare well when challenged in the Delaware courts in the late 1980s. As the Supreme Court noted in the seminal *Revlon* case, "[W]hile those lock-ups which draw bidders into a battle benefit shareholders, similar measures which end an active auction and foreclose further bidding operate to the shareholders' detriment." Building on the holding in *Revlon*, the court in *Macmillan* said that "[e]ven if the lock-up is permissible, when it involves 'crown jewel' assets careful board scrutiny attends the decision. When the intended effect is to end an active auction, at the very least the independent members of the board must attempt to negotiate alternative bids before granting such a significant concession." Although crown jewel lock-ups fell out of favor following these rulings, modern and modified versions of the traditional crown jewel lock-up have been finding their way back into the dealmakers' toolkit.

During the height of the 2008 financial crisis, we saw a crown jewel lock-up in its most traditional form in the JPMorgan rescue acquisition of Bear Stearns. Driven by "life-or-death" urgency, Bear Stearns agreed to an option for JPMorgan to buy its Manhattan headquarters for approximately $1.1 billion, including in circumstances where a topping bid emerged. In the ensuing litigation, the plaintiffs argued that the option to purchase the building constituted an "effective" termination fee because the purchase price under the option was allegedly below fair value. A New York court, applying Delaware law, rejected this argument stating that the record did not substantiate the claim that the price was below fair value. The court, mindful of the extreme circumstances, also noted that the plaintiffs' criticism of the "effective" termination fee and lock-ups as being excessive or unprecedented was also misplaced because Delaware law does not "presume that all business circumstances are identical or that there is any naturally occurring rate of deal protection, the deficit or excess of which will be less than economically optimal."

More recently, in Apple's 2012 deal to acquire AuthenTec that grew out of initial discussions of a commercial and development arrangement, the target agreed to grant Apple an option to acquire a non-exclusive license to its sensor technology, exercisable whether or not the broader acquisition were to close, in exchange for an upfront option payment and additional future cash payments if Apple chose to license the technology. Presumably, granting one of the largest players in the electronics space a non-exclusive license to its technology could have the effect of making AuthenTec a less attractive target to potential topping bidders. Likely mindful of the close judicial scrutiny of this type of lock-up, the parties were careful to document the benefit of the option to AuthenTec as well as the fact that Apple insisted on the option as a condition to doing the acquisition. In its proxy statement, the AuthenTec board highlighted its belief that the option served an independent business purpose, and would be appealing to a potential competing bidder, because the license was non-exclusive and could bring in significant future payments from Apple as well as the reputational benefits of a relationship with Apple. Having chosen to commit to the acquisition as a means to advance its plans in this area, Apple likely justified its insistence on the option as a means of ensuring that it would have long-term access to the necessary technology in the fast-paced tech world irrespective of whether the wider deal closed.

A similar fact pattern appears to have played out in the recently announced acquisition of the NYSE by ICE. As part of the deal, the parties entered into a separate agreement whereby ICE was appointed the exclusive provider of certain clearing services for NYSE's leading European derivatives business whether or not the acquisition was completed. Notably, the clearing agreement is a standalone commercial arrangement as opposed to an option and was announced in a separate press release. Notwithstanding its potential deterrent effect on competing bidders, in their recently filed disclosure documents the parties explain the independent business purpose for the separate clearing agreement. The disclosure notes that the contemporaneous clearing services agreement addressed the risk that announcing a transaction with ICE would make it difficult for the NYSE to continue developing an internal clearing house, as customers and partners would likely be unwilling to invest the necessary funds and internal resources for a new NYSE clearing house when ICE would expect to shift clearing to its clearinghouse after closing of the merger. In post-announcement interviews, the NYSE CEO also highlighted that its prior failed merger with Deutsche Boerse had delayed NYSE's building of its own European clearinghouse, leaving residual commercial risk around NYSE's need for clearing services that had to be addressed regardless of the completion of the ICE merger.

