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Post-Crispo World

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POST-CRISPO WORLD

A crucial issue for U.S. M&A practitioners and stakeholders, especially in light of the tales of the Twitter-Musk acquisition, is what deal protection and remedies are available to sellers (both target companies and their stockholders) in the event of a buyer's wrongful failure to close on the acquisition of a public company target. And while *Twitter v. Musk*[1] primarily dealt with the target company's right to enforce a specific performance provision in the merger agreement, a related stockholder lawsuit, *Crispo v. Musk*[2], raised, for the first time in Delaware courts, the question of the enforceability of a lost-premium provision (*i.e.*, a provision in a merger agreement that defined the target company's damages from the buyer's breach to include the stockholder premium lost as a result of the termination of the deal).

We should note the actual issue before Chancellor McCormick in *Crispo* was whether a former Twitter stockholder, Luigi Crispo, was entitled to a mootness fee in connection with a suit he had previously brought against Elon Musk for seeking to back out of the Twitter transaction (which suit, Crispo argued, deserved partial credit for Musk's turnaround and the eventual closing of the deal).[3] However, in order to be entitled to a mootness fee, the plaintiff's claim needed to be "meritorious when filed"—meaning, among other things, that Crispo needed to have standing to recover damages under the merger agreement in the first place.[4] This further meant that Crispo, in his capacity as a stockholder of the company, needed to be a third-party beneficiary under the merger agreement. As is typical in modern merger agreements, however, the Twitter agreement contained a provision expressly disclaiming any third-party beneficiaries to the merger agreement (with exceptions irrelevant to the issue at hand).[5] At the same time, the agreement contained a lost-premium provision expressly allowing for the recovery of damages related to any share premium lost by stockholders.[6] And so, in trying to answer whether Crispo had standing to recover damages as a third-party beneficiary under the merger agreement, Chancellor McCormick was compelled to consider the lost-premium provision and its relationship to the "no third-party beneficiary" provision.[7]

Con Ed and the Rise of the Lost-Premium Provision

The lost-premium provision in the Twitter merger agreement, and comparable or similar provisions in other U.S. public company merger agreements, resulted from a 2005 court decision, *Consolidated Edison v. Northeast Utilities*[8], which held, first, that stockholders of a target company in a failed merger could not sue for the lost stockholder premium under a merger agreement with a "no third-party beneficiaries" provision and, second, that the target company itself could not sue for the lost stockholder premium because the target company itself did not suffer that loss.[9] The merger agreement at issue in *Con Ed* was governed by New York law.[10] On the first issue, the *Con Ed* court reasoned that the target company stockholders were not entitled to lost-premium damages because contractual promises can only be enforced by parties to, or beneficiaries of, the contract.[11] Under a merger agreement that—per the "no third-party beneficiaries" provision—disclaims the rights of all third parties, except for the right of stockholders to receive the merger consideration if and when closing occurs, any stockholders' third-party rights consequently do not vest until closing (in other words, such rights would *never* vest in a busted deal).[12] On the second issue, the *Con Ed* court ruled that only the target stockholders—not the target company—had an expectation to receive the premium via the merger consideration.[13] Therefore, the *Con Ed* court found that neither the target stockholders nor the target company could collect lost-premium damages from the buyer.

In the years following the *Con Ed* decision, M&A practitioners who were concerned that buyers would be more willing to walk away from proposed deals without the threat of lost-premium damages started drafting provisions designed to get around the *Con Ed* issue and "to make clear that the parties to the contract intended for the buyers to be liable for lost stockholder premium in the event of a busted deal".[14] Otherwise, absent an effective specific performance remedy or a relevant termination fee (*i.e.*, a fee payable by the buyer in the event of a failure to complete the acquisition), buyers could abandon deals with very little consequence (since, as far as damages go, the target would essentially be limited to its out-of-pocket expenses in pursuing the transaction).

