

Revisiting *Consolidated Edison*—A Second Look at the Case that Has Many Questioning Traditional Assumptions Regarding the Availability of Shareholder Damages in Public Company Mergers

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In October 2005, the U.S. Court of Appeals for the Second Circuit in *Consolidated Edison, Inc. v. Northeast Utilities* (“Con Ed”) ruled that electric utility company Northeast Utilities (“NU”) and its shareholders were not entitled to recover the \$1.2 billion merger premium as damages after NU’s suitor, Consolidated Edison, refused to complete an acquisition of NU. This case surprised many M&A practitioners who believed that the shareholder premium (or at least some measure of shareholder damages) would be recoverable in a suit against a buyer who wrongfully terminated or breached a merger agreement. If Con Ed proves to have established a general rule precluding the recovery of shareholder damages for a buyer’s breach of a merger agreement, the potential consequences to targets in merger transactions would be substantial—shifting the balance of leverage in any MAC, renegotiation, or settlement discussions decidedly to the buyer and effectively making every deal an “option” deal. This ruling, therefore, has left some target counsel struggling to find a way to ensure that the merger agreement allows for the possibility of shareholder damages while also avoiding the adverse consequences of giving shareholders individual enforcement rights as express third-party beneficiaries of the agreement.

The Con Ed case, however, merits a second look. This Article revisits the Con Ed decision and challenges the conclusion of some observers that the court in Con Ed established a general precedent denying the availability of shareholder damages. This Article also discusses how the holding of Con Ed may very well be confined to the facts and the specific language of the merger agreement at issue in the case. Notwithstanding, given the uncertainty surrounding how any particular court may approach the issues raised in Con Ed, this Article proposes model contract language that a target might employ to avoid creating a “Con Ed issue” and to minimize the risk of a result that was not intended by the parties.

OVERVIEW

In October 2005, the U.S. Court of Appeals for the Second Circuit ruled in *Consolidated Edison, Inc. v. Northeast Utilities* (“Con Ed”) that electric utility

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company Northeast Utilities (“NU”) and its shareholders were not entitled to recover the \$1.2 billion merger premium as damages after NU’s suitor, Consolidated Edison (“Con Ed”), refused to complete an acquisition of NU at the negotiated price.¹ The Second Circuit found that the parties’ merger agreement unambiguously prohibited NU or its shareholders from recovering the shareholder premium or other shareholder damages in the event of Con Ed’s breach prior to the effective time of the merger.² As a result of the court’s ruling, NU’s potential damages plummeted from \$1.2 billion to approximately \$27 million, which represented NU’s out-of-pocket costs incurred in connection with the failed deal.³

Con Ed highlighted for practitioners the danger of an inherent incongruity that exists within the majority of public company merger agreements. Specifically, many merger agreements include broad language in which the parties expressly disclaim any third-party beneficiary rights under the agreement (with a narrow exception for indemnification of the target company’s directors and officers).⁴ However, while not expressly carving out any rights with respect to the target company’s shareholders, the parties proceed with the underlying assumptions that (1) the target corporation is acting for the benefit of its shareholders in the merger context, and (2) in the event of a buyer’s breach or wrongful termination, the shareholders’ damages are effectively merged with damages suffered by the company and may be pursued and collected by the target corporation on the shareholders’ behalf.⁵ For ease of reference, we will

1. 426 F.3d 524, 531 (2d Cir. 2005). Con Ed refused to proceed with the merger on the ground that NU’s business had suffered an alleged material adverse change (commonly referred to as a “MAC”). *Id.* at 526. Following Con Ed’s refusal to proceed, NU declared the merger “effectively terminated.” *Id.* Con Ed then sued NU for breach of contract and fraudulent inducement, among other things, and NU counterclaimed for breach of contract. *Id.*

2. *Id.* at 529–30.

3. See *id.* at 527 & n.1. The only damages sought by NU were the out-of-pocket costs expended by NU to obtain various regulatory permits that were necessary for the merger. See *id.*