Yet another twist on the traditional lockup has been seen in a number of recent deals for financially strapped companies where the formal acquisition agreement is accompanied by some form of bridge loan or commitment. For example, the board of Complete Genomics believed that the company was likely headed to bankruptcy absent a sale transaction. Even with a signed merger agreement, the company may have lacked sufficient cash resources to fund its business until closing. At the signing of the merger agreement, the target also entered into a bridge loan with the buyer, BGI, that could, under certain circumstances, convert into a significant amount (20%) of Complete Genomics stock. In denying the plaintiffs' request to preliminarily enjoin the deal based in part on the alleged preclusive impact on competing bidders of this potentially large equity position for the first buyer, VC Laster noted in a bench ruling that the bridge loan "provided substantial benefit to Genomics in the form of much needed cash to get them through at least most of, and ideally all of, the transaction process and possibly a little bit beyond." (See our Spotlight/Deal Transaction.)

As with any other aspect of dealmaking, consideration of inclusion of a lock-up, especially of the crown jewel variety, should be with a careful eye to the specific facts on hand and overall deal dynamics. While there is little recent case law offering specific guidance, a number of general principles would seem to apply. Any lock-up mechanism is likely to be evaluated within the framework of the target's particular circumstances. What might pass muster for targets in "life-or-death" situations or in financial distress may not be advisable forms of deal protection in the ordinary course. Similarly, a contractual arrangement outside the four corners of the merger deal that may also have corollary deal-protection effects will be more defensible if the target has a demonstrable business purpose for, or benefit from, the separate arrangement. In addition, a contractual arrangement that truly stands on its own (*i.e.*, is not merely an option triggered if a deal is topped) may be supportive evidence that the arrangement was not merely designed for its deterrent impact. While perhaps less intuitive, a lock-up also could be justified, notwithstanding its potential deterrent effect, by a particular need of the <u>buyer</u>—for example, if the buyer articulates a business justification for insisting on, as a condition to its willingness to do the deal, locking up a target asset or contractual arrangement (*e.g.*, its foregoing other acquisition opportunities or business development efforts in light of pursuing the acquisition of the target).

After a long period of dormancy, lock-ups—"crown jewel" or otherwise—have seen a recent creative rebirth with some structural twists. What remains clear is that, absent extreme circumstances (such as Bear Stearns), an old-fashioned "crown jewel" asset lock-up that serves only to end an auction by virtue of its preclusive impact on other bidders will be subject to significant judicial scrutiny under basic *Revlon* and *Unocal* principles. However, a small sampling of recent case law, coupled with developing market practice, suggest that in appropriate circumstances there may be room in the dealmaking toolkit for modern and creative variations on traditional lock-up arrangements (particularly where there is demonstrable business benefit to one or both parties beyond the resulting deal protection). It goes without saying that these lock-ups, even in their modern iterations, must be handled with care with ample discussion and documentation of the reasoning and justification for their implementation.

Divisional Acquisitions: A Clean Break?

By Sean McGuinness of Chadbourne & Parke LLP

A divisional acquisition involves the purchase of a business unit of a larger parent seller entity, where the seller will continue to operate other lines of business following the closing of the divisional divestiture. While the acquisition of a divisional enterprise will have many features in common with the acquisition of an entire enterprise, the assets and liabilities associated with the divisional enterprise—especially one that is not a separate legal entity—may be less well defined than in the case of an entire business. Moreover, the operations of the division typically are closely entwined with those of the parent, a situation that creates numerous legal issues for parties to the transaction (and their advisors) that do not normally arise in the acquisition of a stand-alone enterprise. This article discusses some of the more important of these issues.

Form of Acquisition

The divisional enterprise may or may not be organized as a separate legal entity that is a subsidiary of the parent. In the case of a target divisional enterprise that is a separate legal entity (e.g., a subsidiary corporation or limited liability company), the acquisition may take the form of a merger, stock purchase or asset purchase. When, however, the target division is not separately organized, the acquisition must be accomplished via an asset purchase.

Preparing for the Divisional Disposition

As described below, a key aspect of documenting a divisional acquisition involves precisely defining the assets and liabilities to be included in the transaction. In the first instance, it is incumbent upon the seller and its counsel to make these determinations, and to provide guidance to the purchaser and its counsel who necessarily will start with less knowledge of the underlying facts. Sellers therefore should position themselves to educate would-be buyers as to the details of the divisional assets and liabilities proposed to be included in the divestiture as early in the sale process as possible. One way of accomplishing this is through careful preparation of the initial drafts of the term sheet (if one is employed) and of the proposed purchase agreement. Especially in the context of a divisional disposition, sellers should facilitate the due diligence process by preparing detailed disclosure schedules early in the purchase agreement negotiation process.

