

Del. v. N.Y. Law in Determining Liability Under Acquisition Agreements

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Although often overlooked as mere legal boilerplate, the governing law provisions in an acquisition agreement can have subtle but significant effects on interpreting the agreement's key provisions. Given such potential impact, this article addresses how the selection between two fairly customary choice-of-law jurisdictions, Delaware or New York, can affect certain key liability provisions contained in acquisition agreements. While not an exhaustive comparison of New York and Delaware law, this article highlights the effects that the choice between the laws of these states can have on certain critical contractual provisions. It attempts to assist buyers and sellers alike in better assessing the consequences that the choice of governing law may have on the risk management choices they bargained for in their acquisition agreement.

Law of Damages and Remedies

One area affected by the choice of Delaware or New York law is the ability of the parties to limit liability or select remedies under an acquisition agreement. Absent willful misconduct, both Delaware and New York generally uphold contractual provisions that limit a party's liability. However, as an exception to this rule and in contrast to Delaware, New York will generally not uphold contractual liability limitations for gross negligence.

Further, Delaware and New York have slightly different standards concerning the availability of specific performance. While Delaware requires a higher proof standard than New York, insisting that a

plaintiff establish by "clear and convincing evidence" that each of the elements to specific performance have been satisfied, it permits the parties to stipulate that one of these elements—that the breach will cause irreparable harm—has been satisfied. In contrast, New York requires the elements be established by the lower "preponderance of the evidence" standard, but does not give conclusive weight to contractual stipulations of any specific performance elements.

In addition, as held in *Consolidated Edison v. Northeast Utilities*, 426 F.3d 524 (2d Cir. 2005), under New York law a buyer is not liable to the public stockholders of a target for damages on account of lost premium unless those stockholders are intended third-party beneficiaries of the acquisition agreement. Delaware courts have not squarely addressed this issue, meaning that a buyer in an acquisition agreement governed by Delaware law could face potential liability to a target company's stockholders even if the stockholders are not party to the agreement.

Sandbagging

Another fundamental liability issue involves determining when a party's knowledge of a breach prevents such party from making a post-closing breach claim. That is, can a party "sandbag"—close a transaction despite knowledge of a breach and then later sue for that breach? Absent an express provision in an acquisition agreement denying a buyer the right to sandbag, the practice is generally permitted under both



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Delaware and New York law. However, the states differ in the details. In Delaware, knowledge acquired by the buyer through its own due diligence has no bearing on its right to rely on the seller's warranties. New York is more complicated, however, in that if the buyer's knowledge of the breach comes from a source other than the seller, the buyer may generally bring a claim, but if the seller disclosed a set of facts constituting a breach under the terms of the contract the buyer will likely be foreclosed from later asserting the breach. Under the laws of either state, buyers should consider adding in specific language to allow the buyer to make claims of which it was aware prior to closing, no matter how the buyer learned of such information.

Statute of Limitations

In addition to the limitations discussed above, acquisition agreements often contain contractual survival periods that restrict the time period in which a party may bring an otherwise permissible claim. The scope and enforceability of these contractual periods will be affected by the statute of limitations of the agreement's governing law. Delaware

establishes a three-year default statute of limitations for breach of contract claims, which may be shortened but not extended. (Certain commentators have recently noted that a contractual statute of limitations may extend up to 20 years in a contract executed under seal, and legislation has been proposed in Delaware that, if enacted, would permit parties to any contract involving consideration in excess of \$100,000 to opt for up to a 20-year period.) New York, by contrast, has a six-year default statute of limitations, which cannot be extended (under seal or otherwise). Unlike Delaware, New York strongly disfavors shortening the statute of limitations and requires clear and explicit language to find that provisions purporting to limit the survival of a claim will actually be effective to shorten the statute of limitations. Note that because the courts in both states have held that contractual claims expire at the end of the default statute of limitations, common contractual language supposedly permitting the “indefinite” survival of claims for breaches of certain “fundamental representations” is unenforceable in both Delaware and New York.

Fraud

No matter how carefully provisions limiting liability are drafted, claims alleging fraud may negate such provisions because fraud has been specifically carved out from such limitations or because a party fraudulently induced to sign an agreement can challenge the enforceability of such limitations. While the actual elements of a fraud claim are similar under Delaware and New York law, the burden of proof and the ability to disclaim reliance differs between these states in a significant manner. Delaware requires fraud claims to be proven by the preponderance of the evidence, a lower standard than New York’s clear and convincing evidence standard. In addition, Delaware clearly allows parties to disclaim reliance of extracontractual representations, whereas, in contrast, New York appears to question boilerplate disclaimers of reliance and instead require

that any such disclaimer be specific in covering the representation that is the subject of an extracontractual fraud claim. Further, Delaware allows a fraud claim to be premised on a knowingly false representation within the acquisition agreement, while courts in New York have suggested that fraud can only arise out of conduct or statements outside of the contract.

Material Adverse Effect

Provisions

Finally, acquisition agreements usually permit a buyer to walk away from a transaction without liability to the seller if the seller suffers a “material adverse effect” or MAE. Although there appears to be little clear difference in practice between Delaware and New York law in the treatment of MAE provisions, primarily because these provisions are seldom discussed by the New York courts, the choice of Delaware or New York law (and related venue provisions) may shift negotiating leverage later on in the deal if an MAE is asserted. Delaware courts have been very clear in creating a virtually insurmountable hurdle to finding that an MAE has occurred. In *Hexion Specialty Chemicals v. Huntsman*, 965 A.2d 715, 738 (Del. Ch. 2008), the Delaware Court of Chancery held that adverse changes constitute MAEs only when the changes are proven to be material as “viewed from the long-term perspective of a reasonable buyer.” Although one case, *Osram Sylvania v. Townsend Ventures*, C.A. No 8123-VCP (Del. Ch. Nov. 19, 2013), found that short-term changes could conceivably constitute an MAE for purposes of a motion to dismiss (where plaintiff alleged fraud), “Many commentators have noted that Delaware courts have never found a material adverse effect to have occurred in the context of a merger agreement,” according to Hexion. Delaware’s strict standard, when combined with the numerous carve-outs found in typical MAE provisions, means that a buyer will seldom be likely to prove the existence of an MAE in a Delaware

court and thus have little bargaining power to renegotiate a deal based on an assertion of an MAE.

By contrast, the New York courts have not significantly examined MAE provisions in acquisition agreements. While one leading case examining MAE provisions in an acquisition agreement, *In re IBP Shareholders Litigation*, 789 A.2d 14 (Del. Ch. 2001), was decided under New York law, it was decided in the Delaware Court of Chancery and thus it is not clear whether this case really can be cited as an interpretation of New York or Delaware law. Accordingly, in light of the Delaware trend to find that events do not qualify as MAEs and the open nature of this issue in New York, MAE provisions in acquisition agreements governed by New York law may (but it is not clear) give buyers greater negotiating leverage than those governed by Delaware law.

Choice of Law

This article focuses on select (but not all) liability provisions in an attempt to show the effect that the choice of Delaware or New York law may have on the relevant provisions and the perceived benefit of the bargain. Parties to such agreements are encouraged to carefully analyze how the choice of law may affect their expected rights, remedies and negotiating positions under the acquisition agreement.

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