4. See, e.g., Agreement and Plan of Merger by and among HCA, Inc., Hercules Holding II, LLC, and Hercules Acquisition Corp. § 10.8 (July 24, 2006), available at <http://www.sec.gov/Archives/edgar/data/860730/000095014406006852/g02483exv2w1.txt>; Agreement and Plan of Merger among Swingset Holdings Corp., Swingset Acquisition Corp., and Bright Horizons Family Solutions, Inc. § 9.07 (Jan. 14, 2008), available at <http://www.sec.gov/Archives/edgar/data/1060559/000095014408000182/g11342exv2w1.htm>. A typical “no third-party beneficiary” provision might read, for example: “Nothing in this Agreement, express or implied, is intended to or shall confer upon any person other than Parent, Merger Sub, and the Company any right, benefit, or remedy of any nature whatsoever under or by reason of this Agreement, provided, however, that after the Effective Time, the Indemnified Persons shall be third-party beneficiaries of, and entitled to enforce, [the section titled ‘Indemnification of Officers and Directors’].” While some agreements expressly provide for the target shareholders as third-party beneficiaries for purposes of enforcing their rights to receive the merger consideration after the closing, this, in our experience, is a minority approach. As discussed in detail below, this minority approach was utilized in the *Con Ed* merger agreement.

5. Delaware courts have found that stockholders do not have direct contract rights under a merger agreement and are limited to pursuing derivative claims, except to the extent the stockholders can show (1) a duty to the stockholders (contractual or otherwise) that was breached, and (2) that they can prevail without showing an injury to the target corporation. See, e.g., *Tooley v. Donaldson,*

refer to this combination of contract language and underlying assumptions as the “Traditional Paradigm.”⁶

Under the traditional commercial contract model, the disclaimer of third-party beneficiary rights would usually preclude an award of damages to (or in reference to) a non-party to the agreement.⁷ However, the corporate merger agreement does not in many respects fall squarely into the traditional commercial contract model. Accordingly, we believe that practitioners utilizing the Traditional Paradigm have historically assumed that courts would adopt a practical (rather than literal) construction of the “no third-party beneficiaries” language and recognize that the purpose of the “no third-party beneficiaries” provision is to avoid the collective action and agency problems that would result from giving shareholders standing

Lufkin & Jenrette, Inc., 845 A.2d 1031, 1034–35 (Del. 2004) (holding that, given stockholders were not express third-party beneficiaries—except as to the right to receive the merger consideration after the effective time of the merger—any contractual stockholder right to payment of the merger consideration did not ripen until the conditions of the agreement were met; also finding no breach of the underlying merger agreement on which stockholders could state a claim); see also *In re Enron Corp.*, 292 B.R. 507, 514 (S.D.N.Y. 2002) (indicating that an express indication of intent to create a separate duty to the shareholders in their personal capacity must be found in order for shareholders to have an independent right of action). This standard is consistent with the assumption of the Traditional Paradigm, see *infra* note 6 and accompanying text, that shareholder damages are available where a merger agreement does not expressly identify shareholders as third-party beneficiaries. *Con Ed* can be cited for the same proposition as *Enron*, although the two courts, both of which followed a variation of the “minority approach,” differed as to whether the contract in question created standing or other rights in the shareholders *prior to the effective time*, with the court in *Enron* concluding it did. Compare *Con Ed*, 426 F.3d at 528–29, with *Enron*, 292 B.R. at 513–14. Though loss of the merger premium sounds like a claim unique to the shareholders, there are multiple theories of damages that correlate closer to loss of value attributable to harm to the corporation—such as “benefit of the bargain” damages, see *infra* note 72—and, in any event, loss of premium is still a claim suffered by all shareholders generally and solely in their capacity as shareholders. While it can be argued, correctly, that paying the shareholders’ damages to the company would not put the shareholders in the same position economically as if the deal were consummated (due to obvious tax inefficiencies should the board determine to distribute the proceeds of any settlement and the unlikely event that the share price increase would correspond dollar-for-dollar should such proceeds be retained by the company), this is no different than the settlement of most other derivative claims enforced by a company relating to actions of third parties.

6. While it is impossible to confirm that a consensus exists among practitioners as to assumptions underlying the “Traditional Paradigm,” our phraseology and the articulation of the related assumptions reflect our belief that the majority of public company merger agreements in recent history follow this approach. Moreover, we believe (educated by anecdotes, research, practice, and discussion among, and writings by, legal peers and commentators) that many mergers and acquisitions (“M&A”) practitioners understood that at least some measure of shareholder damages might be recoverable by a target in the event of a buyer’s breach or wrongful termination of the merger agreement, even if such damages could be difficult to prove or calculate. It is our belief that the latter assumption is in fact what typically brings the parties together to settle merger litigation based on MAC, fraud, or wrongful termination claims before these cases go to trial (thus accounting for the paucity of case law on the damages issues).

