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Reasonable Best Efforts: Cold Comfort to Sellers

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On November 8, 2013, Vice Chancellor Sam Glasscock III of the Delaware Chancery Court issued a preliminary bench ruling in the matter of *Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., et al.*[1], refusing Cooper Tire's request that the Court require Apollo to use its reasonable best efforts to complete negotiations with Cooper Tire's union and immediately close the merger of Cooper Tire and Apollo. This case's colorful fact pattern has garnered significant attention. More significantly, it provides a rare Delaware court interpretation of the actions required to satisfy the "reasonable best efforts" standard that has become commonplace in antitrust covenants in merger agreements. While this standard is used frequently and is often the subject of bitter dispute in negotiations, lawyers are hard pressed to tell their clients what actions this standard requires. Sellers have sometimes relied on this standard, believing it to provide some closing certainty regarding regulatory and third-party approvals in transactions where specific divestiture commitments, reverse termination fees or other antitrust risk-shifting provisions have not been used. This appears unwise in light of *Cooper*: a reasonable best efforts standard alone provides cold comfort to sellers seeking deal certainty in circumstances where there is a meaningful likelihood that the antitrust authorities will require economic concessions in order to approve a transaction.[2]

Background: You Can't Make This Stuff Up

On June 12, 2013, Apollo Tyres ("Apollo"), an Indian company, agreed to acquire Cooper Tire & Rubber Co. ("Cooper") for $35 per share pursuant to a long-form merger valued at approximately $2.5 billion in the aggregate. Apollo was financing the transaction through, among other facilities, a $1.875 billion bridge to bond facility. Although the drop-dead date for the transaction was December 31, 2013, the closing of the transaction was anticipated

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to occur in early October 2013 and was not conditioned upon Apollo receiving its financing.

Within days of announcing the transaction, Che Hongzhi, the minority shareholder in Cooper's Chinese joint venture ("CCT"), which according to court testimony accounted for approximately 25% of Cooper's total enterprise revenue, began agitating against the merger. By the end of June, a letter protesting the merger had been circulated by the CCT labor union to Cooper employees globally and public protests, including labor strikes, were occurring at Cooper's manufacturing facilities in China. Over the course of the next few months, Mr. Che proceeded to cease manufacturing Cooper-branded products, stop making payments to certain suppliers, cease sending business and financial records to Cooper and physically deny Cooper appointed managers access to the CCT plant. Among other issues these events raised, the ongoing decrease in production and profitability of CCT forced Cooper to lower its third-quarter forecast multiple times between July and October. In addition to the debacle in China, the proposed merger faced opposition in the United States. Cooper's domestic union, the United Steelworkers ("USW"), filed grievances alleging that the merger had violated the union's collective bargaining agreements covering certain Cooper plants in the United States. Cooper and Apollo jointly agreed to arbitrate the grievances, a choice that had unexpected consequences. On September 13, 2013, the arbitrator determined that the merger could not occur until Cooper and the USW re-negotiated their collective bargaining agreements and Apollo approved the new agreements.

Receipt of the arbitration decision prompted Apollo and Cooper to meet in New York on September 17. At the meeting, the vice chairman of Apollo mentioned his dissatisfaction with Cooper's financial performance, the situation in China and the arbitration decision and hinted that the costs of these changed economics should come from the Cooper shareholders. Cooper responded by pushing for immediate resolution of the USW situation, believing that an agreement with the USW could be reached in a short period of time if all of the parties remained at the table, thus preserving an early October closing. Apollo agreed to begin negotiations immediately and also entered into a contract with Cooper and the USW pursuant to which the parties agreed that the arbitration award would be treated as if it were an injunction. This agreement, consistent with the arbitrator's order, effectively prevented Cooper from forcing Apollo to close the transaction until an agreement had been reached with the USW.

On September 19, 2013, Cooper, Apollo and the USW commenced negotiations. After the initial meetings, Apollo's representatives announced to Cooper and the USW that they were unable to continue the negotiations at that time and would need to reconvene at a later date. In addition to postponing the negotiation meetings, Apollo also halted all work on it financing. Prior to the arbitration decision, Apollo had been working closely with its financing sources and Cooper to prepare to market its debt. Pre-marketing meetings had been set up for the week of September 16, all of which were promptly cancelled after Apollo heard the results of the arbitration.