Divisional enterprises often do not maintain separate financial statements, and to the extent they do, the financial statements may not be audited. Depending on the nature of the assets to be sold, the absence of audited financial statements may negatively impact their value and have a chilling effect on the sale process generally. Buyers are less likely to aggressively value a business when there are questions as to its financial performance as represented by the seller. The absence of reliable financials may also negatively impact a purchaser's ability to use debt to finance its purchase. In addition, if the purchaser is a public company, then depending upon the size of the purchaser relative to the target, the purchaser may be required to file audited financial statements for the divisional enterprise with the Securities and Exchange Commission. Consequently, sellers lacking audited financial statements for a divisional enterprise proposed to be sold should consider preparing them in advance of commencing the sale process.

Special Due Diligence Considerations

Purchasers should carefully evaluate the consequences that separating the divisional enterprise from its seller will have upon the division's business going forward and its related value. Any intra-company transactions that are not conducted on market terms may affect valuation. For instance, purchasers should investigate whether the seller has provided necessary services to the division, and if so whether the associated costs have been properly recorded and charged at market rates. Likewise, purchasers should determine whether the division may benefit from certain economies in procuring goods or services by virtue of its ownership by a much larger enterprise that may no longer be available to it as a stand-alone entity.

Defining the Acquired Assets

In an acquisition of a stand alone enterprise, the purchaser either acquires the target and with it all of its assets (in the case of a merger or stock purchase), or acquires all of the target's assets (in the case of an asset purchase). Although the purchaser must take care to ensure that the closing of the sale transaction will not result in the termination of the target's contractual rights or governmental permits, or otherwise negatively impact the target assets, defining the assets to be included in the sale transaction generally does not present difficult issues.

In contrast, defining clearly what assets are to be acquired is a key aspect of structuring a divisional acquisition that is of significant concern to both the purchaser and seller. If the transaction is structured as an asset purchase, all of the assets necessary for the operation of the target's business must be specifically identified and conveyed. Even when the divisional enterprise is separately organized, and the transaction is structured as a merger or stock purchase, the seller must determine whether the target entity owns assets that should be retained by the seller, and if so convey them separately to the seller or an appropriate affiliate prior to or at the closing. In any event, the purchaser must ensure that it obtains all assets required to operate the acquired business, and the seller must ensure that it does not inadvertently convey any assets that are essential to its continuing operations. This is a process that can involve substantial effort, and it is prudent for the seller to facilitate it by identifying the relevant assets as specifically as possible during the due diligence phase.

Defining the Assumed Liabilities

Defining the liabilities that are to be retained (in a merger or stock purchase) or assumed (in an asset purchase) by the divisional enterprise following the closing presents issues similar to those relating to defining the assets that are to be retained by or conveyed to it as described above. The issue of which liabilities are to be retained and which are to be conveyed is likely to be heavily negotiated, and care must be taken to ensure that the asset purchase agreement clearly reflects the parties' business understanding. As in the case of defining the assets to be conveyed, the seller should make every effort to identify the liabilities to be assumed early in the sale process.

Regarding the treatment of contracts relating to the divisional enterprise, the purchaser may seek to have the purchase agreement list all of the contracts to be assumed, and the seller may wish to define them more generically. A related issue is that frequently the seller or an affiliate will have provided guarantees or other credit support, or entered into other contractual arrangements, for the benefit of the target division. For example, the seller may have guaranteed a credit facility provided to the target by a third party lender, or entered directly into a lease of facilities or equipment used by the target. Ideally, at closing the purchaser will substitute other arrangements that are satisfactory to the seller, but in some cases this may not be feasible. For instance, if following closing the credit of the purchaser or the target company will be weaker than that of the seller, the other party to the contractual arrangements may be unwilling to accept substitute arrangements proposed by the purchaser. In that case, it may be necessary for the seller and purchaser to negotiate arrangements whereby the seller will continue to provide the arrangements on an interim basis.

Contingent liabilities relating to the divisional enterprise can often present difficult issues. For example, if the division is a defendant in a potentially significant lawsuit, it may materially effect its valuation. One approach is for the seller to retain the related liabilities, control the litigation and indemnify the purchaser. Alternatively, the parties may wish to negotiate purchase price adjustments to come into play upon the final resolution of the litigation.