7. See, e.g., *MBIA Ins. Corp. v. Royal Indem. Co.*, 519 F. Supp. 2d 455, 464 (D. Del. 2007) (“To have standing to recover on a contract as a third party beneficiary, the contracting parties must have expressed an intention that the third party be a beneficiary, and that intention must affirmatively appear in the contract.”); *Nepco Forged Prods., Inc. v. Consol. Edison Co.*, 470 N.Y.S.2d 680, 681 (App. Div. 1984) (“The best evidence of whether contracting parties intended their contract to benefit third parties remains the language of the contract itself. . . . Where a provision exists in an agreement expressly negating an intent to permit enforcement by third parties . . . that provision is decisive.”).

to sue under the merger agreement—not to preclude an award of expectancy or other damages to (or on behalf of) a target corporation's shareholders.⁸

Several commentators have suggested that the Second Circuit's decision in *Con Ed* may call into question the viability of the Traditional Paradigm by broadly precluding the recovery of shareholder damages such as the merger premium in a failed merger transaction absent a clear contractual expression to the contrary.⁹ If *Con Ed* proves to have established a general rule precluding the recovery of shareholder damages for a buyer's breach of a merger agreement, the potential consequences to targets in merger transactions would be substantial—shifting the balance of leverage in any MAC, renegotiation, or settlement discussions decidedly to the buyer. In effect, every existing deal under the traditional construct would be arguably transformed into an “option” deal such that the buyer could walk away with little consequence. The recent string of busted deals has put a spotlight on these and other termination, remedy, and “deal certainty” issues, each of which has become a recent topic of concern and debate among M&A practitioners and commentators.¹⁰

A primary purpose of this Article is to take a closer look at the *Con Ed* decision and to challenge the broad conclusions that have been drawn by some commenta-

8. See, e.g., *infra* note 70 (commentary of Delaware Vice Chancellor Leo Strine). For example, the target has an obvious interest in controlling the litigation, making enforcement and settlement decisions, and determining whether to terminate the agreement or waive or amend (or grant any consent under) any provision of the agreement. Similarly, the buyer is interested in achieving certainty of closure following the outcome of any litigation with the target. See *Orban v. Field*, No. 12820, 1993 WL 547187, at *9 (Del. Ch. Dec. 30, 1993) (stating that “[t]he idea of shareholders having directly enforceable rights as third party beneficiaries to corporate contracts is, I think, one that should be resisted. One of the consequences of the limited liability that shareholders enjoy is that the law treats corporations as legal persons not simply [as] agents for shareholders.”). Thus, the Traditional Paradigm seeks to clarify the *Orban* court's view as between the parties, albeit at the expense of ambiguity as to the calculation or availability of shareholders damages to the extent enforced by the company. However, under the minority approach to the drafting of third-party beneficiary provisions in merger agreements, as in *Con Ed* where shareholders were express third-party beneficiaries, it becomes more challenging to justify an interpretation that would allow the company to collect shareholder damages. It is also possible, of course, that parties could limit damages to those incurred by the target corporation only.

9. See, e.g., Victor Lewkow & Neil Whoriskey, *Left at the Altar—Creating Meaningful Remedies for Target Companies*, M&A LAW., Oct. 2007, at 1, 1; see also Kevin Miller, *The Con Ed Decision—One Year Later: Significant Implications for Public Company Mergers Appear Largely Ignored*, M&A LAW, Oct. 2006, at 1, 1 (noting “the Second Circuit effectively held that, under New York law, an acquiror could not be held liable for target shareholders' lost merger premium if the target shareholders were not intended third-party beneficiaries entitled to such relief”).

10. See, e.g., Kevin M. Schmidt, *Going-Private Deal Terms: Allocating Risk in Today's Troubled Markets*, DEBEVOISE & PLIMPTON PRIVATE EQUITY REP., Spring 2008, at 3; Herbert F. Kozlov & Jonathan P. Moyer, *Deal Termination Litigation: The “Material Adverse Change Clause” and Other Escape Clauses in a Tightening Deal Market*, REED SMITH BULL., Jan. 2008, at 1; Malcolm Landau, Raymond Gietz & Michael Aiello, *A Closer Look at Reverse Termination Fees and Exclusive Remedy Provisions*, WEIL BRIEFING: MERGERS & ACQUISITIONS, Nov. 29, 2007, at 1; David Shine & Omri Flicker, *GC New York: The Unhappy Buyer*, N.Y.L.J., July 17, 2008, at 1; Memorandum from Peter S. Golden, Arthur Fleischer Jr. & David N. Shine, Fried, Frank, Harris, Shriver & Jacobson LLP (Dec. 2, 2008) (“Negotiated Cash Acquisitions of Public Companies in Uncertain Times”) (on file with *The Business Lawyer*) [hereinafter “Golden, Fleischer & Shine”]; Overton Thompson III & Ryan D. Thomas, *The New World of Leveraged Buyout “Deal Protection,”* CORP. BOARD, July/Aug. 2008, at 15.

