The Corporate Counselor

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California Law Considerations with Respect to Mergers and Acquisitions

By: Robert L. Efthimos, Esq.

Hogan & Hartson LLP

In addition to expertise (or access to expertise) in a number of legal disciplines, including tax, employment, benefits, antitrust, real estate and regulatory law, lawyers advising clients in connection with merger and acquisition (M&A) transactions in California need to keep informed of critical distinctions of California law applicable to such transactions. In fact, California law comes into play even in the planning stages, before the transaction occurs.

When is your "non-binding" letter of intent binding after all?

Most M&A transactions begin with the parties executing a letter of intent, which serves to outline the principal terms of the proposed transaction. While letters of intent can be made binding (and in such case, you need to treat the letter of intent the same way you would a purchase agreement, as it may be enforced against the parties), they are most often styled as "non-binding."

A "non-binding" letter of intent is typically negotiated by the business principals, often without counsel's input. The business principals often believe that because they have styled the letter of intent as "non-binding," it merely sets forth the preliminary expectations of the parties with respect to the proposed transaction and is thus not enforceable against the parties. They believe, often erroneously, that they have an unfettered ability to "walk away" from the proposed transaction if they so choose. Corporate counsel should caution clients that in California, this is not always the case.

Experienced M&A counsel understand that certain provisions of a "non-binding" letter of intent should nonetheless be specifically set forth as binding on the parties. Typical "binding" provisions include confidentiality, exclusivity, expenses and governing law/dispute resolution. M&A counsel practicing in California should also be aware that in addition to these binding provisions, which the parties will be aware of by virtue of their designation as such in the "non-binding" letter of intent, California law may impose additional "binding" obligations on the parties.

In *Copeland v. Baskin Robbins U.S.A.*, 96 Cal. App. 4th 1251 (2002), the California Court of Appeals held that a "non-binding" letter of intent imposed a duty on the parties to negotiate in good faith towards a definitive agreement, and that a party could sue under the "non-binding" letter of intent for the other party's failure to negotiate in good faith towards a binding agreement. If successful on such a claim, the court held that a party could recover reliance damages (e.g. out-of-pocket expenses incurred in connection with the negotiation of the transaction and perhaps lost opportunity costs) but not lost expectations damages.

In order to maintain your client's expectation

that she can truly "walk away" from the deal if she chooses to, counsel should ensure that the letter of intent contains language similar to the following:

> "While the parties acknowledge that they may attempt to enter into definitive agreements with respect to the proposed transaction, either party may, at any time prior to the execution of such definitive agreements, and for any reason, propose different terms from those set forth herein or unilaterally terminate negotiations with respect to the proposed transaction without any liability to the other party. Each party shall be liable for all of its own fees, costs and expenses in connection with the negotiation and preparation of any drafts of definitive documents related to the proposed transaction.

And remember to specify that this provision is binding.

HOGAN & HARTSON
1999 Avenue of the Stars
Suite 1400
Los Angeles, California 90067
Tel: (310) 785-4600
Fax: (310) 785-4601
www.hhlaw.com
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How are we getting sued three years after the closing? I thought the reps and warranties expired!

In negotiating a definitive purchase agreement, the parties often focus most intently on the representations and warranties made by the seller. While the representations and warranties serve multiple purposes, including their continued accuracy being a typical condition to closing the transaction, business principals often focus on the role of representations and warranties in proscribing the recourse afforded the buyer post-closing, and the accompanying post-closing liability of the seller for their breach.

In negotiating a purchase agreement, the buyer typically seeks the broadest set of representations and warranties possible, to both backstop due diligence as well as provide the basis for recourse in the event something goes awry in the business after closing the transaction. The seller, on the other hand, seeks to give as narrow a set of representations and warranties as possible, so as to limit her potential liability for their breach.

In order to maintain the right to sue post-closing for a breach of the representations and warranties (which by their nature speak to a period at or prior to closing), buyers include a "survival clause," which provides the length of time that the representations and warranties are deemed to "survive" the closing. Without an explicit survival clause, the representations and warranties are deemed to have expired at the closing. While the survival clause may provide that the representations and warranties survive for the duration of their applicable statute of limitations, the parties typically agree on a shorter period of time, perhaps from one to three years. The theory is that such a period of time gives the buyer sufficient opportunity to discover breaches of the representations and warranties, and that, at that point, it is appropriate that the seller be "off the hook."

So if (1) without a survival clause, the representations and warranties will not survive the closing and thus the parties cannot sue over their breach post-closing and (2) the parties, recognizing this, agree on a survival clause providing that the representations and warranties "survive" for two years post-closing, then after this two year period, the representations and warranties "expire" and the seller can rest easy, knowing she cannot thereafter be sued for their breach, right? Not so fast.

Less than a year ago, the Ninth Circuit applied California law in *Western Filter v. Argan*, 540 F.3d. 947 (2008) and upset conventional notions that a survival clause serves to effectively shorten the statute of limitations by setting a deadline by which parties may bring claims for breaches of representations and warranties. Instead, the court held that the survival clause merely serves to specify the period during which breaches may "occur" post-closing, and that absent express language of the parties, a survival clause does not shorten the period to bring suit set forth in the statute of limitations.

