Del. Dispatch: Lessons From Failed ETE-Williams Merger

By **Gail Weinstein, Steven Epstein and Phillip Richter** (October 27, 2023)



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In Energy Transfer LP v. The Williams Companies Inc., the Delaware Supreme Court, sitting en banc, on Oct. 10 unanimously affirmed the Delaware Court of Chancery's previous holdings in various decisions issued in the case — ending 7½ years of litigation between the parties over a terminated $38 billion merger pursuant to which Energy Transfer, or ETE, was to have acquired Williams.

In this recent and final decision in the case, the Supreme Court affirmed that ETE — which had validly terminated the parties' merger agreement due to the failure of a closing condition — (1) was not entitled to payment of the $1.48 billion termination fee that the merger agreement provided for under certain circumstances, and (2) must pay Williams more than $600 million under certain other merger agreement provisions related to the deal termination.

Key Points

Significant Monetary Consequences of Merger Terminations

The case highlights that, in addition to payment of a termination fee or reverse termination fee, a merger agreement may provide for other significant deal termination-related fees.

The Supreme Court observed, "Although failed mergers are not uncommon, a failed merger without consequence is virtually unheard of. Indeed, these collapses typically generate significant — typically, monetary — consequences."

No Change of Board Recommendation

The Supreme Court affirmed that Williams' public negative statements about ETE and the merger did not constitute a change in the Williams board's recommendation of the merger.

The Supreme Court interpreted the language of the merger agreement requiring the Williams board to adopt four specific resolutions in connection with recommending the merger as themselves comprising the recommendation. As those resolutions were adopted, and not formally withdrawn or changed, there was no change in the recommendation.

Moreover, and we would think importantly, the board had repeatedly publicly reaffirmed its commitment to the deal and had taken affirmative steps to try to ensure that the closing occurred.

Drafting and Factual Context Matter

Both the Court of Chancery and the Supreme Court focused on the precise wording of the merger agreement in reaching their decisions. At the same time, though, the Supreme Court emphasized throughout its opinion that Williams had consistently and repeatedly

recommended the merger, the Williams shareholders had approved the merger by a wide margin, and Williams had taken affirmative steps toward closing, including suing ETE for specific performance of the merger agreement — all of which contradicted ETE's main thesis that Williams had engaged in a clandestine effort to thwart the merger.

In addition, both courts were critical of ETE's actions in connection with the failure to deliver a tax opinion (the receipt of which was a condition to closing), the proposed public offering and the preferred offering, each described below.

Background

The Planned Merger

The parties entered into the merger agreement in September 2015. Thereafter, there was a major energy market downturn, and some dissent developed internally at Williams about the deal.

Nonetheless, Williams' bankers advised that the merger would still be a boon for Williams' shareholders, and the Williams board repeatedly recommended that the shareholders approve it — which they ultimately did, with 80% of the shares voting in favor.

In June 2016, ETE decided to terminate the deal after its law firm determined that it could not deliver on the tax opinion closing condition.

Williams had sued for specific performance of the merger agreement. The Court of Chancery, in a 2016 decision, was critical of ETE's actions in connection with the failed condition, but found that the law firm had made its determinations in good faith and independent of ETE, and therefore held that ETE was entitled to terminate the merger agreement. That decision was later affirmed by a split Supreme Court.

ETE's Offering of Preferred Units

Pending closing of the merger agreement, ETE, responding to a liquidity crunch, had requested that Williams consent to a public offering of a new class of ETE preferred units — the proposed public offering.

Williams' bankers advised that the offering would have an "extraordinary detrimental impact" on Williams' shareholders. Williams offered to consent if ETE agreed to permit Williams' shareholders to participate.

When ETE would not agree, Williams refused to consent. Without notifying Williams, ETE then effected a nearly $1 billion private offering of a new class of preferred units — the preferred offering — which did not require Williams' consent, as it was a private placement.

The preferred offering operated similarly to the proposed public offering, but provided for even greater preferences and was offered to just a small group of ETE insiders. In separate litigation brought by ETE's common unitholders, the Court of Chancery held, in a 2018 decision, that the preferred offering violated ETE's LLC agreement.

WPZ Reimbursement and Attorney Fees Reimbursement

In order to be able to enter into the merger agreement, Williams terminated an agreement with its master limited partnership — Williams Partners LP, or WPZ — pursuant to which

Williams had agreed to acquire the MLP's public units.

The merger agreement provided that, if the merger agreement were terminated, Williams would be entitled to reimbursement for the $410 million termination fee it paid under the WPZ agreement when that agreement was terminated, so long as at the time of termination of the merger agreement ETE was in breach of certain provisions and Williams was not in breach of certain provisions — the WPZ reimbursement.

