Del. Dispatch: Refining M&A Terms After Twitter Investor Suit

By **Gail Weinstein, Philip Richter and Steven Epstein** (November 9, 2023)



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While there has been a rise over recent years in deals terminated by the buyer before closing, the Delaware Court of Chancery's Oct. 31 decision in Crispo v. Musk has rendered unenforceable a common merger agreement provision that has been used, for almost two decades, to disincentivize buyers from wrongfully terminating agreed-upon mergers.

So-called Con Ed provisions, deriving from the U.S. Court of Appeals for the Second Circuit's 2005 decision in Consolidated Edison v. Northeast Utilities, provide that if a buyer breaches or wrongfully terminates a merger agreement and the deal does not close, the damages payable by the buyer include the loss to the target stockholders of the merger premium they would have received.

Without such a provision, a merger agreement may provide a buyer with what is essentially an option to acquire the target company — if a specific performance remedy is not available for any reason — as there would be little financial consequence to keep the buyer from walking away from the deal.

In Crispo, the validity of the Con Ed provisions arose in the unusual context of a petition by a former Twitter stockholder, Luigi Crispo, for a mootness fee in connection with litigation he had brought against Elon Musk when Musk had told Twitter that he would be terminating the merger agreement pursuant to which he had agreed to acquire Twitter.

Crispo contended that his lawsuit, which was brought at the same time that Twitter was suing Musk for specific performance of the merger agreement, deserved partial credit for Musk's deciding ultimately to close the merger, which mooted both lawsuits. In analyzing whether Crispo's claim in his lawsuit for lost premium damages, based on the standard Con Ed provision in the merger agreement, was meritorious when filed, the court concluded that neither Crispo nor Twitter was entitled to sue to enforce the Con Ed provision.

Key Points

The court established, for the first time, that a target company's stockholders generally cannot enforce the Con Ed provisions — at least under current standard structures and drafting in merger agreements. The court concluded that under the merger agreement, which, as is typical, provided that there were no third-party beneficiaries, the stockholder-plaintiff lacked standing to bring suit to enforce the merger agreement.

The court reasoned further that, even if the Con Ed provisions were interpreted as implicitly granting stockholders third-party beneficiary status to enforce that provision, such status would not vest until the company's remedy of specific performance — also provided for in

the merger agreement, as is usual — was no longer available.

The court also established, for the first time, that a target company itself cannot enforce the Con Ed provisions — at least under current standard structures and drafting in merger agreements.

The court held that the lost merger premium could not be part of Twitter's expectation damages because, as is universally the case in merger agreements, it was not Twitter, but rather its stockholders who would have received the premium in a nonterminated deal. Recovery of a lost merger premium thus would be a "penalty," which would be unenforceable under Delaware law on damages.

Accordingly, based on Crispo, target companies will want to consider new approaches to seeking to ensure the payment of lost premium damages upon a buyer's wrongful termination of a merger agreement. We offer suggestions below.

Discussion

The Merger Agreement

The merger agreement provided as follows: (1) the no-third-party beneficiaries provision, in which the parties stated that they intended there be no third-party beneficiaries of the merger agreement — with three specified exceptions, none of which applied in this case; (2) the specific performance provision, in which the parties stipulated to the remedy of specific performance; and (3) the lost premium provision.

The parties agreed that, if Musk breached or wrongfully terminated the merger agreement and the merger was abandoned, monetary damages would be payable, which would take into account the loss of benefits to Twitter's stockholders, including the loss of the merger premium.

Twitter Stockholders Not Third-Party Beneficiaries

As the Twitter stockholders were not parties to the merger agreement, they would have standing to sue to enforce it only if the parties intended that the stockholders be third-party beneficiaries. The agreement stated that the parties intended there to be no third-party beneficiaries.

The court noted that such a provision is a "helpful starting point" for determining the parties' intentions, and is entitled to "a non-trivial amount of weight." Further, the court explained, considerably more weight is accorded to such a provision when, as in this case, the provision specifies exceptions for certain persons or categories of persons, and the exceptions do not include the person at issue — as the specified exceptions indicate that the parties knew how to grant third-party beneficiary status when they wanted to.

Moreover, the court emphasized that "Delaware courts are reticent to confer third-party beneficiary status to stockholders under corporate contracts for a mix of doctrinal, practical, and policy reasons" — including that under Delaware law, the board generally should manage the company's litigation assets and that a board's responsibility for a sale process should not be undermined by stockholders bringing a multitude of lawsuits to enforce a merger agreement.

Lost Premium Provision

The court concluded that, alternatively, it was also reasonable to interpret the lost premium provision — which was a more specific provision than the general provision against third-party beneficiaries — as implicitly granting third-party beneficiary status to the stockholders for the purpose of enforcing that provision.

Even if so, however, the court reasoned, such a grant would be limited by the "contractual scheme," which, the court found, "forecloses stockholders from pursuing a claim for lost premium damages while the company is seeking specific performance."