Throughout the month of September, Apollo and Cooper engaged in separate discussions with the USW. On September 25, at a meeting that Cooper was not invited to attend, Apollo made a counter proposal to the USW that was contingent upon a reduction in the merger consideration. No formal request for a price reduction was discussed with Cooper until September 28, a mere two days prior to Cooper's shareholders meeting. Not surprisingly, at the shareholders' meeting the transaction was approved on its original terms of $35 per share.

By October 1, it was clear that Cooper and Apollo had no agreement regarding when the transaction would close or at what price. During meetings held on October 1 with the USW, Apollo maintained its position that the cost of any agreement with the USW would be borne by the Cooper shareholders through a price reduction and that they expected the closing to be delayed. Cooper, in a final bid to close the transaction in early October, negotiated a separate agreement with the USW, one that was contingent upon the transaction closing without a price reduction. On October 4, 2013, Cooper filed suit in the Delaware Chancery Court, requesting that the Court order Apollo to use its reasonable best efforts to negotiate the new USW agreements and to complete the merger immediately.

In asking the Court to force a transaction to close prior to its termination date, Cooper highlighted its fears regarding Apollo's ability to comply with its obligations under the merger agree-

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ment. Apollo's negotiation timeline and its request to re-cut the transaction terms put Cooper in an extremely difficult position due to the events that were simultaneously occurring in China. Under the terms of the financing commitments and as a precondition for funding, Cooper was obligated to provide Apollo's lenders unaudited financial statements within 45 days of the end of each fiscal quarter. When Apollo requested the delay in negotiations with the USW, it raised the specter for Cooper of producing third quarter financial statements, which under the original transaction timetable would not have been required. Due to the physical seizure of the Cooper plant, Cooper would be unable to prepare its consolidated financial statements as it could not obtain the necessary business and financial records from CCT.

At the trial, Cooper tried to persuade the Court that Apollo's financing sources had suggested that Apollo use the situation with the USW to either delay the transaction until the situation in China was resolved, as it was hindering the marketing of the bonds, or until the termination date of December 31, 2013, thus giving the bankers and Apollo a way out of the transaction. In support of this argument, Cooper produced an e-mail from an Apollo banker who asked Apollo: "Hypothetically, what would prevent A[pollo] from taking a very difficult position with the USW and then watching the clock run out to the end of the year? In other words, does A[pollo] now have an out to the deal?" Cooper claimed in its pre-trial brief that delay is precisely what Apollo did—by not staying in Nashville until an agreement had been reached with the USW, by only making proposals to the USW that were contingent upon a price reduction, and by requesting the price reduction from Cooper only two days prior to Cooper's scheduled shareholder meeting. All of these actions, Cooper argued, showed a breach of Apollo's contractual obligation to use its "reasonable best efforts" to reach the required agreement with USW and, but for that breach, Cooper would not have been required to produce its third quarter financial statements, which it could not do.

Court's Analysis

Vice Chancellor Glasscock rejected Cooper's argument that Apollo had deliberately delayed its negotiations with the USW in an attempt to thwart the closing of a deal that Apollo and its financing sources no longer wanted and in breach of its "reasonable best efforts" obligations under the merger agreement. The Court seemed unimpressed by Cooper's argument that Apollo's behavior was reminiscent of the calculated bad behavior of the buyer in *Hexion*,[3] bluntly noting that Cooper had failed to demonstrate that Apollo had not met the reasonable best efforts standard contemplated by the merger agreement and that, in fact, Apollo had taken appropriate steps to satisfy its contractual obligations.[4]

Since the merger agreement did not explicitly contemplate obtaining the USW's consent, the Court made an initial determination as to which "reasonable best efforts" provision in the merger agreement applied. Cooper argued that Apollo was subject to the reasonable best efforts standard in a general efforts provision governing consummation of the transaction, which included obtaining regulatory clearance and other governmental approvals. This provision would also have required Apollo to act "in the most expeditious manner possible."[5] The Court was not swayed by Cooper's argument and found that the USW consent was governed by a separate covenant relating to third-party consents, waivers and approvals obtained in connection with contracts, and which required reasonable best efforts but omitted language requiring Apollo to be expeditious. Vice Chancellor Glasscock commented that this was not a dispositive issue, since he would have found that Apollo had both met the "reasonable best efforts" standard and had acted expeditiously.