Purchase Price Adjustment

In the typical acquisition agreement, the purchase price is adjusted post closing based on the change in the target's net working capital between the date the agreement is signed and the closing date. This procedure may be complicated by the lack of adequate financial information relating to the divisional target. One approach to the problem is to conduct a post closing audit of the closing date balance sheet of the target, and to make the net working capital adjustment by reference to the audited balance sheet.

Shared Internal Resources; Transition Services

Divisional enterprises often share certain business resources with their parents. These may include physical resources such as office space, computers and the like, as well as personnel resources such as accounting, legal, human resources, research and development and so forth. In all such cases, the parties must reach agreement as to which one will own the assets, or continue to employ the personnel, following the closing.

Then, they must make appropriate arrangements whereby the other party will have appropriate access to the shared resources following closing. For example, in the case of intangible assets such as intellectual property, the party that is to own the asset after the closing will grant the other party a license to use it on some basis. Where the shared resources in question are physical assets or employees—such as real estate or equipment, or accounting or legal personnel—the problem may be addressed via a transition services agreement, whereby the parties agree how the party that is to own or employ the previously common resources following the closing will make them available to the other party on a shared basis for a period following the closing that is sufficiently long to permit that party to make alternative arrangements.

Shared Services Provided by Third Parties

Divisional enterprises often share services provided by third parties under contracts entered into by their parent entities. Examples include the following:

- Property/casualty insurance
- Employee medical insurance
- Other employee benefit arrangements

In such cases, during the pre-closing period, the acquirer must put in place substitute arrangements to cover the target company from and after closing. In the case of complex enterprises, this can be a relatively long lead item and purchasers should plan accordingly.

“Short Slate” Rules: A Recap

By Enrico Granata of Morrison & Foerster LLP

“Short slate” proxy contests (*i.e.*, contests where a dissident is soliciting proxies in support of nominees that, if elected, would constitute a minority of the board of directors) are expected to continue to be popular during the 2013 proxy season (see, for example, the International Game Technology proxy contest).

There are several strategic and practical reasons why a dissident would choose to run a short slate rather than a control slate, including, among others, the perception among stockholders that adding a limited number of a dissident’s nominees is often of some benefit to the company and usually not particularly disruptive, a comparatively greater willingness of proxy advisory firms to support a dissident’s short slate rather than a control slate, and the fact that dissidents may want to achieve some influence through a successful campaign but may not want to run the company.

What follows is a recap of the basic dos and don’ts under the “short slate” voting rules:

- *Rounding out with company’s nominees*: Notwithstanding the “bona fide nominee” rule[1] (requiring the consent of any dissident nominee to be named in a proxy statement and to serve on the board if elected), if a dissident is soliciting proxies in support of a short slate, the proxy rules[2] specifically permit the dissident to round out its slate by including on its proxy card nominees named in the company’s proxy statement without obtaining their prior consent. This rounding out permits stockholders to vote for the dissident’s short slate without forgoing their right to vote for all seats up for election. A dissident’s ability to round out its slate with the company’s nominees is subject to four requirements:
  - The dissident must seek authority to vote in the aggregate for all director positions subject to election;
  - The dissident must represent that it will vote for all the company’s nominees, other than those specified;
  - The dissident’s proxy card must provide stockholders with an opportunity to withhold authority with respect to any other company nominee by writing the name of that nominee on the proxy card; and
  - The dissident must state on its proxy card that there is no assurance that the company’s nominees will serve if elected with the dissident’s nominees.
- *Rounding out with another dissident’s nominees*: If a dissident is soliciting proxies in support of a short slate, the dissident can also round out its slate with nominees supported by another dissident (see Icahn Associates Corp.’s slate in the 2009 Amylin Pharmaceuticals, Inc. proxy contest). The SEC has articulated certain conditions to the ability of a dissident to round out its slate with nominees of another dissident[3], including:
  - The two dissidents must have not expressly or impliedly agreed to act as a group, must have not otherwise formed a group, and must have no intention to form a group within the meaning of Regulation 13D;
  - Each dissident must be soliciting proxies in support of a short slate; and
  - The dissident will not actively recommend the election of the nominees of the other dissident but will only state its intention to vote for the nominees of the other dissident other than those specified.
- *No clear way to mix and match*: Unless there is an agreement between the company and the dissident(s) on voting for any composition of nominees via electronic voting (if permitted under state laws) or voting is done at the meeting (after obtaining a legal proxy for the shares held in

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[1] Securities and Exchange Act Rule 14a-4(d)(1).

