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“Exclusivity” — Not As Preclusive As It Sounds?

A recent appellate decision applied a surprisingly narrow reading of a broad exclusivity provision, offering a cautionary note on the drafting of such terms.

During the course of early-stage negotiations, exclusivity provisions are often used to protect the time and economic investment being made in the potential transaction by ensuring that the counterparty deals only with the named party for a stated period. In a [recent appellate decision](#) in the First Circuit, the court applied a surprisingly narrow reading of the scope of what appeared to be a very broad exclusivity provision, offering a cautionary note to dealmakers as they draft such terms.

Gemini, a private equity firm, signed a preliminary outline of terms to finance the acquisition by AmeriPark of a competitor (Mile Hi). While the rest of the term sheet was expressly non-binding, the paragraphs entitled “Exclusivity” and “Confidentiality” were agreed to be binding. The exclusivity provision, which was coterminous with the separate exclusivity arrangement between Mile Hi and AmeriPark, stated, in relevant part, that AmeriPark “agrees not to discuss this opportunity or reach any agreement with any person or entity regarding financing for this Transaction or the pursuit of any sale or major other financing”. During the exclusivity period, AmeriPark abandoned its discussions with Gemini and instead held talks with a large AmeriPark shareholder (Greenfield) and then the sole shareholder of Mile Hi about financing the acquisition, eventually completing the acquisition using the seller financing.

Gemini sued AmeriPark for breach of the exclusivity provision and lost in a jury trial in Federal court. One of the issues on appeal was the trial judge’s failure to instruct the jury that the phrase “any person or entity” in the exclusivity provision was unambiguous and therefore clearly covered the other parties with whom financing was discussed by AmeriPark. On appeal, the court found no fault with the jury instruction regarding the potential ambiguity of the seemingly broad phrase. The court noted that an exception to the “Confidentiality” section (the other binding term) contemplated that the transaction could be discussed with “those in a confidential relationship with [AmeriPark]”, suggesting that there was ambiguity as to who was covered by the “any person or entity” phrase in the exclusivity provision. Moreover, because the proposed Gemini financing outline included funds to redeem the Greenfield stake in AmeriPark, the court assumed that discussions with Greenfield about the Gemini financing would be necessary.

The procedural nature of this decision, an appellate review of jury instructions, by necessity limited the scope of the court’s exploration of this issue. However, one can certainly wonder why the fact that the outline naturally contemplated discussions with others about the deal (which is true of any letter of intent, term sheet or similar document) was read to necessarily imply that such persons were excluded from the ambit of the exclusivity provision as to the provider of the financing. If this logic is extended, a private equity sponsor obtaining a broadly-worded exclusivity at the end of an auction nevertheless would be exposed to being displaced, during the exclusivity period, by a management buyout or a transaction led by a significant target shareholder. Equally, a lender which bargains for exclusivity to finance an acquisition would be at risk of being dislodged by the target’s or buyer’s existing lender whose consent may be required.

Exclusivity provisions serve an important role in dealmaking. By offering a favored position for a limited period, it often serves as the (only) incentive for a party to invest the time and money necessary to translate preliminary handshakes into definitive terms. This recent decision suggests that rather than following the habitual instinct of favoring broadly-crafted words that on their face would seem to cover all parties, in certain cases the beneficiaries of such terms might be better-served by expressly and specifically addressing persons of concern.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

David Fox
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
<http://www.kirkland.com/dfox>
+1 212-446-4994

Daniel E. Wolf
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
<http://www.kirkland.com/dwolf>
+1 212-446-4884

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