Following Delaware precedent of treating a best efforts analysis as a fact intensive inquiry,[6] Vice Chancellor Glasscock clearly delineated the affirmative actions that Apollo had engaged in that showed it had used its "reasonable best efforts" to negotiate the agreements with the USW. The Court cited to the following facts: That instead of immediately appealing the arbitrator's decision, Apollo entered into an agreement with Cooper and the USW to treat the arbitration award as if it were an injunction and attempt to negotiate the new collective bargaining agreements. That Apollo's representatives, including the vice chairman, flew to Nashville to meet with Cooper and the USW promptly after hearing about the arbitration decision. That, when necessary to facilitate agreement with USW, Apollo hired experts within a reasonably prompt timeframe. That over the course of several weeks, Apollo representatives

met to negotiate with the USW several times. That Apollo relied on the advice of Cooper's lawyers on a number of negotiating points, and that Apollo's proposals to the USW incorporated almost all of the points Cooper recommended.

In addition to noting Apollo's affirmative actions, the Court also refuted Cooper's arguments that Apollo had taken actions designed to delay and frustrate the negotiations process. The Court was dismissive of Cooper's allegations that Apollo had acted in bad faith by not inviting Cooper's representatives to meetings with the USW. Vice Chancellor Glasscock stated that there was "no credible evidence" that Apollo intended to cause unreasonable delay in the negotiations or acted in bad faith simply because Cooper was excluded from certain meetings. The Court gave considerable weight to the fact that Apollo had given a valid business reason for excluding Cooper, namely the contentious business relationship and history between the USW and Cooper.

Vice Chancellor Glasscock also gave no credence to Cooper's contention that Apollo was delaying its negotiations based on the advice of its lenders. The Court noted that while there was "abundant evidence" that Apollo's lenders wanted Apollo to delay the negotiations and allow the merger agreement to expire, there was no evidence demonstrating that Apollo followed this advice. To the contrary, the Court felt that the evidence convincingly showed that Apollo wanted the transaction to close, just at a lower price.

The Court seemed particularly untroubled by the fact that Apollo had conditioned its proposals to the USW on a reduction in the merger price. The Court explained that even though Apollo had no right to attempt to renegotiate the merger consideration based on the necessity of reaching agreement with the USW, since the price reduction requests had been based on "a good faith but unavailing reading of the provisions of the merger agreement," conditioning the proposal on a lower price was not a contractual breach or an act of bad faith. In fact, Vice Chancellor Glasscock appears to chastise Cooper for complaining about the requested price reduction, observing that "Cooper would have a much stronger case if there were evidence that Apollo had not attempted to settle this deal with the USW in order to coerce concessions from Cooper."

Practical Implications of the *Cooper* Decision for Regulatory Efforts Covenants

While the *Cooper* decision did not establish a definitive criteria under Delaware law for the actions required to satisfy the "reasonable best efforts" standard, and Vice Chancellor Glasscock was at pains to emphasize the fact-specific nature of the inquiry, his bench ruling provides some important lessons for sellers and buyers in negotiating regulatory efforts covenants.

For buyers, *Cooper* suggests that so long as they make the effort to fulfill their contractual obligations within the transaction's timeframe, the "reasonable best efforts" standard will not require them to act against their good faith business judgment or make unprofitable decisions, absent explicit contractual provisions requiring them to do so. The *Cooper* decision also implies, however, that while a buyer need not suffer meaningful economic harm, it is not excused from the ordinary costs and expenses of complying with various regulatory reviews. Such costs may be considerable, particularly when such reviews entail a Hart-Scott- Rodino Second Request and EU Phase II review, or in the most contentious cases, litigation with government agencies.