Three variations of these so-called *Con Ed* provisions began to emerge. The first approach expressly designates stockholders as third-party beneficiaries for purposes of recovering damages under the relevant merger agreement. The second approach designates the target company as the stockholders' agent for purposes of recovering damages. Lastly, the third approach expressly defines the target company's damages due to the buyer's breach to include the lost stockholder premium. And while specific performance still remained the remedy of choice for most, of the three *Con Ed* variations discussed above, the last one—the lost-premium provision (the very same examined in *Crispo*)—became the most common.

Notwithstanding the rise of lost-premium provisions and other reactions to *Con Ed*, however, a majority of public merger agreements did not expressly address this concern,[15] at least in part because many practitioners believed that Delaware courts would take a more favorable view on the availability to target companies of lost-premium damages. That is, until *Crispo*.

***Crispo*'s Take**

Though not the core issue at hand, the Chancery Court in *Crispo* noted that a provision giving the target an exclusive right to recover lost-premium damages is an unenforceable penalty under Delaware contract law.[16] The *Crispo* court reasoned, similarly with the *Con Ed* court, that because the target company had no expectation of receiving the premium under the merger agreement (only the stockholders did), a damages provision purporting to entitle the target company to recover the lost stockholder premium would be unenforceable.[17] On this point, the *Crispo* court's reasoning is consistent with long-standing Delaware jurisprudence regarding damages, liquidated damages and penalties;[18] in effect, the *Crispo* court analyzed the Twitter merger agreement as just like any other contract, as opposed to viewing merger agreements generally as being in a special category of contracts of their own.

Following from the determination that the lost-premium provision would be unenforceable if it sought to give the target company the right to recover the lost premium, the *Crispo* court then reasoned the lost-premium provision could only have economic or legal effect if Twitter stockholders could sue to enforce it.[19] But because the merger agreement in *Crispo* contained a "no third-party beneficiaries" provision (without a carve-out applicable to the recovery of lost-premium damages by the stockholders), the lost-premium provision would still not have any economic or legal effect.

The *Crispo* court also considered an interpretation of the lost-premium provision as implicitly granting third-party beneficiary status to stockholders for the limited purpose of seeking lost-premium damages notwithstanding the express “no third-party beneficiary” provision.[20] Again, in this regard, the *Crispo* court was following long-standing Delaware jurisprudence of general applicability that a court should seek to adopt contractual interpretations that avoid the result that a specific contract provision has no economic or legal effect: if the purpose of contractual interpretation is to discern the intent of the drafters, it is unlikely they intended a provision to have no such effect.[21] However, even under this interpretation, the *Crispo* court found that the right to recovery vests in “exceptionally narrow circumstances”.[22] Given the specific performance provision in the *Crispo* merger agreement, a “limitation necessarily implied . . . 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.”[23] Otherwise, the target company’s ability “to specifically enforce the deal or secure the best deal possible for stockholders” would be undermined.[24] Therefore, according to *Crispo*, even if we read the lost-premium provision as necessarily granting third-party beneficiary status to stockholders, such status “would not vest while the remedy of specific performance is still available.”[25]

Market Response to *Crispo*

The *Crispo* court’s suggestion that a lost-premium provision (*i.e.*, a *Con Ed* provision #3) is effectively unenforceable in the absence of third-party beneficiary status granted to stockholders came as a surprise to a number of practitioners. Boiled down, mergers are ways for a target company to deliver a control premium to stockholders; the target company is not meant to get much else by way of the merger agreement. Therefore, if merger agreements are not seen as creating and allowing for ways to deliver such premium to the stockholders (through the lost-premium provision or otherwise), one may wonder: what’s even the point? In other areas of Delaware law, such as fiduciary duties, the Delaware courts recognize that, from the perspective of the target company and its stockholders, “end of life” mergers are just different from ordinary course transactions,[26] yet on the lost-premium provision the *Crispo* court treated merger agreements as just like other contracts.

