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Inside Del. Determinations Of Specific Performance In M&A

By **James Hu, Stephen Mar and Hiroyuki Koda** (January 19, 2024, 5:46 PM EST)


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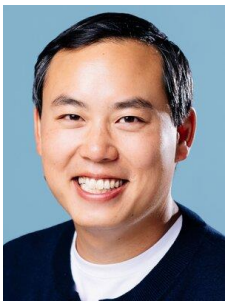
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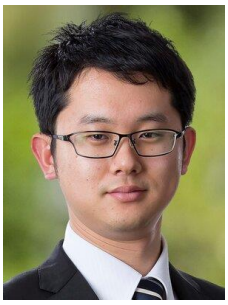
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Virtually all M&A contracts governed by Delaware law contain specific performance provisions.

With some degree of variation, such provisions generally affirm the buyer's and seller's agreement that Delaware courts can force a party to comply with its contractual obligations.

A specific performance remedy is therefore an important remedy for a contractual party because it forces the counterparty to perform, or refrain from, a specific act that is bargained for in the contract.

In the context of an M&A transaction, a seller or target company can use the specific performance remedy to force the buyer to close the deal, and vice versa.

Delaware courts have maintained that a party seeking specific performance must establish that:

- A valid enforceable agreement exists between the parties;
- The party seeking specific performance was ready, willing and able to perform under the terms of the agreement;
- A balancing of the equities favors an order of specific performance.[1]

While the first two factors are relatively straightforward in their application, the third factor — balancing of the equities — is less clear-cut.

Delaware cases — including decisions in the final months of 2023 — shed light on how Delaware courts apply the third factor and the facts they may consider when determining whether a party to an M&A transaction is entitled to specific performance.

Given the importance of the specific performance remedy for M&A contracts, deal-makers should be aware of these factors and how courts may consider certain facts that may enhance or diminish the likelihood that specific performance remedies will be granted.

Pathway to Enforcement

An M&A contract typically contains a covenant that requires each party to make reasonable best efforts to consummate the transaction.

Delaware cases suggest that a Delaware court's willingness to award a specific performance remedy to enforce this effort-based covenant depends on the complexity, and number of steps required, to consummate the transaction and the court's practical ability to oversee the enforcement.

In the 1988 Carteret Bancorp Inc. v. Home Group Inc. decision, the Delaware Court of Chancery chose not to enforce a covenant requiring the parties to use their best efforts in good faith to "take or cause to be taken all action necessary or desirable on [defendants'] part so as to permit consummation of the Merger" due to factors suggesting that enforcement would be difficult.[2]

Specifically, the court saw "no appropriate or even feasible way for the court to specifically enforce a covenant of best efforts" to close the merger in a complex transaction where numerous regulatory, financial and corporate steps required to effectuate the merger were still pending.[3]

The court also noted that its intervention at that stage of the transaction would risk involving the court in a detailed administration of the agreement, and, absent a strong public interest to the contrary, a court ordinarily will not enter a decree of specific performance that requires constant supervision by the court.[4]

In contrast, Delaware courts have granted specific performance to enforce a closing of an M&A transaction where the closing was predicated on a limited number of steps and the court was able to oversee and enforce compliance in a practical manner.

In the 2021 Snow Phipps Group LLC v. KCake Acquisition Inc. decision, the Chancery Court ordered specific performance and enforced a reasonable best efforts provision to require a buyer to secure debt financing and close the transaction where all closing conditions in that transaction were satisfied, except for the receipt of debt financing.[5]

There, the defendant-buyers, which were entities associated with a private equity fund, agreed to acquire a target company from the plaintiff-seller.

As part of that acquisition, the buyers entered into a debt commitment letter and committed to use their reasonable best efforts to obtain the debt financing pursuant to the debt commitment letter and to seek alternative financing if the committed debt financing was unavailable.[6]

Like any typical leveraged buyout deal, the parties agreed in the stock purchase agreement that the remedy of specific performance was available only if the full proceeds of the debt financing had been funded to the buyer at the closing.[7]

Pointing to this express language in the contract, the buyers alleged that the remedy of specific performance should not be available as the debt financing was not obtained.[8]

The court, however, invoked the prevention doctrine[9] and ruled that the buyers failed to use reasonable efforts to obtain the debt financing and that their failure to obtain the financing was due materially to their failure to finalize a credit agreement pursuant to the terms of the debt commitment letter.