tors about the precedential significance of the case.¹¹ This Article also attempts to provide additional support for the validity of the Traditional Paradigm and considers how a court might reach a contrary result to that reached in *Con Ed* even under the facts of that case. Finally, given the continuing uncertainty about whether the Traditional Paradigm continues to be a viable approach after *Con Ed*,¹² this Article offers a suggested model approach for dealing with what has become known as the “*Con Ed* issue”—the desire to ensure that the contract allows for shareholder damages while also avoiding the adverse consequences of making shareholders express third-party beneficiaries to the merger agreement. A workable solution to the “*Con Ed* issue” is critical to ensure balanced leverage to both the buyer and the target (apart from the merits of any MAC, fraud, or breach of contract claim) when it comes to termination, remedies, and settlement discussions—a balance that was previously accomplished by what might be called an “intentional ambiguity” in the merger agreement regarding the availability or calculation of shareholder damages. The Article concludes by highlighting ways to help avoid the result in *Con Ed* where such a result was not intended by the parties.

I. THE *CON ED* DECISION

A. BACKGROUND

In the fall of 1999, Con Ed agreed to purchase NU for \$3.6 billion, representing a \$1.2 billion premium over the aggregate trading price of NU’s outstanding shares at the time.¹³ A few months after the deal was announced, Con Ed declared that NU had suffered a material adverse change in its business and announced that Con Ed would not proceed with the merger unless NU agreed to a lower purchase price.¹⁴ NU rejected Con Ed’s invitation to renegotiate the deal, treated Con Ed’s demand as an anticipatory breach, and declared that the merger was “effectively terminate[d].”¹⁵

Con Ed thereafter sued NU for breach of contract, fraudulent inducement, and negligent misrepresentation, among other claims.¹⁶ NU responded with a counterclaim for breach of contract, alleging that Con Ed was simply suffering from a case of buyer’s remorse and claiming as damages the \$1.2 billion merger premium to which NU’s shareholders had been entitled under the merger agreement.¹⁷ On its motion for summary judgment, Con Ed argued that NU lacked standing to recover its shareholders’ lost merger premium because the shareholders were

11. See *supra* note 9.

12. This uncertainty includes a lack of certainty as to uniformity across the innumerable jurisdictions and venues in which the merger contracts may be considered, including the varying degrees of commercial sophistication and experience (in complex merger litigation) of the courts.

13. *Consol. Edison, Inc. v. Ne. Utils.*, 426 F.3d 524, 526 (2d Cir. 2005).

14. *Id.* at 526.

15. *Id.* (alteration in original) (internal quotation marks omitted). NU also alleged \$27 million in damages representing out-of-pocket expenses. See *id.* at 527 n.1.

16. *Id.* at 526.

17. *Id.*

not entitled to third-party enforcement rights until after consummation of the merger.¹⁸ The U.S. District Court for the Southern District of New York disagreed with Con Ed and ruled that NU was entitled to sue on behalf of its shareholders to collect the \$1.2 billion merger premium.¹⁹ The court based its decision largely upon the prevention doctrine, finding that if Con Ed “unilaterally and unlawfully breached the merger agreement” as alleged by NU, Con Ed should not be excused from its obligations to NU’s shareholders on the basis of a technical argument that the shareholders’ third-party rights did not arise until the consummation of the merger.²⁰

Thereafter, NU shareholder Robert Rimkoski intervened in the case as a representative of a proposed class of NU shareholders asserting a claim for “expectancy damages.”²¹ Over objection by NU, the district court granted Rimkoski’s motion to intervene.²² The court also denied a motion by Con Ed to dismiss NU’s counterclaim for recovery of the merger premium.²³

Shortly thereafter, the district court ruled that Rimkoski’s class had the right to pursue Con Ed for recovery of the lost merger premium and that NU did not.²⁴ Accordingly, the court dismissed NU’s claim against Con Ed for recovery of the merger premium and denied a motion by NU to dismiss Rimkoski’s cross-claim against Con Ed.²⁵

B. THE SECOND CIRCUIT’S RULING

On appeal, the Second Circuit reversed the district court’s ruling and found that neither NU acting on behalf of its shareholders nor any other class of NU shareholders was entitled to recover the lost \$1.2 billion merger premium as damages for Con Ed’s alleged breach of the merger agreement.²⁶ In reversing the district court, the Second Circuit relied heavily on the precise language of the merger agreement and rejected the district court’s prevention doctrine analysis, finding that the prevention doctrine could not be used to circumvent the plain language of the agreement.²⁷

18. *Consol. Edison, Inc. v. Ne. Utils.*, 249 F. Supp. 2d 387, 416 (S.D.N.Y. 2003), *rev’d in part*, 426 F3d 524 (2d Cir. 2005).