The *Crispo* court’s implicit response to this challenge is that contracting parties are perfectly free to make the target stockholders express third-party beneficiaries under the merger agreement for purposes of lost-premium damages (*i.e.*, a *Con Ed* provision #1) and to allow for stockholder suits to pursue such damages once specific performance is no longer available to, or enforceable by, the target company. Despite concerns with granting stockholders such rights, which runs the risk of burdening the buyer with many independent claims and undermining the target’s general control over process, the *Crispo* court noted that the stockholders’ right to seek damages “would run concurrent to the target’s right to pursue damages under the merger agreement” and that stockholder claims would be subject to the forum selection clause and the courts’ power to consolidate cases.[27]

The *Crispo* court also noted that it would be possible to authorize the target company to pursue lost-premium damages as an agent for the stockholders (*i.e.*, a *Con Ed* provision #2).[28] The court further suggested, however, that any such agency relationship would require more than a statement to that effect in the merger agreement (“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”).[29]

The market response to *Crispo* has been quick and clear. There has been a significant increase in the percentage of Delaware merger agreements with some form of *Con Ed* provision. Based on our review of 38 Delaware public company merger agreements available since *Crispo,*[30] 18 (nearly 50%) contained a lost-premium provision,[31] of which all but one (17 merger agreements) carved out stockholders (for purposes of pursuing damages) from the "no third-party beneficiaries" provision. In addition, all these merger agreements that designated stockholders as third-party beneficiaries also contained a *Con Ed* provision #2, *i.e.*, a provision designating an agent to pursue remedies on behalf of the third-party beneficiary stockholders.

While the *Crispo* court did cast doubt on the sufficiency of this market approach, we view the agency model as a viable approach to lost-premium damages. If two parties to a merger agreement wish to grant third-party beneficiary status to non-parties, the contracting parties have wide contractarian freedom to agree when and how those third-party beneficiaries may enforce those rights. Third-party beneficiary status itself is a creature of the contract—the contracting parties' decision (mutual as between the contracting parties, unilateral vis-à-vis the third-party beneficiaries) to create the enforceable benefit. In our view, the contracting parties, in their "unilateral" decision to create third-party beneficiary status, should be permitted "unilaterally" to limit the enforcement of the created rights. In the context of a merger agreement, which needs stockholder approval, ratification of the agency appointment should even be implied by the stockholder vote to approve the merger agreement, and, in any event, it is difficult to see why stockholders, having voted to approve a merger agreement that included an exclusive agency arrangement, should then be permitted to enforce contract rights under the merger agreement free of the exclusive agency. There has also been a long history of contingent rights being granted in Delaware merger agreements (*e.g.*, provisions with respect to contingent value rights or post-closing purchase price adjustments), with related merger agreement provisions governing the agency relationship between a stockholders' representative and the stockholders, and the agency issue in the context of the lost-premium provision should not be any different. We question why the agent cannot be one of the contracting parties, and, in most of these agreements, the agent is a contracting party.

These post-*Crispo Con Ed* provision #2s come in several different variants. For example, a large majority of these provisions (13 out of 17) *required* that the target company act as an *exclusive* agent for stockholders with respect to any claim for lost-premium damages and often explicitly gave the target (or its board) full discretion over whether to pursue such a claim. A minority (3 out of 17) authorized the target company to act as an agent to the stockholders but not on an exclusive basis (meaning stockholders presumably are free to pursue their own claims). One other example required the appointment of an agent for the stockholders to pursue lost-premium damages on an exclusive basis, but did not specify that the agent had to be the target company. Only one merger agreement formalized the appointment of the target as agent through a separate charter amendment (which we assume was in response to the *Crispo* suggestion in dicta discussed above).