As such, the buyers could not benefit from the failure of their own conduct; and the court granted a decree of specific performance, ordering the buyers to use reasonable best efforts to obtain debt financing and close the transaction.[10]

Similarly, in Bardy Diagnostics Inc. v. Hill-Rom Inc., the defendant-buyer had entered into a merger agreement to acquire the plaintiff-target, but the defendant decided not to close the transaction after the Medicare rates decreased significantly before the closing.[11]

It was undisputed that all closing conditions were satisfied and the only missing step was for parties to actually close the merger.[12] In 2021, the Chancery Court therefore ordered the buyer to close the merger.[13]

A similar fact pattern and result occurred in the Chancery Court's 2022 Level 4 Yoga LLC v. CorePower Yoga LLC decision.[14]

Taken together, these cases suggest that a Delaware court is more likely to grant a specific performance remedy to enforce an obligation to close a transaction if the pathway to discharge that obligation involves limited and concrete steps.

For example, if the failure of a party solely involves the failure to close the transaction when all the closing conditions were satisfied, and equitable factors do not otherwise warrant a different result, one should expect a Delaware court to readily grant the specific performance decree and order the closing to take place.

On the flip side, if the pathway to discharge an obligation involves numerous steps and multiple potential outcomes, a Delaware court would be reluctant to grant a specific performance remedy.

Jurisdiction of Counterparty

When determining the practicality of enforcing a decree of specific performance against a party, at least one Delaware court has considered the location and the jurisdiction of that party.

Take the Sept. 23, 2023, 26 Capital Acquisition Corp. v. Tiger Resort Asia Ltd. decision. 26 Capital, a special-purpose acquisition company, or SPAC, sought a decree of specific performance requiring the Philippines-based target company to use its reasonable best efforts to close the de-SPAC transaction.[15]

The Chancery Court conducted a multifactor inquiry and declined to enforce specific performance. The court held that, in addition to the complex factual circumstances and difficulties in providing judicial oversight, an order issued by a Delaware court likely would be insufficient to enforce the specific performance in the Philippines.[16]

The court quipped candidly that it had no "blue water navy" to send to the Philippines to enforce ultimate compliance with a specific performance decree — indicating that its decision not to grant specific performance was influenced by its limited ability to administer the remedy in a non-U.S. jurisdiction.

As this case shows, a Delaware court's jurisdiction over a dispute between multinational parties will not necessarily mean that the court will issue a decree of specific performance against a non-U.S. party where the administration of the remedy will take place in a non-U.S. jurisdiction.

In a transaction involving a non-U.S. party, the predictability, speed and fairness of Delaware courts should

be weighed against the Delaware courts' practical ability, or lack thereof, to enforce specific performance.

Automatically stipulating Delaware courts as the arbiter of disputes may not serve the best interest of the U.S. party when it looks to petition a specific performance remedy against the non-U.S. party.

Conduct of the Plaintiff

Recognizing that specific performance is an equitable remedy, Delaware courts have also considered whether the plaintiff has so-called clean hands and therefore deserved a decree of specific performance.

The Chancery Court has noted in 26 Capital that a request for specific performance will be denied when the plaintiff has obtained the agreement by sharp and unscrupulous practices, by overarching, by concealment of important facts, even though not actually fraudulent, by trickery, by taking undue advantage of [its] position, or by any other means which are unconscientious.[17]

For example, the court in 26 Capital found that the SPAC, the plaintiff, engaged in conduct that did not warrant a decree of specific performance where a hedge fund hired by the target company, the defendant, as an exclusive financial adviser owned 60% ownership interest in the SPAC sponsor and partnered with the SPAC to secure a more favorable deal for the SPAC.

Among other things, the hedge fund guided the negotiation of transaction documents in favor of the SPAC to the detriment of its client, the target, and secretly revealed to the SPAC the positions that the target would take in negotiations.[18]

In less egregious examples, Delaware courts have considered whether the party seeking specific performance performed its own obligations under the transaction document within the time specified, noting that where time is of the essence, a plaintiff seeking a decree of specific performance "must have performed [its own] obligations within the specified time, unless prevented from doing so by the defendant."[19]

In Twin Willows LLC v. Pritzkur, the plaintiff-buyer and the defendant-seller were parties to a real estate sale and purchase agreement that included a "time is of the essence" clause. The plaintiff-buyer petitioned the court to extend the drop-dead date of the agreement and to grant a specific performance remedy for the closing of the transaction.[20]

The court refused, finding that the plaintiff defaulted on a material obligation under the agreement when it failed to close on the date specified in the agreement.[21]

From the perspective of Delaware courts, the plaintiff seeking specific performance must come with "clean hands" and have done its part to perform under the relevant transaction agreement. In a typical M&A agreement, this line of thought is typically already memorialized in a reciprocal closing condition that each party shall have complied with its pre-closing covenants in all material respects.

