Operating in the Ordinary Course of Business after an Extraordinary Event: *Cooper Tire & Rubber v. Apollo (Mauritius) Holdings*

In a typical public company merger agreement, the target is required to continue to operate in the "ordinary course of business" prior to closing. This covenant provides protection for the buyer who is obligated to complete the acquisition subject only to the fulfillment of limited closing conditions, including, typically, the non-occurrence of a "Material Adverse Effect," and wants some certainty as to what it will be acquiring come the closing. Recently, in *Cooper Tire & Rubber Company v. Apollo (Mauritius) Holdings,*[1] Vice Chancellor Glasscock of the Delaware Court of Chancery considered the issue of what it means to operate in the ordinary course of business in the face of an extraordinary event and how the ordinary course covenant interacts with the condition that no Material Adverse Effect occur prior to the closing.

I. The Ordinary Course of Business

Cooper Tire and Rubber Company agreed to be acquired by Apollo Holdings, an Indian tire manufacturer, in June 2013. In response to announcement of the merger, workers at Cooper's 65% owned Chinese subsidiary, CCT, went on strike. The strike apparently was instigated by the manager and 35% owner of CCT, one "Chairman Che," who also contrived to halt production of Cooper branded tires at CCT and deny Cooper and Apollo access to the facilities, books and records of CCT. In an attempt to put Chairman Che into a more cooperative mood, Cooper suspended payments to suppliers of the Chinese subsidiary. Although Apollo cooperated with Cooper in its attempt to assuage Chairman Che, Apollo later argued to the Chancery Court that the events at CCT constituted a breach by Cooper of the ordinary course of business covenant relieving Apollo of the obligation to close the transaction.

The ordinary course of business covenant in the Cooper/Apollo merger agreement had two clauses. In its argument, Apollo relied on the first clause of the covenant that provided that, between signing and closing, except as "otherwise expressly contemplated by" the merger agreement, Cooper "shall, and shall cause each of its Subsidiaries to, conduct its business in the ordinary course of business consistent with past practice." In response, Cooper argued that because the events at CCT resulted from actions of employees and a joint venture partner, the applicable clause was the second clause, which provided that Cooper and its subsidiaries need only use "commercially reasonable efforts to preserve intact its present business organization, keep available the services of its directors, officers and employees and maintain existing relations and goodwill with customers, distributors, lenders, partners, suppliers and others having material business associations with it or its Subsidiaries." The court determined that the first clause, which was not qualified by an "efforts" standard, applied to the operations of any "subsidiary," which the parties had defined to include a majority-owned entity like CCT. The

[1] C.A. No. 8980-VCG (Del. Ct. Ch. October 31, 2014).

court then pointed to Cooper's suspension of payments to CCT's suppliers as an action that while perhaps "a reasonable reaction to the extralegal seizure of" CCT, was not an action taken in the ordinary course of business. And in fact, the court implied that given the unqualified language of the first clause of the covenant, the events at CCT caused by Chairman Che and the strike, even absent Cooper's response, alone would have constituted a "failure to cause CCT – its largest subsidiary – to conduct business in the ordinary course."

II. Material Adverse Effect.

Cooper argued that the parties had expressly agreed, as reflected in the definition of Material Adverse Effect, that any negative impact announcement and pendency of the merger might have had on Cooper's relationships with labor unions or joint venture partners would not constitute a Material Adverse Effect. Cooper also pointed to the fact that its obligation to operate in the ordinary course of business was qualified by the language "except as . . . expressly contemplated by this Agreement." Therefore, in Cooper's view, such negative impact, or Cooper taking reasonable actions to deal with such negative impact, should not constitute a violation of the ordinary course of business covenant resulting in the same consequence as a Material Adverse Effect – the failure of a condition to Apollo's obligation to close the merger.

In response, the court noted that there were two distinct clauses to the Material Adverse Effect definition as is the case in many public company merger agreements. The first clause defined Material Adverse Effect as facts and circumstances that would reasonably be expected to have a material adverse effect on the business, results of operations or financial condition of Cooper. That clause, however, was subject to a customary set of exceptions, including that circumstances to the extent attributable to the announcement and pendency of the merger (e.g. the strike at the CCT) could not constitute a Material Adverse Effect. The second clause was broadly worded and stated that facts and circumstances "that would reasonably be expected to prevent or materially delay or impair the ability of [Cooper] to perform its obligations under" the merger agreement would be a Material Adverse Effect. The second clause did not have any qualifications, and the court relied on this fact to reject Cooper's argument. In the words of the court "the logical operation of the [two clauses of the] definition of Material Adverse Effect shifts the risk of any carved out event to Apollo, unless that event prevents Cooper from complying with its obligations under the Merger Agreement." In other words, because the events at CCT could reasonably be expected to impair Cooper's ability to comply with the terms of the merger agreement, they could in fact be a Material Adverse Effect under the second, unqualified clause of the definition (even if excluded under the first clause).

In the end, the court concluded: "The seizure was unanticipated, and neither party caused it to occur; nonetheless, it prevented Cooper from complying with its contractual obligations necessary to close the merger." As a result, Apollo was not obligated to close the transaction or pay the reverse termination fee.

III. Potential Impact

In light of V.C. Glasscock's decision, and in particular the impact of an unqualified obligation to operate in the ordinary course, targets may seek more flexibility to respond to extraordinary events that occur following the signing of a merger agreement. This may take the form of qualifications to the typical ordinary course language (such as an “efforts” standard) or by adding specific scheduled exceptions to the covenant, particularly in the case of joint ventures and non-wholly owned subsidiaries. Following signing, targets may also be more proactive in getting formal consent from buyers when taking actions in response to extraordinary events. The decision also is likely to focus targets and their counsel on the type of language contained in the second clause of the Cooper/Apollo Material Adverse Effect definition, seeking either to remove the clause entirely, word it more narrowly or qualify it in the same manner as the first clause.

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