Another variation concerns the use of proceeds following recovery of damages. Of the 17 merger agreements that took the agency route, about a quarter explicitly stated that the target company, as agent, could retain or distribute, in its discretion, any collected damages. A partially overlapping quarter discussed the ability of the agent to reimburse itself for its expenses incurred in pursuing the claim. Otherwise, merger agreements did not specify (or limit) what the company should do with any collected damages. And while many were silent on the question of use of proceeds, about half of the 17 merger agreements expressly noted that the damages claim attached to the shares.

If an agency relationship truly underpins the right of the target company to recover lost-premium damages from the buyer, we question whether any damages actually recovered may be used or otherwise retained at the sole discretion of the target company. If, as the *Crispo* court suggested, the agency model solves the unenforceability issue associated with the lost-premium provision, it is because the damages claim belongs to the injured third-party beneficiary stockholders who actually suffered the lost premium. While the principal-agent relationship could be documented in a way that allows the agent to retain some proceeds (as compensation or reimbursement for expenses), explicit authorization for the target company, in its sole discretion, to retain all or any portion of the proceeds from a claim that belongs to the injured stockholders does not sound like a true agency relationship. In addition, in our view, provisions that expressly require the claim to attach to (or travel with) the shares if sold may raise unnecessary legal uncertainty. They potentially confuse the question of the calculation of damages and also possibly implicate long-standing concerns about selling litigation claims. Moreover, if *Con Ed* provision #2 remains the prevailing approach to lost-premium damages, we believe more merger agreements should elaborate on the scope of the agent's rights, as well as the standard of care to which the agent will be held in its pursuit of damages. But so far, we have seen only one merger agreement that was explicit on the agent's duties and standard of care and on the agent's right to reimbursement of its expenses.

Finally, we note that both *Con Ed* and *Crispo* involved merger agreements that were structured as single-step mergers, such that target stockholders could not have the right to bring a contract claim against the buyer other than through third-party beneficiary status. In a transaction structured with a first-step tender offer, however, the target stockholders who accept the tender offer have direct contractual privity with the buyer. A target stockholder who accepts a tender offer has a direct claim against the buyer for a failure to complete the offer in accordance with its terms and conditions.[32] If *Con Ed* provision #2 remains the prevailing model, in two-step deals buyers and targets will need to reconcile an exclusive agency relationship with respect to merger agreement claims by all target stockholders with individual claims for non-compliance with the terms of the offer by accepting target stockholders.

Legislative Response to *Crispo*

The Delaware legislative response to *Crispo* has been equally clear, if a little slower. At the time this article is being written, the Corporation Law Section of the Delaware State Bar Association was considering a proposal to amend the Delaware General Corporation Law (the "DGCL") in order to, among other things, address issues raised in *Crispo*.[33]

In response to the finding in *Crispo* that lost-premium damages are unenforceable penalty damages unless stockholders are made third-party beneficiaries to the merger agreement, the proposal seeks to amend DGCL §261(a) to permit merger agreements to contain penalties or consequences for a party's failure to perform before closing, which penalties may include lost-premium damages. The proposal further specifies that parties to the merger agreement are entitled to enforce and retain any penalties. The proposal thus addresses directly the issue in *Crispo* of whether the target company can retain the losses even if not actually suffered by the target company (which was the precise point in *Crispo*). However, the proposal also addresses an issue not decided in *Crispo*, which is the quantum of the damages. By specifically authorizing "penalties", the proposal if adopted will open up the possibility of the parties in a merger transaction agreeing a formula-based penalty on the buyer for failing to complete the transaction, which would have the benefit of eliminating the uncertainty associated with calculating the lost-premium damages if the target company is itself entitled to retain the damages.

Additionally, in response to *Crispo*'s concerns over the "unilateral" appointment of a stockholder's agent in the merger agreement, the proposal also seeks to amend DGCL §261(a) to expressly permit merger agreements to appoint agents to act on behalf of the stockholders for purposes of enforcing stockholder rights.

Given the swift market reactions to the view of the Delaware courts as outlined in *Crispo* and the newly proposed amendments to DGCL, we expect further evolution of the various *Con Ed* provisions, as well as our collective conception of lost-premium damages.