[2] Securities and Exchange Act Rule 14a-4(d)(4).

[3] Icahn Associates Corp., SEC No-Action Letter (March 30, 2009).

street name, a stockholder cannot use a dissident's short slate proxy card and (i) vote for less than all of the dissident's nominees while rounding out the card with additional nominees of the company or another dissident or (ii) vote for nominees of the company or another dissident other than those chosen by the dissident for rounding out its card.

Given the limited SEC guidance on proxy card mechanics, any attempt to split voting in connection with a short slate campaign that is not within the scope of the "short slate" rules (*e.g.*, adding names of different nominees from the company's or another dissident's proxy card or using multiple cards and a letter of direction to indicate a split vote) will be subject to significant scrutiny and is likely to result in a legal battle if its validity would affect the outcome of the proxy contest.

Be Careful What You Wish For: When Drafting Indemnification Clauses, You May Get Exactly (and Only) What You Ask For

By Elizabeth Sluder of Kaye Scholer LLP

Viacom's purchase of video game developer Harmonix Music Systems serves as a testament to the adage "be careful what you wish for." As shown in *Winshall v. Viacom International, Inc. et al.* (Del. Ch. Dec. 12, 2012), the Chancery Court strictly interpreted indemnification provisions and concluded that Viacom, the potential indemnitee, was only entitled to the remedies expressly stated in the merger agreement. In *Winshall*, the court held:

- Harmonix's shareholders (collectively, Sellers) made certain representations relating to video games under development as of the merger closing date and were only liable for breach if such representations were untrue as of such date. Consequently, Viacom was not entitled to indemnification for third party claims related to games that were completed post merger since Harmonix did not control the late stage development and publication.
- Because Viacom failed to show that Sellers had breached a representation, Viacom was not entitled to defense costs.
- Viacom could not unilaterally extend the escrow period by notifying Sellers of the possibility of a future indemnification claim prior to the expiration of the escrow period.

The *Winshall* case stems from the 2006 merger of Viacom and Harmonix. From the $175 million cash consideration, $12 million was placed in escrow to pay indemnification claims arising from losses suffered by Viacom as a result of any breach of Sellers' representations, among other things. In 2008, days before the 18-month escrow period was set to expire, Viacom requested indemnification for legal fees that it incurred in defending against three intellectual property infringement lawsuits related to "Rock Band," a video game under development by Harmonix at the time of the merger. After the escrow period expired, Viacom sought additional indemnification in connection with a fourth intellectual property infringement lawsuit. Sellers rejected Viacom's indemnification requests and, after Viacom refused to release funds from escrow, moved for summary judgment. In its opinion, the Chancery Court granted Sellers' motion on the basis that "Viacom cannot claim indemnification based on representations and warranties that Harmonix made as to the state of its business at the time Viacom bought it, because all of its claims relate to alleged infringements of intellectual property *after* the deal closed."

Date Certain Representations

Viacom alleged that Harmonix breached two representations made under the merger agreement. Harmonix represented that:

- It "ha[d] adequate rights . . . as is necessary for the current use" of Harmonix-developed software (Title Representation); and

- neither the operation of the Business, nor any activity of the Company, nor any manufacture, use, importation, offer for use and/or sale of any Current Games constituted a violation of any third party's intellectual property rights (IP Representation).

Title Representation

In response to Viacom's argument that Sellers had breached the Title Representation, the Chancery Court concluded that "it would ... be strange if the Sellers had indemnified Viacom, in 2006, against intellectual property claims arising out of a *future* version of Rock Band," since Sellers had no control over the final development and production of the game. The court emphasized that its conclusion was supported by the text of the representation, which (i) referred to "the current use" of Harmonix-developed software and (ii) used the present tense (*i.e.*, "*has* adequate rights") to indicate that the representation was made as of the closing date.