The *Western Filter* decision has been met with considerable criticism, not the least of which because breaches of representations and warranties cannot "occur" post-closing, because by their nature, representations speak to a period at or before closing. Perhaps the court meant to say "be discovered" rather than "occur."

In any event, lawyers counseling California sellers should ensure that the survival clause not only specifies the period of time for which the representations and warranties survive, but also explicitly states that any claims for breach must be brought before the expiration of the survival period and that such period is shorter than applicable statutes of limitations.

My client isn't a California corporation… or is it?

For a variety of reasons, corporations are often formed under the laws of a jurisdiction other than the state in which they intend to, or actually, operate. Google, for example, is well-known as a Silicon Valley company, but is a Delaware corporation, formed and incorporated under the laws of that state.

While it does not apply to Google and other public corporations, a California corporate "long-arm" statute provides that private corporations formed under the laws of other states may nonetheless find themselves subject to California law under certain circumstances.

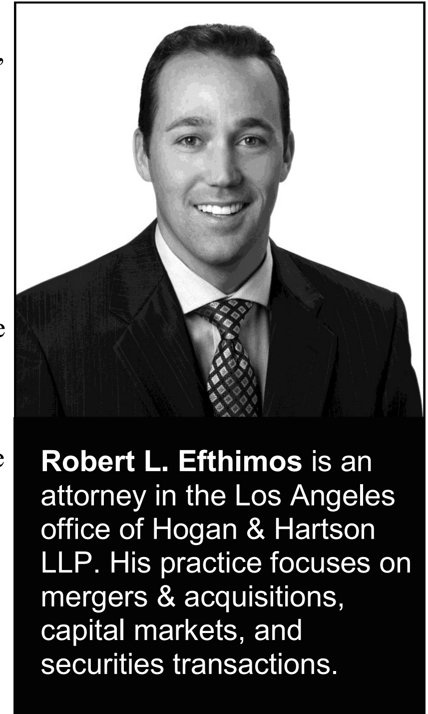
Under California Corporate Code Section 2115, a non-California private corporation that (1) conducts a certain level of business in California based on property, payroll and sales factors and (2) has more than half of its outstanding voting securities held by persons with addresses in California must comply with certain provisions of the California Corporate Code despite being incorporated under the laws of another state. In fact, Section 2115 explicitly states that the application of the California Corporate Code to such "quasi-California" corporations is "to the exclusion of the law of the jurisdiction in which [the foreign corporation] is incorporated."

It's not hard to imagine the problems that Section 2115 creates for lawyers advising "quasi-California" corporations. First, you have to be careful to conduct an ongoing factual analysis of your client's operations and shareholders in order to determine whether Section 2115 applies. Second, and more problematic, is the question – Should your client comply only with California law when Section 2115 applies? After all, the statute does say the application of California law is "to the exclusion" of the law of the other state. That approach, however, may not go over so well with courts in that other state, which may be unwilling to allow California lawmakers to usurp authority over corporations formed under the laws of their state. While a prudent approach would be to attempt to comply with the laws of both states when possible, this approach will not work when the state statutes are mutually exclusive on a particular matter.

The Delaware Supreme Court addressed this problem and the validity of Section 2115 with respect to Delaware corporations in *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108 (2005). Examen was involved in a pending merger, and under its Delaware charter documents and the Delaware General Corporation Law, the merger required the vote of common and preferred shareholders, voting on an as-converted basis. Under Delaware law, VantagePoint's preferred stock represented less than 15% of the vote.

Examen qualified as a quasi-California corporation under Section 2115, which in turn applied California Corporate Code section 1201 to the merger. Under Section 1201, the merger would require the separate approval of each class of voting stock. VantagePoint owned a majority of Examen's Series A Preferred Stock, and this under California law, VantagePoint held veto power over the merger.

While the legal analysis of *VantagePoint* is beyond the scope of this article, the Delaware Supreme Court repudiated Section 2115's application toward the Examen merger, holding that under conflicts of laws and Commerce Clause considerations, Delaware law, and not California law, would apply to the merger.



Robert L. Efthimos is an attorney in the Los Angeles office of Hogan & Hartson LLP. His practice focuses on mergers & acquisitions, capital markets, and securities transactions.

The outcome would undoubtedly have been different had the case been brought in California. Given the conflict between the states, it would seem only a matter of time before the validity of state "long-arm" statutes like Section 2115 is determined by the U.S. Supreme Court. In the meantime, counsel must understand when Section 2115 may apply and, if it does, the consequences of applying California law, rather than the law of the state of incorporation, to the particular facts and circumstances. If, as in *VantagePoint*, an issue arises and there are substantive differences between the two sets of potentially applicable laws, forum shopping and a race to the preferred jurisdiction are likely next steps.

Conclusion

The sale of a business, while only one type of M&A transaction, is often said to be the most significant transaction in the life cycle of a company. It is critical, then, that lawyers advising clients in connection with the sale of a business or other types of M&A transactions involving California law stay informed of developments in California corporate law or consult with experienced M&A counsel when advising clients in connection with these "make or break" transactions.