Also, the merger agreement provided that, if ETE did not promptly pay the WPZ reimbursement, and Williams was the prevailing party in a lawsuit to enforce payment, Williams was entitled to reimbursement of its reasonable attorney fees — plus interest, and costs and expenses — incurred in connection with that lawsuit.

When the merger agreement was terminated, Williams sought, but ETE refused to pay, the WPZ reimbursement and the attorney fees reimbursement. In post-trial decisions issued in 2021 and 2022, the Court of Chancery ordered ETE to pay those reimbursements, plus interest — which amounted to $601.5 million at that time, including a 15% contingency fee, equaling $85.4 million, that Williams paid to its counsel.

The Supreme Court's Holdings

In this recent and final decision in the case, the Supreme Court, in an opinion written by Justice Christopher Griffiths, affirmed the Court of Chancery's holdings in prior decisions that (1) Williams' negative public statements did not constitute a withdrawal or change of the Williams board's recommendation of the merger, and that therefore ETE is not entitled to the $1.48 billion termination fee; and (2) ETE's preferred offering constituted a breach of the merger agreement, while Williams was not in breach, and that therefore Williams is entitled to the WPZ reimbursement and the attorney fees reimbursement.

Discussion

Negative public statements did not constitute a change in the board's recommendation.

The merger agreement required that the Williams board adopt four specific resolutions recommending the merger, and provided that a withdrawal or adverse change of the recommendation would trigger the payment of a $1.84 billion termination fee to ETE. ETE argued that Williams' negative public statements about ETE and the merger — in press releases, court filings and Williams' Form S-4 — constituted a change in the recommendation.

The Supreme Court, affirming the Court of Chancery's finding that the board had not withdrawn or changed its recommendation, wrote, "There is no language [in the merger agreement] that would suggest the Company Board Recommendation is meant to be an expansive term or include anything other than the resolutions."

Therefore, as the required resolutions were adopted, and there was no allegation that they had been formally withdrawn or changed, the recommendation had not been withdrawn or changed. The Supreme Court noted, moreover, that Williams' negative public statements had included reaffirmations by the board that it was committed to completing the merger.

Further, the Supreme Court stressed that Williams had reaffirmed its recommendation throughout the interim period, Williams' shareholders had approved the merger by a wide

margin, and Williams had taken affirmative steps to try to ensure a closing, including by suing ETE for specific performance of the merger agreement.

Williams' CEO's interactions with a shareholder who was challenging the merger did not breach Williams' efforts obligations.

ETE claimed that regular communications between Williams' CEO and a shareholder who eventually sued to enjoin the merger evidenced a breach by Williams of its obligations to use reasonable best efforts to consummate the merger and "to contest and resist any such litigation" challenging the merger.

The Supreme Court affirmed the Court of Chancery's finding, based on the CEO's and the shareholder's testimony, that these communications actually involved an effort by the CEO to try to assuage the shareholder's concerns, and that the reason the CEO had disclosed the communications only to the board chair and not more broadly was not to hide anything but to try to avoid further escalation of the situation.

The Supreme Court affirmed, in addition, that no negative inference had to be drawn from the fact that the shareholder had engaged in — and was sanctioned by the Court of Chancery for — spoliation of evidence by deleting the email account through which he had communicated with the CEO.

Williams' refusal to consent to the proposed public offering did not breach the financing cooperation covenant.

The financing cooperation covenant contained a reasonableness qualifier. The Court of Chancery concluded that ETE's request for consent to the proposed public offering was "unreasonable given the unfair impact of the offering on Williams' shareholders."

The Supreme Court affirmed, rejecting ETE's argument that the reasonableness qualifier referred only to the efforts that would be required of Williams in response to the request — i.e., that "if the 'requested cooperation [is] de minimis' in terms of the effort required, the duty to cooperate is absolute."

That reading "would lead to an absurd outcome," the Supreme Court wrote, "namely, that Williams could be forced to engage in conduct that would potentially be damaging to the company or its shareholders."

ETE's preferred offering breached the merger agreement.

The Supreme Court affirmed that the preferred offering breached ETE's (1) covenant to operate in the ordinary course of business because, as the Court of Chancery had determined in separate litigation brought by the ETE common unitholders, the offering breached ETE's own LLC agreement; (2) interim operating covenants, which limited ETE's equity issuances; and (3) capitalization representation, which stated that ETE's capital structure consisted of just three classes of equity.

The Supreme Court rejected ETE's argument that any breaches were "concededly immaterial as Williams was willing to waive them in order to close the transaction." The Supreme Court affirmed that these breaches "were sufficient for the court to find that the [WPZ reimbursement] was triggered."