19. *Id.* at 417.

20. *Id.* at 417 & n.11. The prevention doctrine “excuses a condition of performance in a contract when a party wrongfully prevents the occurrence of the contract.” *Doherty v. Am. Home Prods. Corp.*, No. 99-9533, 2000 WL 777948, at *2 (2d Cir. June 15, 2000) (citing *Haft v. Dart Group Corp.*, 877 F. Supp. 896, 903 (D. Del. 1995)), *cert. denied*, 531 U.S. 1075 (2001).

21. *See Consol. Edison, Inc. v. Ne. Utils.*, No. 01 Civ. 1893 (JGK), 2003 U.S. Dist. LEXIS 23532, at *7 (S.D.N.Y. Jan. 7, 2004).

22. *Id.* at *21.

23. *Id.*

24. *Consol Edison, Inc. v. Ne. Utils.*, 318 F. Supp. 2d 181, 197 (S.D.N.Y. 2004), *rev’d in part*, 426 F3d 524 (2d Cir. 2005).

25. *Id.* at 197.

26. *Consol. Edison, Inc. v. Ne. Utils.*, 426 F3d 524, 527 (2d Cir. 2005).

27. *Id.* at 528–29.

The court began its analysis by studying the merger agreement to ascertain whether Con Ed and NU “intended to confer upon NU’s shareholders a right to enforce [Con Ed’s] promise to complete the merger (and thus a claim against [Con Ed] for the \$1.2 billion premium).”²⁸ The court analyzed numerous provisions of the agreement to assess the parties’ intent, beginning with the third-party beneficiary provision.²⁹ The third-party beneficiary provision stated, in relevant part, that “except for the provisions of Article II” of the agreement, the agreement was “not intended to confer upon any person other than the parties any rights or remedies.”³⁰ Article II of the merger agreement provided that at the “NU Effective Time” (e.g., the consummation of the merger), each outstanding NU share would be converted into the right to receive cash or stock in the post-merger company.³¹ The court read these provisions in tandem to conclude that “the only third-party right conferred on NU’s shareholders is a right, arising upon completion of the merger, to receive payment for their shares.”³²

The court also observed that the “overall context and scheme” of the agreement supported the conclusion that the parties intended to preclude any third-party rights until after the NU Effective Time.³³ A limited third-party beneficiary right to shareholders was necessary, in the court’s view, because once the NU Effective Time had occurred, NU would no longer exist as an independent entity and could no longer enforce its former shareholders’ rights to the merger proceeds.³⁴ Accordingly, NU’s shareholders needed a third-party right so that they could enforce their post-transaction rights without the aid of NU. Ultimately, the court noted that “[i]f we were to find a third-party right for shareholders to seek damages for breach of the duty to merge before the NU Effective [T]ime, that right would overwhelm the careful arrangements that the Agreement makes for that contingency, and would unduly limit the signatories’ own freedom of action to accept or hazard the contractual consequences of non-performance.”³⁵

The court also considered the breach and termination provisions contained in the merger agreement, observing that the agreement provided that NU could terminate in the event of a material breach by Con Ed.³⁶ Under the merger agreement,

28. *Id.* at 527.

29. *See id.* at 527–29.

30. *Id.* at 528 (emphasis omitted). The entire text of the third-party beneficiaries provision provided:

This Agreement . . . (i) constitutes the entire agreement, and supersedes all prior agreements and understandings, both written and oral, among the parties with respect to the subject matter of this Agreement . . . and (ii) except for the provisions of Article II and Article 5.08, [is] not intended to confer upon any person other than the parties any rights or remedies.

Id. at 528 (ellipses and alterations in original) (emphasis omitted).

31. *Id.*

32. *Id.* (emphasis in original).

33. *Id.* at 529.

34. *See id.*

35. *Id.* at 530.