For sellers, the *Cooper* decision is cold comfort indeed. In situations in which specific divestiture obligations cannot be successfully negotiated, sellers have sometimes agreed to a generalized "reasonable best efforts" covenant on the theory that contractual ambiguity about the scope of efforts required would typically work in favor of the seller (*i.e.*, that a buyer may be implicitly required to agree to certain concessions in order to obtain regulatory approval, even if not explicitly spelled out in the agreement). This may be unwise in light of *Cooper.* Sellers should not assume a generalized regulatory efforts obligation of the type found in Section 6.3 of the *Cooper* merger agreement will provide certainty of closing in the event that the regulators demand any meaningful economic concessions in order to approve a transaction.

Applying the logic of *Cooper*, as long as a buyer engages in the regulatory review process in good faith and does not violate any explicit requirements of the merger agreement, then the buyer will likely be found to have exercised its reasonable best efforts to obtain regulatory approval.

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Furthermore, it appears that a buyer would not need to make *any* divestitures or take other actions that might be demanded by a regulator if doing so would cause the buyer to suffer a "meaningful economic harm." Given that large, complex transactions may require antitrust approvals in a dozen or more different jurisdictions (any of which may demand some economic concession, justified or unjustified) a bare "reasonable best efforts" covenant therefore may expose the seller to significant completion risks. Similar to what apparently occurred in the *Cooper* case, any significant regulatory demands would give the buyer license to attempt to renegotiate the purchase price or to seek some economic contribution from the seller. Using regulatory demands as leverage to renegotiate important transaction terms will not be evidence of the buyer's bad faith.

The clear message to sellers is that a robust risk analysis should be undertaken for all potential regulatory approvals and other consents, not just the standard regulatory approvals, and that the transaction agreement should articulate as affirmative obligations what tangible and particular actions are expected to be part of a buyer's reasonable best efforts, such as making divestitures and bearing all costs associated with obtaining consents.

The gold-standard of covenants in this context is the so-called "hell or high water" (HOHW) provision, which requires that the buyer must do whatever it takes to obtain regulatory approval, including agreeing to make divestitures or take any other actions necessary for approval.[7] Many would suppose that such a provision secures absolute certainty of closing from a regulatory perspective.

However, the *Cooper* decision also implies that so long as divestiture commitments and other settlement offers are made in good faith to the authorities, if the antitrust authorities reject all legitimate settlement offers, a buyer will not be in breach of a HOHW provision; and absent an antitrust-specific reverse termination fee or other relevant risk-shifting provision, a buyer may terminate the transaction with no liability in the face of an intransigent agency. Although rare, there are cases where the buyer has offered to sell all or substantially all of the business to be acquired (or substantial portions of its own business in the alternative), and yet the agencies have still determined to challenge a transaction. This may happen, for example, because the agency finds that there is no package of assets that will be acceptable to the agencies or that there is no suitable buyer for the assets required to be divested.[8]

Because of the potential difficulty of crafting an order for specific performance of a specific divestiture commitment and to backstop the risk that despite complying with a HOHW divestiture commitment, the antitrust authorities nevertheless determine to reject all settlement offers and seek to enjoin a transaction, sellers in high risk transactions may also wish to negotiate significant termination fees in addition to divestiture commitments.

Obtaining such specific divestiture commitments or significant reverse breakup fees is not always an option: there may be practical reasons why specific divestiture commitments are not obtainable; a seller may also lack the bargaining power to insist on any significant antitrust risk-shifting. But the lesson from *Cooper* is clear: if a strategic buyer comes offering assurances of reasonable best efforts without any specifics, let the seller beware.

NOTES

1. *Post-Trial Oral Argument, Partial Post-Trial Bench Rulings of the Court, Oral Argument on Plaintiff/Counterclaim Defendant's Motion for Certification for Interlocutory Appeal, and Bench Rulings of the Court, Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., No. 8980-VCG* (Del. Ch. argued Nov. 8, 2013*).*
2. We note that the inferences drawn in this article are based on a preliminary bench ruling and may need to be re-evaluated in the event Vice Chancellor Glasscock issues a written opinion of this case.
3. *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.,* 965 A.2d 715 (Del. Ch. 2008). In *Hexion* the court found that the buyer breached its obligation to use its "reasonable best efforts" to consummate the transaction by failing to make any effort to meet its obligations and by taking specific actions designed to prevent the transaction from closing.
4. Cooper immediately filed for an interlocutory appeal, which was granted by Vice Chancellor Glasscock. On December 16, 2013, just three days prior to the date the appeal was to be heard, the Delaware Supreme Court dismissed Cooper's appeal. In a brief one-sentence decision, Justice Randy J. Holland stated that "the Court has concluded that this interlocutory

appeal was improvidently granted." *See Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd.*, 2013 Del. LEXIS 624.