The court also noted that Viacom sought indemnification based on third party claims made against the final, published version of Rock Band. Viacom did not allege that Harmonix failed to have the necessary rights required to develop the 2006 prototype of Rock Band. As such, the Chancery Court leaves open the possibility that, if Viacom had instead sought indemnification on the grounds that Harmonix did not have all rights as of the closing date, the court may have ruled against Sellers' motion for summary judgment because there was a dispute of fact for trial.

IP Representation

The court's analysis of the IP Representation was bifurcated. First, the court reviewed Viacom's claims that the Business and activities of Harmonix infringed on third-party intellectual property. In the merger agreement, "Business" was defined as "the business of the company *as currently conducted*." Accordingly, the court held that a representation as to the Business was tied to Harmonix's business as of the 2006 closing date. Likewise, the court dismissed Viacom's argument that Harmonix's 2006 activities breached the IP Representation because the infringement lawsuits related to Viacom's 2007 activities (*i.e.*, publication of the Rock Band game).

Second, the court reviewed Viacom's claim that the sale of a Current Game infringed on third-party intellectual property. The court found that Viacom's interpretation of the merger agreement on this issue violated a basic principle of contract interpretation: "where possible, effect is to be given to all terms of the contract." It reasoned that the defined term "Current Game" and the disclosed list of Current Games would be superfluous if the IP Representation was interpreted to cover Harmonix-published software and *future* published games, such as Rock Band.

Legal Fees

Viacom represented that it incurred $28 million in defense costs in connection with the intellectual property infringement lawsuits. It argued that Harmonix was responsible for such costs based on the following provisions of the merger agreement: (i) Viacom had the right to conduct the defense of any indemnification claim "at the expense of the applicable indemnifying parties" and (ii) if Viacom chose not to permit Harmonix to assume the defense, Sellers were obligated to pay "the reasonable fees and expenses of counsel retained by [Viacom]."

However, the Chancery Court noted that such arguments were "out of their contractual and logical context" since such contractual rights were dependent on the existence of a breach of representation. Again, the court emphasized that its conclusion was supported by the text of the indemnification provision, which stated that the defense fees would be paid by the "indemnifying parties." If Viacom failed to show a breach of representation, then Sellers had no duty to indemnify and, therefore, no duty to pay defense costs.

In addition, the court found Viacom's argument "odd" because, if the court accepted the argument, it could result in Sellers being responsible for all defense costs related to the subject matter of Sellers' representations, irrespective of whether Sellers had breached any representation. Moreover, pursuant to Viacom's analysis, Sellers would be responsible for defense costs, which could not be foreseen as of the closing date, a risk that a sophisticated seller would never accept. Accordingly, the court held that

"Viacom's argument that the Harmonix stockholders have a duty to pay its defense costs even when there has not been a breach of the representations and warranties in the merger agreement is based on a misreading of the agreement."

Time-Barred

In Viacom's April 2008 notice of the first three infringement lawsuits, it stated that it "reserve[d] the right to seek indemnification for any other claims by [the plaintiffs in the existing infringement lawsuits] or by other third parties that may result due to [Harmonix's] breach of its representations and warranties under the [merger agreement]." Almost three months after the indemnification escrow period expired, Viacom relied on this "placeholder" to seek indemnification for defense costs incurred in connection with a fourth intellectual property lawsuit.

The merger agreement required Viacom to notify Sellers "in writing of such claim" within 18 months of the closing date. In its April 2008 notice, Viacom did not notify Sellers of a *claim*, but rather of a *possibility* of a claim. Accordingly, the Chancery Court rejected Viacom's fourth indemnification request because it was "impermissible" under the terms of the merger agreement and time-barred.

Lessons Learned

The *Winshall* case reminds us of the following lessons in contract drafting and interpretation:

- Carefully review defined terms and provisions that introduce a timing qualifier to confirm that their use throughout the contract reflects the business deal.
- Courts strictly interpret contractual provisions. The mutual agreement among parties as expressed within "the four corners" of the document will prevail over one party's interpretation of the contract absent some ambiguity.
- To successfully claim a breach of representation, the claimant must show that the representation was breached as of the date made. Thus, with respect to representations regarding assets under development at the time of acquisition, a later claim must prove that the representation was breached as of the closing.
- A party cannot unilaterally amend contractual terms if such amendment will adversely affect the other party. In the context of indemnification claims, a party cannot simply extend a specified indemnification period by notifying the other party of the possibility of future claims.

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