36. *Id.*

the effect of a termination was that the agreement “shall forthwith become null and void and have no effect, without any liability or obligation on the part of [Con Ed] or NU, other than the provisions of Section 3.01(q), Section 3.02(o), the penultimate sentence of Section 5.04(a), Section 5.09, this Section 7.02, and Article VIII, which provisions shall survive such termination.”³⁷ Yet, the court noted that none of the specified sections that survived termination provided any support for the shareholders’ right to sue Con Ed for the merger premium.³⁸ Indeed, the merger agreement provided that a party that terminated the agreement on the basis of a violation of the other party’s covenants, representations, and warranties would be entitled to a \$20 million expense reimbursement to be paid by the breaching party.³⁹ The court found that “[n]one of [the breach and termination] provisions contemplate the NU shareholders’ right to sue [Con Ed] for the lost \$1.2 billion premium, and any such right would overwhelm the specified and limited remedies available to each party in the event of breach and termination of the Agreement.”⁴⁰

Finally, the court considered a provision in the merger agreement setting forth the remedy for a “willful and material breach” of the agreement by either party.⁴¹ The merger agreement provided that, in the event of a

termination result[ing] from the willful and material breach by any party of its representations, warranties, covenants or agreements set forth in the Agreement:

... such termination shall not relieve any party of any liability or damages resulting from its willful and material breach of this Agreement (including any such case in which a Termination Fee or any expense reimbursement fee is payable pursuant to Section 5.09), to the extent any such liability or damage suffered by the party entitled to such payment exceeds the amount of such payment.⁴²

The court placed great weight upon this provision, which applied only to “liability or damage suffered by *the party*,” not by non-parties, and therefore not by NU’s shareholders.⁴³ The court thus concluded that the sections of the merger agreement that governed breach and termination provided no support for NU’s shareholders’ right to sue Con Ed for failure to complete the merger.⁴⁴ To the contrary, the court found, “[T]hat article reflects the parties’ intent [i] to limit the damages resulting from a breach of the Agreement to those owed to each other; and even then, [ii] to liquidate and limit those damages, except in the case of a willful and material breach.”⁴⁵ The court found that this contractual scheme afforded to each

37. *Id.* (emphasis omitted).

38. *See id.*

39. *Id.* at 530–31.

40. *Id.* at 530.

41. *See id.* at 531.

42. *Id.* (emphasis omitted).

43. *Id.* (emphasis altered).

44. *See id.*

45. *Id.*

party “a critical power to abandon the merger if it is willing to suffer the stipulated consequences, a power that would be illusory if such abandonment could trigger a potential billion-dollar liability to the shareholders.”⁴⁶

The Second Circuit also rejected NU’s argument based on the prevention doctrine. NU argued that Con Ed should not be excused from paying the merger premium because it was Con Ed’s wrongful breach that prevented the merger from closing and the NU Effective Time from arising.⁴⁷ However, the court found that the prevention doctrine created nothing more than an implied contractual obligation and could not create rights that were specifically denied under the terms of the parties’ merger agreement.⁴⁸ In sum, the court found that neither NU (on behalf of its shareholders) nor NU’s shareholders directly had a right to seek the merger premium because the parties’ agreement carefully limited the damages resulting from a breach of the agreement to those damages owed to each other and expressly limited the shareholders’ pre-consummation third-party rights.

II. WHAT IS THE PRECEDENTIAL SIGNIFICANCE OF *CON ED*?

Several practitioners have suggested that *Con Ed* stands for the broad proposition that “absent clear contractual language to the contrary, neither the shareholders of a target company nor the target company itself (on behalf of its shareholders) [can] collect lost shareholder premium as damages for a breach of a merger agreement.”⁴⁹ In other words, they believe that *Con Ed* calls into question the continued viability of the Traditional Paradigm as an approach to drafting and understanding the corporate merger agreement. Commentators have also suggested that the *Con Ed* decision “challenged, and potentially seriously undermined, the legal arguments used to justify granting a target’s request for specific performance of a merger agreement—e.g., in cases like *In re: IBP*”⁵⁰ Ostensibly, this is because a critical factor in any specific performance analysis is the inadequacy of money damages (as well as the difficulty of calculating such damages).⁵¹ Were shareholder damages

46. *Id.*

47. *Id.* at 528.

48. *See id.*

49. *See, e.g.,* Lewkow & Whoriskey, *supra* note 9, at 1; *see also* Miller, *supra* note 9, at 1.

50. *See, e.g.,* Miller, *supra* note 9, at 1 (citing *IBP, Inc. v. Tyson Foods, Inc. (In re IBP, Inc. S’holders Litig.)*, 789 A.2d 14 (Del. Ch. 2001) [hereinafter “*Tyson*”]).

