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Change of Control — Words, and Creativity, Matter

The specific terms, words and structure of "change of control" and "anti-assignment" clauses in company agreements and the M&A documents that implicate them can go a long way toward facilitating the ultimate success of a future deal.

Much attention has been focused recently on the depressing impact on M&A activity of "change of control" and "anti-assignment" clauses (for ease of reference, referred to as "CoC provisions") in company agreements. In many cases, these contractual provisions are deemed insurmountable obstacles to achieving a deal. To take a recurring example in the current financing environment: if a potential target's outstanding debt instruments deem a change of control of the target an event of default or give rise to a put right in favor of the bondholders, the inability to keep this debt in place following a sale is often a deal-killer. Pricing and covenant terms that may have been achieved in the boom years of 2006-2008 are simply not replicable in today's post-bust lending situation, rendering the alternative of a refinancing unachievable.

A pair of recent court decisions emphasize two key points that dealmakers should keep in mind when approaching a CoC provision:

- Words Matter – The specific terms and words of the CoC provision (which vary widely in obvious and subtle ways), as well as the specific M&A transaction documents that implicate the CoC provision, often will be decisive of whether an M&A transaction will trigger, or alternatively successfully navigate through, a CoC provision.
- Structure Matters – While on first blush a potential transaction may appear unfeasible due to the impact of CoC provisions, careful structuring may facilitate the completion of such a transaction by working creatively within the specific words of the relevant CoC provision while achieving most, if not all, of the wider transaction goals.

In a recent decision in the U.S. District Court for the Southern District of New York, the court found that a set of strategic collaboration and financing agreements between Johnson & Johnson and Elan constituted a violation of the anti-assignment clause of the existing Tysabri collaboration arrangements between Elan and Biogen Idec. The court engaged in a detailed parsing of each word of the anti-assignment clauses in the Elan/Biogen agreements and the purported assignment of rights under the J&J/Elan agreements and concluded that Elan's attempt to allow J&J to exercise control over certain contingent rights in the Biogen relationship was an impermissible assignment of those rights. The court, having engaged in lengthy debate with counsel about each clause of the various contract terms, rejected Elan's argument that by remaining the nominal counterparty to those contingent rights it had avoided an assignment of those rights to J&J. The result of the court's decision was an almost immediate 12 percent reduction in the purchase price that J&J was willing to pay for its investment in Elan.

Separately, in a closely-watched bankruptcy court case involving Charter Communications, Judge James Peck announced that he would approve, over the objections of a pre-petition bank lending group, Charter's reorganization plan that included a creative post-emergence ownership structure. The bank lenders argued, among other things, that if Paul Allen did not retain economic and voting power over Charter, the CoC default provisions in the loan documents would be triggered. However, the judge approved the reorganization plan that sought to avoid such a change of control by bifurcating voting and economic rights, and leaving Allen with more than 35 percent voting power while reducing his economic stake to approximately three percent. Because the CoC provision in the credit agreements specifically and exclusively referred to voting power of Charter, this structure enabled Charter to reinstate the bank debt on its current terms while shifting actual ownership to its pre-petition bondholders who had agreed to convert their bond debt into equity.

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Any review of CoC provisions in the context of a proposed M&A transaction is highly fact-specific. The structure and terms of the proposed deal, as well as the specific words of the relevant CoC provision, will determine whether the parties to the transaction can avoid triggering the CoC provision. Structural work-arounds, as we have seen in the Charter deal and the Merck/Schering Plough merger (where an inverse merger structure is proposed to avoid triggering a change of control of Schering-Plough under a distribution agreement with J&J), are possible if creatively deployed. Such work-arounds have potential value even if their success is less than 100% certain—the mere potential of using such a structure may be sufficient to create negotiating leverage to achieve a more tolerable outcome with a counterparty seeking to enforce a CoC provision.

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