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## The Lessons of Clear Channel

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It was November 2006 and the terms of the commitment letter signed by the banks financing the \$22 billion acquisition of Clear Channel Communications by Bain Capital Partners LLC and Thomas H. Lee Partners LP ("the sponsors") were market for late 2006.<sup>[FOOTNOTE 1]</sup> But it was now early 2008, and the markets had changed dramatically. The banks financing the deal claimed they would have to take a \$2.6 billion mark-to-market loss if they were to complete the financing.

So when negotiation of the financing documents stalled in late March 2008, the sponsors filed suit in both New York and Texas,<sup>[FOOTNOTE 2]</sup> claiming that to get out of the deal, the banks negotiated in bad faith, adding provisions that were contrary to the parties' understanding in the months before closing and proposing limitations that would require refinancing within three years. The banks denied this and maintained that they were willing to continue to negotiate in good faith in accordance with the terms of the commitment letter. They admitted to hard bargaining but not bad faith negotiating.

In late May, the parties announced that the acquisition had been funded in escrow, but a close look at the arguments that were made in the pleadings is instructive in understanding (i) how specific performance can be a valid claim under a contract to lend and (ii) how open terms in a commitment letter can be a real liability.

### TERMS OF THE COMMITMENT LETTER

Under the terms of the commitment letter, the banks were fully committed to fund, with minimal conditions. There was no "syndication out" or "change-in-market conditions out," notwithstanding the fact that the parties expected the closing of the acquisition and its financing to take place more than 12 months after the commitment letter was executed.

As for documentation and the terms to be negotiated, the commitment letter provided that the final loan agreements contain the terms set forth on attached term sheets, and if any terms were not agreed to, the parties were to look to the existing sponsors' loan agreements, called "Sponsors Precedent."

### THINGS TURN SOUR

Within a month of signing the amended commitment letter in May 2007, market conditions were starting to deteriorate. According to the sponsors' response to the banks' motion for summary judgment in the New York action, as early as August 2007, an internal email from the banks indicated that they were working on a "plan of action for restructuring

the financing." The sponsors claimed that in September 2007, Citibank threatened not to commit to fund a separate deal with the sponsors if it did not get concessions on Clear Channel. Then, the sponsors claimed, the banks stalled and did not deliver documentation until late November 2007. In December 2007, at a meeting of the parties, the banks (characterized by the sponsors as attending with "hat in hand") proposed to renegotiate the terms of the commitment letter, explaining that their mark-to-market losses made the transaction untenable. The sponsors rejected the banks' request.

Subsequently, in early February 2008, the banks delivered a draft credit agreement. The parties agreed to schedule the closing for March 27, which coincided with the end of the syndication marketing period. According to the banks, on March 25, counsel for the sponsors promised documents reflecting compromises by the sponsors in form for execution. The following day the sponsors delivered drafts with a list of open items. That same day, the sponsors filed suit in New York and Texas alleging that the banks' unreasonable negotiating positions were nothing but a thinly veiled effort to "run out the clock" on the commitment letter.

### SPONSORS' COMPLAINT

In their March 26 complaint in the New York action, the sponsors claimed fraud, breach of contract, unfair trade practices and civil conspiracy under Massachusetts law and sought specific performance. In support of their claims, the sponsors argued that in the loan documentation, the banks limited the ability of Clear Channel to repay its existing notes in 2011 and required the refinancing of intercompany debt by 2010. These two provisions, the sponsors argued, would force an equity infusion or refinancing within three years.

### THE BANKS' RESPONSE

On April 10, the banks filed a motion for summary judgment in New York, claiming, among other things, that the sponsors' breach of contract claim was premature because the termination date under the commitment letter was June 12, 2008. The banks contended that they continued to negotiate in good faith until the date the sponsors filed suit; further, they denied that their negotiating positions were ever inconsistent with the commitment letter. The banks characterized their position as "tough," rather than a breach of the implied covenant of good faith and fair dealing.



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The banks also argued against specific performance on the basis that it was not an available remedy to the sponsors. Under New York law, specific performance is generally not available for breach of a contract to loan money because money is fungible and the aggrieved party should always be able to seek alternative financing in the marketplace.

The banks also argued that in the credit agreement there remained approximately 40 open business items, 25 open baskets, ratios or exceptions to negative covenants with differences ranging from \$50 million to \$750 million, and a dispute over the calculation of the 30 percent cushion in the leverage ratio covenant. A similarly long list of items was alleged to be unsettled with respect to the description of notes. Accordingly, with so many open items, enforcing specific performance would be impractical.