51. One of the critical considerations evaluated by the *Tyson* court in determining whether to award specific performance was whether the merger represented a unique opportunity to IBP’s shareholders that could not be adequately monetized. *See Tyson*, 789 A.2d at 83. The *Tyson* court ultimately found that, “because the Merger Agreement provides the IBP stockholders with a choice of cash or Tyson stock, or a combination of both, . . . the IBP stockholders were offered a chance to share in the upside of what was touted by Tyson as a unique, synergistic combination.” *Id.* The difficulty of calculating the appropriate measure of damages for a cash deal would also be a significant factor contributing to a court’s conclusion that specific performance is the preferable remedy. *See id.*; *but see* *Rus, Inc. v. Bay Indus.*, No. 01 Civ. 6133 (GEL), 2004 WL 1240578, at *22 (S.D.N.Y. May 25, 2004) (finding that the measure of contract damages in New York for breach of a stock purchase agreement involving a privately owned target company is the difference between the contract price and the fair market value of the property being sold at the time of breach), *aff’d sub nom. Recticel Foam Corp. v. Bay Indus., Inc.*, 126 F. App’x 798 (2d Cir. 2005). *Rus v. Bay* is likely more of academic interest than direct relevance in the context of a public company merger.

eliminated from the equation, the target corporation would have the burden of demonstrating other types of irreparable injury—a difficult task given that most types of legal injuries, such as the incurrence of out-of-pocket expenses, are easily quantifiable and presumably could be readily redressed through an award of money damages.⁵² It is possible, therefore, that specific performance would not be the preferred remedy of the court even where specific performance is expressly available under the contract.⁵³

If these sweeping conclusions follow from *Con Ed*, target corporations should be concerned that nearly every public merger transaction will be transformed, in substance, into an “option” deal allowing the buyer to walk away with little consequence.⁵⁴ This would also shift the balance of leverage in any renegotiation or settlement discussions firmly into the buyer’s camp. We believe that buyer behavior has historically been checked, in part, by the prospect of meaningful (if not massive) shareholder damages in the event of the buyer’s breach or wrongful termination. For this reason alone, a broad rule that shareholder damages are generally unavailable *cannot* be correct. What reasonable policy would be served by so severely disadvantaging target corporations in their ability to enforce the deal or to negotiate a settlement on behalf of their shareholders? The approval of a true “option” deal should be (and is generally understood to be)⁵⁵ an informed, deliberate

52. Certain types of damages would, however, be potentially significant, but inherently challenging to quantify, which presents other issues. See *infra* note 105.

53. See *Peden v. Gray*, No. 188, 2005, 2005 Del. LEXIS 389, at *10 (Oct. 14, 2005) (“[S]pecific performance is a matter of grace that rests in the sound discretion of the court.”); but see *Tyson*, 789 A.2d at 82–84 (concluding that precisely because of the challenges of quantifying certain damages, specific performance was the preferable remedy to ensure the target and its shareholders were made whole and received the benefit of the bargain). In a state that recognizes freedom of contract broadly, such as Delaware, it is also likely that the court will give more deference to the parties’ written agreement that specific performance should be an available remedy to both parties, despite the possibility of an adequate damages remedy. See *infra* note 115.

54. The so-called “option” deal structure has been utilized in recent years principally by private equity buyers—whereby the target does not have specific performance rights and the sole remedy for the buyer’s breach is liquidated or other damages capped at a specified dollar amount. Notably, such damages are set well in excess of what “out-of-pocket” costs may be (often mirroring the target’s break-up fee), and sometimes are in addition to such out-of-pocket costs. See Jane Grey, “Reverse Break-Up Fees”—A New Trend in “Going Private” LBOs?, M&A SMART CAPITAL (LATHAM & WATKINS), Nov. 2005, at 1; Landau, Gietz & Aiello, *supra* note 10, at 1. This presumably reflects an understanding and expectation of the parties that shareholder damages are part of the mix when a buyer breaches or wrongfully terminates. Moreover, the only reason the damages are capped is a result of a concession targets must make in a private equity leveraged buyout (“LBO”) in order to avoid a financing condition—private equity buyers typically do not effect acquisitions through operating companies with tangible assets from which a target could seek recourse and thus will not or cannot, pursuant to the fund documents, agree to expose themselves or their funds to unlimited liability for their breaches. However, the “option” deal structure has recently spread to certain transactions with strategic buyers. See *infra* note 110 and accompanying text.