While the failure of this closing condition alone would be sufficient to preclude the grant of a specific performance remedy from a pure contractual standpoint, it is important to note that satisfying these closing conditions does not by itself guarantee the grant of a specific performance remedy if the plaintiff does not otherwise come to the court with clean hands.

Irreparable Harm — No Adequate Remedy at Law

Another factor Delaware courts have considered is whether the party seeking specific performance has suffered irreparable harm and lacks an adequate remedy at law.

In the 2001 In re: IBP Inc. Shareholders Litigation decision, the Chancery enforced the closing of a merger agreement upon finding that the target stockholders would suffer irreparable harm if the agreement was not enforced. In so holding, the court considered that the target company was unique and that the business combination would yield value of an unquantifiable nature, rendering it difficult to determine the quantum of damages.[22]

The Chancery Court in the 1997 True North Communications Inc. v. Publicis S.A. decision similarly characterized a merger as an opportunity that cannot be quantified and held that monetary damages likely would not be a sufficient remedy for the loss of such opportunity.[23]

This line of cases suggests that Delaware courts will likely find that a party to an M&A transaction would suffer irreparable harm if the deal fails to close, given that each M&A transaction is unique and carries its unique benefits to any transaction party.

Other Factors

International Comity

The court in 26 Capital, among other factors, considered the existence of a binding order issued by the Philippine Supreme Court that might have been violated by the closing of the transaction.[24]

As a matter of comity, the court was reluctant to issue an order that potentially would cause a citizen of a foreign country to violate an order issued by that country's highest court, particularly when compliance with the U.S. court's order might subject a party to criminal contempt in a foreign country.[25]

Existence of a Specific Performance Provision — Language in the Contract

The existence of a specific performance provision demonstrating parties' clear intent in invoking this remedy has been given weight where "sophisticated parties represented by sophisticated counsel stipulate that specific performance would be an appropriate remedy in the event of" a breach, as per Snow Phipps and Level 4 Yoga.[26]

On the flip side, Delaware courts also give weight to language pointing to an intent of the parties not to avail themselves of a specific performance remedy. In the 2008 Hexion Specialty Chemicals Inc. v. Huntsman Corp. decision, the specific performance provision in the merger agreement included language precluding specific performance as a remedy for breach of defendants-buyer's obligation to close.[27]

After consideration of extrinsic evidence — including the plaintiff-target's own disclosure in its merger proxy statement — the court held that the agreement did not allow the plaintiff-target to specifically enforce the defendants-buyer's obligation to consummate the merger.[28]

Balancing the Harm

In balancing the equities, Delaware courts have considered whether, as per the October 2023 Schell Brothers LLC v. Pickard decision, "specific enforcement of a validly formed contract would cause even greater harm than it would prevent."[29]

In Schell Brothers, the Chancery upheld a lower court's award of specific performance, finding that specific enforcement would prevent greater harm to the petitioners than it would impose on the respondents. Without specific performance, the petitioners would lose the benefit of their bargain; and the respondents failed to show that an order of specific performance would harm them in any way.[30]

Key Takeaways

While the decision whether to grant a specific performance remedy is ultimately a decision reserved for the discretion of Delaware courts, the cases identified in this article provide important guidance for M&A practitioners.

The likelihood of obtaining a specific performance remedy to enforce the closing of a transaction increases in the later stages of a transaction when there is a more definitive pathway to closing. On the flip side, when there is a complex pathway with numerous remaining steps, Delaware courts are much less likely to grant a specific performance remedy.

In drafting a covenant of "reasonable best efforts," or its other variations, practitioners should include milestones and specific actions that the party should take or avoid. More specificity would increase a Delaware court's willingness to fashion and administer a specific performance remedy.

While the selection of Delaware law and courts is the default in many M&A transactions, this decision merits consideration when dealing with non-U.S. counterparties. In a transaction involving a non-U.S. party, the U.S. party should weigh the certainty and speed of obtaining the "right" juridical decision in Delaware against the ability to actually enforce a conduct remedy against a non-U.S. party, especially when there is no international treaty for mutual recognition of judgments.

4Specific performance is an equitable remedy that is available at the court's discretion. Any party seeking specific performance should keep in mind that its own conduct during the course of the transaction may impact its ability to obtain a remedy of specific performance.

If specific performance is a desired remedy, parties should ensure that the transaction documents include a provision clearly stating that specific performance remedy would be available, monetary damages would not be an adequate remedy, and a breach of the agreement would result in irreparable harm. While the existence of such provision is not dispositive, Delaware courts have given meaningful weight to its inclusion in transactions involving sophisticated parties.