The court wrote that, given the specific performance provision, a "limitation necessarily implied by the Merger Agreement is that the drafters did not intend to vest stockholders with a right to enforce lost premium damages while the company pursues a claim for specific performance" — as any contrary interpretation would mean that the stockholders could undermine efforts by the company "to specifically enforce the deal or secure the best deal possible for stockholders."

Thus, under this alternative interpretation, the court concluded that "any third-party beneficiary status conferred on stockholders would not vest while the remedy of specific performance [was] still available" — and would vest only if the deal was terminated and the remedy for specific performance was no longer available, for example, because a court had denied that relief.

If third-party beneficiary status so vested, the stockholders' right to seek lost premium damages "would run concurrent to the target's right to pursue damages under the merger agreement," the court wrote.

Stockholder-Plaintiff Lacked Standing

Under the above interpretations of the merger agreement, Crispo either lacked standing as a third-party beneficiary or, alternatively, such standing had not vested when he brought his claim.

Therefore, under either interpretation, his claim could not have withstood a motion to dismiss at the time it was made. Accordingly, he was not entitled to a mootness fee, a required element of which is that the claim made was "meritorious when filed."

Con Ed Provisions

In 2005, the Second Circuit in Con Ed v. Northeast, applying New York law, reversed the lower court and surprised M&A practitioners by holding that damages payable by a buyer who wrongfully terminates or breaches a merger agreement will not include the lost merger premium — unless the parties had specifically provided otherwise.

In Crispo, the Court of Chancery reviewed three forms of Con Ed provisions, the lost premium provision being an example of the third form, which is the one commonly used.

Target Stockholders as Third-Party Beneficiaries

A merger agreement may expressly provide that target company stockholders are third-party beneficiaries for the purpose of recovering lost premium damages.

This approach, the court noted, is antithetical to Delaware law's board-centric model and raises serious practical problems for both buyers, who would be subjected to the potential of a multitude of stockholder suits to enforce a merger agreement, and sellers, whose efforts to enforce a merger agreement and obtain the best possible result for stockholders in the face of a buyer's wrongful termination could be undermined by stockholder suits.

Target as an Agent for Its Stockholders

A merger agreement may appoint the target company as the agent for its stockholders for recovering damages, including a lost merger premium, on their behalf.

This approach is on "shaky ground," however, the court stated, "because there is no legal basis for allowing one contracting party to unilaterally and irrevocably appoint itself as an agent for a non-party for the purpose of controlling that party's rights."

Damages Definition

A merger agreement may define the damages recoverable in the event of wrongful termination or breach by the buyer to include any lost merger premium.

Such a provision as commonly crafted, the court established in Crispo, generally will be unenforceable by the target company or its stockholders.

Possible New Approaches in Response to Crispo

Stockholders could approve the target company's acting as their agent to obtain lost premium damages.

A merger agreement could provide that the company will act as an agent for the stockholders in recovering lost premium damages, subject to approval by the stockholders.

With this approach, the company would avoid the problem of self-appointment by the company as the stockholders' agent. Where a target stockholder vote for the deal is required, the company could disclose that a vote for the deal will also be deemed to be a vote for the agency.

This approach may be less appealing in deals not otherwise requiring a target stockholder vote.

A company undergoing an initial public offering should consider including a provision in the company's charter to permit the company to act as the stockholders' agent for the purpose of recovering lost premium damages in the event that a buyer wrongfully terminates a merger agreement with the company.

A target board could have the right to decide at any time to grant stockholders third-party beneficiary status.

A merger agreement, rather than providing that stockholders are third-party beneficiaries of the merger agreement or including a lost premium provision, could provide that damages include a lost merger premium and that the target board can decide at any time — and whether or not the company has a specific performance lawsuit pending — to grant its stockholders third-party beneficiary status to enforce the lost premium damages.

With this approach, the board would retain control over the litigation asset, while also having the leverage over the buyer created by the potential that stockholders could be enabled to sue to recover lost premium damages. This formulation largely avoids the doctrinal and practical problems the court cited with respect to granting stockholders third-party beneficiary status in the merger agreement.

An alternative formulation, more favorable to buyers, could include parameters under which the board could grant third-party beneficiary status to the stockholders — for example, only after the company has brought and lost an action for specific performance of the merger agreement.

The merger consideration could be made payable to the company for distribution to the stockholders.

In concluding that recovery of a lost premium would constitute so-called penalty damages, the court noted in Crispo that under a merger agreement, "no [merger consideration] passes to or through the target" company, but rather "is paid directly to the stockholders."

We would suggest that, subject to any tax issues, a merger agreement could provide that the merger consideration would be paid to the target company, which then would distribute it to the stockholders.

Under this approach, the court might view the company as having a direct interest in receiving the merger consideration, which would support a right by the company to enforce a lost premium-damages provision.

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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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