So what happened here? Clear Channel's performance was strong in 2007 and revenue and EBITDA exceeded projections. But after the closing of the financing, the average interest rate of the facilities would be approximately 5 percent, with an interest coverage ratio of 2 to 1 and excess cash flow of \$500 million a year.<sup>[FOOTNOTE 3]</sup> The banks had agreed to terms in the commitment letter that were no longer financially attractive. They had no market conditions out or syndications out (unsold leverage buyout syndicated debt was estimated to be \$130 billion in late March), and they stood to suffer a substantial loss immediately on closing. As a result, the banks asked to renegotiate, stalled and then when they had to come to the table, they negotiated hard. Does that give rise to a claim for fraud, breach of contract and bad faith?

#### WHERE THINGS STAND NOW

On May 7, the New York court denied the heart of the banks' motion for summary judgment. Although it dismissed the fraud, civil conspiracy and unfair practices claims, the court allowed the sponsors' breach of contract and specific performance claims to proceed to trial -- holding that whether the banks' actions during negotiations constituted an anticipatory repudiation of the commitment letter or whether Clear Channel was a sufficiently unique asset to merit specific performance of the commitment letter were questions of fact that could not be resolved on the banks' motion. The fact that the door to specific performance was left open by the court means that the terms agreed to in the commitment letter together with Sponsors Precedent could have been sufficient to merit enforcement. A few days later, on May 12, rumors of settlement talks were confirmed. The purchase price was reduced from \$39.20 to \$36.00 per share, resulting in an aggregate purchase price of \$17.9 billion, down from \$22 billion. The purchase price would be funded in escrow and the interest rate increased. As of the date of writing of this article, the fate of the open terms is unknown.

#### LESSONS LEARNED

**Open Terms:** If the parties had been negotiating the terms of the documentation on June 12 as they were on March 25, the commitment letter would have been terminated, and, assuming good faith negotiations throughout (which was in question here), the sponsors would not have had a claim for breach, now or ever. Whether one party's tough negotiation stance gives rise to a contract or tort claim is often a question of fact that could require a trial to resolve. But to avoid all of this, document the terms in the commitment letter as much as possible, even where referencing existing agreements among the parties. Note that in the United Kingdom common practice is to have the transaction fully documented upon signing the commitment papers. Query whether market practice will move in that direction in the future.

**Specific Performance and Damages:** The sponsors sought specific performance on the basis that, with the significant change in the credit markets and the unique nature of the transaction -- one of the largest acquisitions in history -- they could not obtain equivalent financing from new lenders. The New York court agreed that Clear Channel might be

sufficiently unique to merit an order of specific performance in favor of the sponsors, but the court's opinion also noted that (i) specific performance is not an ordinary remedy for breach of a contract to lend money; (ii) there are only "very few" exceptions to this well-settled rule; and (iii) the sponsors' own expert admitted that it would likely not be impossible for his clients to obtain alternative financing -- though it would be on far less favorable terms. The takeaway here for borrowers is, if you want specific performance rights, negotiate for them.

If specific performance had not been granted, monetary damages would have been considered. In their motion for summary judgment, the banks claimed that the commitment letter excluded claims for special and consequential damages. The language reads as follows: "No indemnified person shall be liable for any damages arising from ... breach of this Commitment Letter or the Fee Letter by, such indemnified person (or any of its related parties), or for any special, indirect, consequential or punitive damages in connection with the Credit Facilities." So it would seem that the commitment letter precluded special and consequential damages, but only with respect to the credit facilities, not breach of the commitment letter itself.

Accordingly, lenders, pay close attention to your indemnification language and try to exclude special and consequential damages incurred as a result of breach of the commitment letter as well as of the loan documents.

**Termination Fees in Merger Agreements:** Look at who is limited by, and who benefits from, the termination fee in the merger agreement. The banks argued that any damages against them under the commitment letter could not exceed \$500 million because the merger agreement provided for a termination fee. The termination fee limited Clear Channel from seeking damages in excess of \$500 million from the sponsors or their financing sources. The litigation settled before the banks' claim was heard, but the argument was certainly viable.

**Choice of Forum:** With suits pending in Texas and New York, the banks would have been better served if the forum selection clauses in the merger agreement and the commitment letter were the same.

As of May 29, the deal has been funded into escrow only. It remains to be seen where the parties end up on refinancing of Clear Channel's notes and intercompany debt as well as all of the other open items.

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#### ::::FOOTNOTES::::

FN1 The banks that are party to the commitment letter are Citigroup, Deutsche Bank, Morgan Stanley Senior Funding, Credit Suisse, Royal Bank of Scotland and Wachovia.

FN2 In the Texas proceeding, the sponsors and Clear Channel obtained a temporary restraining order and injunction based on their claim that the banks' refusal to provide the financing tortiously interfered with the merger agreement between the sponsors and Clear Channel. The banks' motion to dismiss based on the commitment letter's forum selection clause was denied by the trial court and on appeal because the tortious interference claim relied on the forum selection clause in the merger agreement.

FN3 David Carey, "Clear Channel Numbers Look Sweet," *The Deal.com*, March 28, 2008.

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