This article is for informational purposes only and is not intended as basis for decisions in specific situations. This information is not intended to create, and receipt of it does not constitute, a lawyer-client relationship.

From the Chair

By: Linda D. Barker
Trust Company of the West

Dear Fellow Corporate Counselors:

It was terrific to see so many of our fellow corporate counselors at our Annual Meeting at the end of May. The Bullock's Wilshire Building at Southwestern served as the perfect venue. We wish to thank our featured speaker, **California Controller John Chiang**, whose remarks were informative and well received, although quite sobering as he described the many economic challenges facing our State. Mr. Chiang gave all those present the helpful reminder to check the State Controller's website (http://www.sco.ca.gov/) for up-to-the-minute information on whether the State is holding unclaimed property for your company (or for you personally). A number of those in attendance at the Annual Meeting found that they had hundreds of dollars being held in their name just waiting to be claimed! A special thank you to **Elliot Shirwo**, **Steve Nissen** and the Marketing Committee for planning this outstanding event.

Retiringing Executive Committee Members: Roger Reynolds, Robert van Schoonenberg and Tim Glassett

On June 30, 2009, my term as Chair came to a close and the recently elected officers took their new positions. I know you will join me in supporting the Section's new chair, **Lynne Brickner** of Northrop Grumman Corporation; Vice Chair **Michael Cowan** of U.S. TelePacific Corp.; Secretary **Michael Russell** of AquaNano, LLC and Treasurer **Elliot Shirwo** of Bolour & Associates. I wish to thank all of these officers who have contributed greatly to the success of the Section's activities for many years and have been invaluable to me as Chair. I also want to take this opportunity to thank our Section Administrator, **Gail Coleman** and the Committee Chairs for their support during the most recent 2008/09 term:

Susan Reardon of KCET who chaired the Pro Bono Committee;
Randy Morrow of Sempra Energy who serves as Newsletter Chair
Carol Mauch Amir of USC who chaired the Legislation and Amicus Committee;
Michael Downer of Capital Research and Management Company who chaired the Roundtable together with **Alan Fox** of Westland Construction, Inc.;
Michael Cowan who chaired the OCCA Award Dinner;
Elliot Shirwo who chaired Membership and Marketing;
Bruce Carpenter of the Cooperative of American Physicians who chaired the Technology Committee;
Larry Michlovich of International Rectifier Corporation who chaired the Section's CLE

Lunch Programs; and

Roger Reynolds of Wells Fargo who served as our CLE Program Chair.

As I reflect back to when I first joined the Business and Corporations Section Executive Committee in the late 1980s and then the Corporate Law Departments Section in early 2000, I am reminded of the network of friends and role models that have enriched both my personal and professional life. It was this network of individuals who were a great help to me in the transition from private practice to in-house counsel. I encourage all Section members to step up and volunteer to get more involved in Section activities. If you are interested in becoming a member of the Executive Committee, please contact Gail Coleman at LACBA at gcoleman@lacba.org. As you can see from the long list of Committees, there are so many ways to get involved and to build your own network of fellow counselors.

Last month we held a dinner to honor three remarkable individuals and leaders in the corporate counsel community who retired from the Executive Committee after many years of service. **Robert van Schoonenberg**, former General Counsel of Avery Dennison, served on the Committee for 21 years and was Chair of the Committee during the 1993-94 term. Bob's leadership, mentoring and countless volunteer hours for the Section were also recognized when he was named the Section's 1997 Outstanding Corporate Counsel Award recipient. **Tim Glassett**, former General Counsel of Hilton Hotels Corporation, retired from the Committee after fourteen years of service and served as Chair during the 2001-02 term. In recent years, Tim served as the Section's Technology Chair and helped to advance the development of our Section's website. Our third retiree, **Roger Reynolds** of Wells Fargo, with 20 years of service on the Committee, served as Chair during the 1997-98 term. For many years Roger has also served as the Section's CLE Program Chair and as a leader and mentor in the Boy Scouts of America program. We wish to thank these gentlemen for their countless hours of service to the Executive Committee and look forward to seeing them at Section events for many years to come.

Ben Stein speaks at Outstanding Corporate Counsel Award Dinner

Charles Michaels
2009 Outstanding Corporate Counsel Award Recipient

Stay up to date with Section programs and activities by going to our website—www.lacba.org and clicking on "Calendar" or "Sections" for the latest news.

Thank you for your support of the Section and I look forward to seeing you at Section events.

With warmest regards,

Linda D. Barker

Linda Daves Barker
2008-09 Chair, Corporate Law Departments Section
Deputy General Counsel, Trust Company of the West
linda.barker@tcw.com

Calendar of Events

SAVE THE DATE

INSTITUTE FOR CORPORATE COUNSEL
December 3, 2009

OUTSTANDING CORPORATE COUNSEL AWARD DINNER
March 25, 2010

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Welcome New Members

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Edison International

Vincent Chan

David M. Krikorian
Bank of America