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# NEWS & INSIGHTS

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### **Is There Such a Thing as a Forthright Negotiator? The Case of *United Rentals v. Ram Holdings*.**

ARTICLE

MERGERS AND ACQUISITIONS NEWSLETTER

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How will a Delaware court reconcile a merger agreement that, on the one hand, provides that the seller's "sole and exclusive" remedy if the buyer walks away from the acquisition is a "reverse" termination fee, and, on the other hand, also entitles the seller to seek specific performance?

In *United Rentals Inc. v Ram Holdings, Inc.*, Case No. 3360-CC, Dec. 21, 2007, the Delaware Chancery Court denied the seller's demand for specific performance of a merger agreement, which is a court order compelling the parties to complete the merger, and allowed the buyer to walk away from the acquisition upon payment of a reverse break-up fee. But the case was a very close call, and it provides a cautionary tale for M&A lawyers.

#### **"Forthright Negotiator Principle" Is Rarely Invoked**

In allowing the buyer to walk away from the deal, the court dusted off the rarely invoked "forthright negotiator principle" to resolve the contractual ambiguity created by the existence of both the reverse termination fee provision and the specific performance provision. According to the Court, the forthright negotiator's principle provides that "where the extrinsic evidence does not lead to a single, commonly held understanding of an ambiguous contract's meaning, a court may consider the subjective understanding of one party that has been objectively manifested and is known or should be known by the other party." **In other words, beware:** What your adversary tells you about his understanding of an ambiguous contract term may turn out to be determinative if you don't clearly express your disagreement to him.

But, what happens if you decide not to speak up because you think that your adversary's interpretation is wrong, and you perceive an advantage in not pointing out the incorrect interpretation to him during negotiations? At least in Delaware, it's now pretty clear that your silence is likely to be viewed as a form

of gamesmanship that **may be held against your client.**

In 2007, United Rentals, Inc. (URI) offered itself for sale through a draft merger agreement that was sent to a number of parties. Because URI wanted “deal certainty,” the draft included a provision entitling URI to specific performance. In response to URI’s offer, entities affiliated with a private equity fund, Cerberus Partners, L.P., made what appeared to be the best bid of approximately \$7 billion and the parties moved forward to negotiate the other terms of the merger agreement.

### **Deal Included Hotly Negotiated Reverse Break-up Fee Provision**

While URI insisted on deal certainty, Cerberus insisted on retaining the ability to walk away from the deal by paying a reverse break-up fee. This issue was hotly negotiated by the parties and their respective counsel. Reflecting the difficulty of the negotiations, the final merger agreement included both a specific performance provision entitling either party to force the completion of the merger and a reverse break-up fee provision providing the seller with the right to walk away from the deal if it paid the buyer \$100 million. The reverse break-up fee provision stated that it was the “sole and exclusive” remedy in the event of a termination of the merger agreement. Confusingly, the specific performance provision stated that it was “subject to” the reverse break-up fee provision and also stated that the reverse break-up fee provision would apply “notwithstanding” anything to the contrary in the merger agreement. But, as it turned out, the “subject to” and “notwithstanding” provisions were far less certain than they may have seemed at first.

### **Buyer’s Remorse**

Sure enough, as the credit markets tightened during the summer of 2007, Cerberus experienced buyer’s remorse. In November 2007, approximately four months after the merger agreement was signed, Cerberus notified URI that it would not proceed with the acquisition of URI on the terms stated in the merger agreement but would be prepared to enter into discussions with URI about revised terms, including a lower purchase price. Cerberus’s notification was reported in the media that same day, and URI’s shares fell by more than 30 percent. URI’s stock was the NYSE’s largest decliner of the day.

### **Termination or Breach?**

URI rejected Cerberus’ offer to renegotiate and instead commenced a lawsuit seeking specific performance of the merger agreement. URI acknowledged that its right to specific performance was “subject to” the reverse break-up fee provision. However, URI argued that the reverse break-up fee provision only applied in the event of an actual “termination” of the merger agreement, which had not occurred, but that it did not come into play if Cerberus breached the agreement, which URI believed had occurred. URI also argued that, under principles of contract interpretation, the merger agreement should be read to harmonize seemingly conflicting provisions so as not to render one provision--the specific performance provision--mere surplusage. Cerberus, on the other hand, argued that the specific performance remedy was intended to be “subject to” the reverse break-up fee and that the reverse break-up fee was intended to be URI’s sole remedy in the event of either a termination of the agreement or a breach of the agreement.

The court found both URI’s interpretation and Cerberus’s interpretation of the merger agreement to be reasonable. Because both parties’ interpretations were reasonable, the court determined that the merger agreement was ambiguous. As noted by the court, it “is unlikely that a single, unambiguous contract can

simultaneously affirm and deny the availability of a specific performance remedy.” Although the court held that “subject to” and “notwithstanding” provisions could reasonably be used to negate other inconsistent contractual terms, it clearly did not give those provisions the full force and preclusive effect that Cerberus expected them to have.

The court then turned to the extrinsic evidence, the negotiation and drafting history of the merger agreement, to identify the parties’ “shared” intent. That intent, however, defied identification from the extrinsic evidence. Indeed, the court found that the extrinsic evidence, taken alone, did not “lead to an obvious, objectively reasonable conclusion.” Put simply, the court found itself in an interesting situation because it identified two reasonable, but diametrically opposed, interpretations of the merger agreement and a history of negotiating and drafting that failed to shed light on the shared intent of the two parties. The court was faced with the question of what to do.

### **URI “Should Have Known”**

In this case, the court ultimately relied on an interesting though obscure principle of contract interpretation called the “forthright negotiator principle.” The forthright negotiator principle provides that, in cases where the extrinsic evidence does not lead to a single, commonly held understanding of a contract’s meaning, a court may consider the subjective understanding of one party that has been objectively manifested and is known or should be known by the other party. The court believed that “the evidence in this case shows that [Cerberus] understood this Agreement to preclude the remedy of specific performance and that [URI] knew or should have known of this understanding.”

According to the court, even if URI believed that the merger agreement preserved a right of specific performance, URI’s attorney “categorically failed to communicate that understanding to [Cerberus] during the latter part of the negotiations” when the issue was vigorously debated. On the other hand, the court found that the attorney representing Cerberus did clearly communicate to URI his understanding that the merger agreement precluded specific performance rights, despite the ambiguous drafting. As stated by the court “even if URI understood the Agreement to provide a specific performance remedy, Cerberus did not know and had no reason to know this understanding.” And “if URI disagreed with that understanding [of Cerberus], it had an affirmative duty to clarify its position in the face of an ambiguous contract with glaringly conflicting provisions.”

Because the court believed that URI knew or should have known that Cerberus understood the merger agreement to preclude the remedy of specific performance, the court found in favor of Cerberus. In other words, in order to be a forthright negotiator, URI’s attorney was obligated to “correct” his adversary’s view of the contract language during negotiations, rather than exploiting that (mis)understanding tactically.

### **Will This Principle Have Broader Effects?**

URI decided not to appeal the Chancery Court’s opinion, which now stands as the last word on the case. The URI decision has already generated a good deal of legal commentary and is likely to become a core decision on contract interpretation under Delaware law. The court clearly did not approve of URI’s decision to reveal its interpretation of the merger agreement on Cerberus in a litigation setting, and the wording of the decision implies a strong preference for parties to work out their differences at the negotiating table, not at the courthouse. Nevertheless, it will be interesting to see if the heretofore little known and rarely invoked “forthright negotiator principle” attracts interest outside of Delaware.