Fee-shifting provision was enforceable, even as to a contingent attorney fee.

ETE argued that Williams was not entitled to the attorney fee reimbursement because, as contractual fee-shifting provisions have been applied only to hours-based fees, the provision should be interpreted to apply only to such fees and not a contingent fee.

Further, ETE stressed that when the provision was agreed upon, Williams' arrangement with its legal counsel was hours-based and Williams only later agreed with its counsel to change to a contingent fee, which amounted to $85.4 million.

The Supreme Court affirmed that the merger agreement required only that the attorney fee was reasonable, and it deferred to the lower court's conclusion that a 15% contingency fee was reasonable.

Practice Points

Consider carefully the parties' respective rights on termination of the merger.

In addition to termination and reverse termination fees, depending on the facts and circumstances and the parties' respective negotiating leverage, a party may wish to consider seeking reimbursement for significant costs it may have incurred in connection with entering into the merger agreement — for example, a termination fee paid to exit an agreement to enable entry into the merger agreement, and/or for significant costs that it expects it will or may incur during the interim period. This includes costs associated with seeking major approvals, costs associated with the loss of major customers and so on.

These determinations should be made by legal counsel together with the key business people who understand the details and nuances of the specific industry, business and company.

Clarify what constitutes a change in the board's recommendation.

A target may seek to have the merger agreement explicitly provide that only the adoption of a formal board resolution withdrawing or changing the board's resolutions recommending the merger will constitute a change in the recommendation.

Conversely, a buyer may wish to state that any negative public statements by the board or the company about the target or the deal — other than those complying with the conditions set forth in the safe harbor provision for company disclosures, and/or those accompanied by an express reaffirmation of the board's recommendation — will be deemed to constitute a change in the recommendation.

Address deal uncertainty.

Deal uncertainty increases when, as in this case, there are volatile industry or market conditions that could result in significant changes in value and/or novel aspects to the transaction structure, and thus less clear authority on potential issues, permitting colorable issues to arise. It also increases when, as in this case, a closing condition may to some extent be within the control of the other party, such as its receipt of a tax or other legal opinion from its own counsel.

Where there is a higher potential than usual that issues may arise with respect to satisfaction of an opinion condition — and, particularly, where the condition is based on the issuance of the opinion by a party's own counsel, or where the standard of certainty for the

opinion is high — the other party should consider seeking to negotiate for a meaningful reverse termination fee to be payable in the event that the condition is not satisfied.

Also, parties seeking to maximize deal certainty could consider including precatory language in the merger agreement that expresses their strong commitment to closing and requests that, in the event of a future dispute, a court interpret the merger agreement provisions to favor respecting the parties' intent that the transaction close. Such language, underscoring the parties' intentions, should influence a court's interpretation of the agreement provisions.

Other Drafting Reminders From ETE-Williams:

Agreement Provision Interactions

Drafters must pay special attention to the interaction of various sections of a merger agreement, so that the parties' intentions are properly and clearly reflected. Drafters should be aware of the common trouble spots in merger agreements with respect to the interaction of provisions.

In ETE-Williams, the Supreme Court stated that the Court of Chancery correctly observed that ETE had misunderstood the interaction of the provisions relating to the board recommendation, the fiduciary out and the safe harbor for company statements.

Simple or Compounded Interest

Where interest is provided for, the agreement should specify whether it is to be compounded or simple interest.

In ETE-Williams, where the provision was silent on this matter, the Court of Chancery decided, and the Supreme Court affirmed, that the interest should be paid on a compounded basis — as the parties were sophisticated and "dealt in compound interest in their day-to-day operations."

Ordinary Course Covenant

Extraordinary events of various types actually occur fairly commonly, and the parties' incentives may be skewed in certain respects with respect to providing consent for actions outside the ordinary course.

Careful consideration should be given to the types of events that may arise in the interim period, the types of responses that may be needed that could be outside the ordinary course and what parameters should be imposed for consents.

Headings

Drafters should clarify whether an exception to the ordinary course or interim operating covenants — which is listed on a schedule or a disclosure letter under a heading referencing a section of the merger agreement — applies only to that section or also to all or some other sections to which it may be relevant.

In ETE-Williams, the court found the merger agreement was ambiguous on this issue with respect to an exception for "Offerings Less Than $1 Billion." The court considered extrinsic evidence and determined that the exception did not apply to the preferred offering — and, therefore, that the preferred offering breached the merger agreement.

Fee-Shifting

Drafters should consider being explicit as to whether a fee-shifting provision would or would not be enforceable in the event of a contingency fee rather than an hours-based fee.

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This article is part of a monthly column that delves into the most significant corporate law cases emerging from Delaware and offers practice points arising from recent court decisions.

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