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[1] Szambelak v. Tsipouras, 2007 WL 4179315, *4 (Del. Ch. Nov. 19, 2007).

[2] Carteret Bancorp, Inc. v. Home Grp., Inc., 1988 WL 3010, at *1-4 (Del. Ch. Jan. 13, 1988).

[3] Id. at *8.

[4] Id. The principle that a decree of specific performance should not require constant supervision by the court is widely recognized in Delaware court decisions, including in non-M&A contexts. For example, in Northern Delaware Industrial Development Corp. v. E.W. Bliss Co., the court denied the plaintiffs' demand for a decree of specific performance of an alleged term of a building contract to have more workers placed on a massive construction project and order the requisitioning of 300 workers per night (the number of workers plaintiffs deemed appropriate to promptly complete the project). The court concluded that it would not be appropriate to supervise "the carrying out of a massive, complex, and unfinished construction contract, a result which would necessarily follow as a consequence of ordering defendant to requisition laborers as prayed for" as well as finding that an effective enforcement by a court to keep a specific number of workers at the job to be both impracticable and impossible. N. Del. Indus. Dev. Corp. v. E. W. Bliss Co., 245 A.2d 431, 432-33 (Del. Ch. Jul. 9, 1968).

[5] Snow Phipps Grp., LLC v. KCake Acquisition, Inc., 2021 WL 1714204, at *56 (Del. Ch. Apr. 30, 2021). Technically, the receipt of debt financing was not a "closing condition," but the contract stated that the receipt of debt financing proceeds was a prerequisite for the specific performance remedy.

[6] Id. at *1.

[7] Id. at *51.

[8] Id. at *52.

[9] "Where a party's breach by nonperformance contributes materially to the nonoccurrence of a condition of one of his duties, the nonoccurrence is excused". Snow Phipps, 2021 WL 1714204, at *52 (quoting Restatement (Second) of Contracts § 245 (1981)).

[10] Id. at *52-55.

[11] Bardy Diagnostics, Inc. v. Hill-Rom, Inc., 2021 WL 2886188, at *1-17 (Del. Ch. Jul, 9, 2021).

[12] See id. at *40-42.

[13] Id. at *3, *40-42; see also Bardy Diagnostics, Inc. v. Hill-Rom, Inc., 2021 WL 2986308 (Del. Ch. Jul. 14, 2021) (order granting specific performance).

[14] Level 4 Yoga, LLC v. CorePower Yoga, LLC, 2022 WL 601862, at *30-31 (finding that the defendants breached an asset purchase agreement by failing to close by a specified date, and ordering the plaintiff to deliver all assets it agreed in the agreement to deliver and the defendant to pay a specified amount for such assets in accordance with the agreement); see also Level 4 Yoga, LLC v. CorePower Yoga, LLC, 2022 WL 861727 (Del. Ch. Mar. 22, 2022) (order granting specific performance).

[15] 26 Capital Acquisition Corp. v. Tiger Resort Asia Ltd., 2023 WL 5808203, at *1 (Del. Ch. Sept. 7, 2023).

[16] Id. at *26-28.

[17] Id. at *32 (quoting John Norton Pomeroy, Equity Jurisprudence, § 1335, at 931 (5th ed. 1941)).

[18] Id. at *32-33.

[19] Twin Willows, LLC v. Pritzkur, Tr. for Gibbs, 2022 WL 3039775, at *8 (Del. Ch. Aug. 2, 2022).

[20] Id. at *1-2.

[21] Id. at *12. Under the agreement, the petitioner had an obligation to use "good faith, diligent efforts" to obtain approvals required for the intended development of the property being sold, but the petitioner's obligation to consummate the purchase was not conditioned on the receipt of the approvals as it could waive the approvals and proceed to settlement or terminate the agreement. Id. at *9.

[22] In re IBP Inc. S'holders Litig. , 789 A.2d 14, 82-84 (Del. Ch. Jun. 18, 2001).

[23] True N.Commc'ns Inc. v. Publicis S.A. , 711 A.2d 34, 44-45 (Del. Ch. Dec. 23, 1997).

[24] 26 Capital, 2023 WL 5808203, at *30-31.

[25] Id. at *31.

[26] Snow Phipps, 2021 WL 1714204, at *51; Level 4 Yoga, 2022 WL 601862, at *30.

[27] Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 759 (Del. Ch. Sep. 29, 2008).

[28] Id. at *759-63.

[29] Schell Brothers LLC v. Pickard, 2023 WL 7132358, *3 (Del. Ch. Oct. 30, 2023) (citing Hastings Funeral Home, Inc. v. Hastings, 2022 WL 16921785, at *8 (Del. Ch. Nov. 14, 2022)).

[30] Id.