5. *See* Section 6.3 of the Agreement and Plan of Merger, by and among Apollo (Mauritius) Holdings PVT. LTD., Apollo Tyres B.V., Apollo Acquisition Corp. and Cooper Tire & Rubber Company, dated as of June 12, 2013, *available at*: http://www.sec.gov/Archives/edgar/data/24491/000119312513256252/0001193125-13-256252-index.htm (Jan. 3, 2014).

6. *See Brown v. Buschman Co.,* 2002 U.S. Dist. LEXIS 4087, *5 (D. Del. 2002); *Liafail, Inc. v. Learning 2000*, 2002 U.S. Dist. LEXIS 22620, *8-9 (D. Del. 2002).

7. *See* Agreement and Plan of Merger among Optimer Pharmaceuticals, Inc., Cubist Pharmaceuticals, Inc. and PDRS Corporation (Form 8K Ex. 2.1) § 7.4(f)(iii)–(iv) (July 30, 2013) requiring the parties to agree to:

   (iv) the prompt taking of any and all actions (the sequencing of which shall lie in the reasonable discretion of Parent) necessary to avoid the entry of any permanent, preliminary or temporary injunction or other order, decree, decision, determination or judgment that would delay, restrain, prevent, enjoin or otherwise prohibit consummation of the Transactions, including the defense through litigation on the merits of any claim asserted in any court, agency or other proceeding by any person or entity, including any Governmental Entity, seeking to delay, restrain, prevent, enjoin or otherwise prohibit consummation of the Transactions and the proffer and agreement by Parent of its willingness to sell, lease, license or otherwise dispose of, or hold separate pending such disposition, and promptly to effect the sale, lease, license, disposal and holding separate of, any assets, rights, product lines, licenses, categories of assets or businesses or other operations, or interests therein, of the Company, Parent or any of their respective Subsidiaries (and the entry into agreements with, and submission to orders of, the relevant Government Antitrust Entity giving effect thereto) if such action should be necessary to (x) eliminate the actual issuance of any order, decree, decision, determination or judgment that would delay, prevent, enjoin or otherwise prohibit consummation of the Merger or the other Transactions by any Government Antitrust Entity or (y) cause the Closing to occur prior to April 30, 2014.

8. For example, in its 1997 challenge to the proposed Staples/Office Depot Merger, the FTC rejected Staples' offer to sell 63 stores to the third office supply superstore, OfficeMax, finding that the divestiture could not solve the competitive problems in markets where three competitors would be reduced to two and that the proposed divestiture could not solve potential competition concerns. *See* Press Release, Fed. Trade Comm'n, FTC Rejects Proposed Settlement in Staples/Office Depot Merger (Apr. 4, 1997) *available at* http://www.ftc.gov/news-events/press-releases/1997/04/ftc-rejects-proposed-settlement-staplesoffice-depot-merger. Other cases in which the DOJ appears to have determined that there was no settlement that could be offered that would resolve its competitive concerns include the proposed AT&T/T-Mobile transaction and the Nasdaq/NYSE transaction. *See* Press Release, Dep't of Justice, Justice Department Files Antitrust Lawsuit to Block AT&T's Acquisition of T-Mobile (Aug. 31, 2011), *available at* http://www.justice.gov/atr/public/press_releases/2011/274615.htm; Press Release, U.S. Dep't of Justice, NASDAQ OMX Group Inc. and IntercontinentalExchange Inc. Abandon Their Proposed Acquisition of NYSE Euronext after Justice Department Threatens Lawsuit (May 16, 2011), *available at* http://www.justice.gov/atr/public/press_releases/2011/271214.pdf.

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