The views expressed herein are solely the personal views of the authors and do not represent the views of Cravath, Swaine & Moore LLP or legal advice.

Footnote(s):

[1] Verified Complaint at 1-5, *Twitter, Inc. v. Musk*, No. 2022-0613 (Del. Ch. July 12, 2022), 2022 WL 2713259.

[2] *Crispo v. Musk et al.*, 304 A.3d 567 (Del. Ch. 2023).

[3] *Id.* at 571.

[4] *Id.* at 571-72.

[5] *Id.* at 572.

[6] *Id.*

[7] *Id.* at 573-74.

[8] 426 F.3d 524 (2d Cir. 2005).

[9] *Id.* at 527.

[10] *Id.*

[11] *Id*.

[12] *Id.*

[13] *Id.* at 529.

[14] 304 A.3d at 580.

[15] According to the ABA's latest periodic report on U.S. public deals, 49 out of 184 (*i.e.*, 27%) merger agreements examined for transactions closed between January 1, 2022 and June 30, 2023 contained some form of *Con Ed* provision. In ABA reports from

prior years, the percentage ranged from 23-36% for a given period. *See* American Bar Association, U.S. Public Target M&A Deal Points Study (2024).

[16] 304 A.3d at 583.

[17] *Id.* at 584.

[18] *See, e.g., XRI Inv. Hldgs., LLC v. Holifield*, 283 A.3d 581, 661 (Del. Ch. 2022) ("The law of contracts also places limitations on the ability of parties to contract for certain remedies. For example, a court generally will not enforce a contractual provision aimed at punishing or penalizing the breaching party, rather than compensating the non-breaching party."); *Del. Bay Surgical Servs., P.C. v. Swier*, 900 A.2d 646, 650 (Del. 2006) (outlining other Delaware case law on the distinction between an unenforceable penalty and a valid damages claim).

[19] 304 A.3d at 577.

[20] *Id.* at 579.

[21] *See, e.g., Norton v. K-Sea Transp. P'rs L.P.*, 67 A.3d 354, 360 (Del. 2013) ("When interpreting contracts, we construe them as a whole and give effect to every provision if it is reasonably possible. A meaning inferred from a particular provision cannot control the agreement if that inference conflicts with the agreement's overall scheme."); *Kuhn Constr., Inc. v. Diamond State Port Corp.*, 990 A.2d 393, 396–97 (Del. 2010) ("We will read a contract as a whole and we will give each provision and term effect, so as not to render any part of the contract mere surplusage."); *E.I. du Pont de Nemours and Co., Inc. v. Shell Oil Co.*, 498 A.2d 1108, 1114 (Del. 1985) ("The basic rule of contract construction gives priority to the intention of the parties. . . . In upholding the intentions of the parties, a court must construe the agreement as a whole, giving effect to all provisions therein.").

[22] 304 A.3d at 585.

[23] *Id*.

[24] *Id.*

[25] *Id.*

[26] *See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); *see also Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

[27] 304 A.3d at 585.

[28] *Id.* at 581.

[29] *Id*.

[30] Includes merger agreements available as of March 8, 2024 involving full or all remaining stake acquisitions of public Delaware targets. Excludes merger agreements superseded by another agreement pursuant to a deal jump.

[31] We categorized any provision defining damages to include lost "premium", lost "benefit of the bargain" or, in one case, "losses suffered by the stockholders" as a lost-premium provision.

[32] *See, e.g., Lowenschuss v. Kane*, 520 F.2d 255, 267 (2d Cir. 1975) (tendering shareholders have standing to bring contractual

claim against offeror); *Kroeze v. Chloride Group Ltd.*, 572 F.2d 1099, 1104 (5th Cir. 1978) (discussing status of tender offers under contract law); *see also* 8 Williston on Contracts s 948C, at 152 (3d ed. 1964).

[33] 8 Del. C. § 261(a).

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