55. The veracity of this conclusion is evident in the aftermath of the broken deals that followed the subprime crisis beginning in July 2007. Private equity “option” deals such as the Acxiom, Reddy Ice, and PHH deals by and large settled for an amount that approximated a reverse break-up fee (e.g., 3 to 5 percent of the deal price). See Michael Gains, Jamie Koumanakos & Lindsay Bunt, *Leveraged Buyouts Gone Bust*, BLAKE, CASSELS & GRAYDON LLP BULL.: MERGERS & ACQUISITIONS, June 2008, at 1. On the other hand, strategic deals like the failed Genesco/Finish Line merger and the Huntsman/

decision by a target board that is backed by a merger agreement expressly reflecting the parties' agreement as to the "option" nature of the deal. In practice, such "option" deals are more commonly found in private equity buyouts.⁵⁶ Should the burden in every deal be placed upon the target corporation to negotiate with the buyer to expand a limited set of "default" remedies to capture shareholder damages, possibly at the expense of other critical terms or even of value? Such a rule could have a severe chilling effect on target boards' willingness to recommend potential value-creating transactions with strategic buyers because it both reduces the certainty of closure and increases the chance that the company will be unable to achieve a meaningful remedy in the event of a broken deal.⁵⁷

Consequently, *Con Ed* should not be interpreted to stand for these sweeping general propositions. Rather, it should be viewed as a fact-specific analysis and an exercise in strict contractual interpretation.

A. THE MERGER AGREEMENT IN *CON ED* DID NOT FOLLOW THE TRADITIONAL PARADIGM AND THE HOLDING OF *CON ED* CAN BE CONFINED TO ITS FACTS AND CIRCUMSTANCES

At first blush, it is easy to conclude that *Con Ed* calls into question the continued viability of the Traditional Paradigm. A careful reading of *Con Ed*, however, reveals that the Second Circuit may not have intended to make any broad statement about the availability of shareholder damages or specific performance.

The court based its ruling on the express intent of the parties as evidenced solely by the language of the contract, which in the court's view unambiguously defined, and limited, the rights of NU and its shareholders. The court found support for its conclusion in various provisions of the merger agreement:

Hexionmerger settled for amounts substantially in excess of the standard reverse break-up fee levels. See Rose French, *Genesco, Finish Line Agree to Settlement*, USA TODAY, Mar. 3, 2008, http://www.usatoday.com/money/economy/2008-03-03-291494606_x.htm; Ernest Scheyder & Matt Moore, *Hexion's \$6.5B Takeover of Huntsman Terminated*, WASH. POST, Dec. 15, 2008, <http://www.washingtonpost.com/wp-dyn/content/article/2008/12/15/AR2008121500669.html>. As described in *supra* note 54, the so-called "option" structure is a relatively new phenomenon and term of art with respect to public company mergers, catching on principally following the broken private equity going private transactions referenced above.

56. See Landau, Gietz & Aiello, *supra* note 10, at 1; Golden, Fleischer & Shine, *supra* note 10, at 3.

57. This is not to say buyers may not argue that an "option" structure is fair for strategic buyers, especially if the buyer's competition for a target is a private equity group. Target boards have, obviously, found comfort in approving "option" structures in going private transactions with private equity groups—though we anticipate that targets will be seeking higher reverse break-up fee levels given the recently demonstrated willingness of private equity buyers to exercise their options (or seek to renegotiate the prices) and of lenders to fight their way out of good deals turned bad. See Golden, Fleischer & Shine, *supra* note 10, at 3–4. The ability of strategic buyers to achieve such a departure from historical practice is a matter of leverage and negotiation, as they do not have the limitations inherent in the typical private equity buyer merger structure. See *infra* note 110 for a discussion of a recent strategic deal following an "option" model.

- The third-party beneficiary language in the agreement disclaimed any third-party beneficiary rights, *except for* the rights of shareholders to receive the merger premium *after* the NU Effective Time. The use of this construct was instrumental to the court's conclusion that third-party beneficiary rights of shareholders *prior to* the NU Effective Time were expressly precluded by the agreement. Essentially the parties defined and then limited the specific rights of NU's shareholders.⁵⁸
- The merger agreement limited damages in the event of a breach to those suffered "by the part[ies]" and, therefore, specifically excluded shareholder damages. The use of this language not only resulted in a conclusion by the court that shareholder damages were intentionally excluded, but gutted the effectiveness of any argument under the prevention doctrine, which cannot be used to create a term that is inconsistent with the express terms of the agreement.⁵⁹
- The termination provisions of the merger agreement provided a specific remedy for a termination by NU as a result of Con Ed's breach of a covenant, representation, or warranty—payment of the \$20 million expense reimbursement fee—but the merger agreement did not provide for (or seemingly contemplate) shareholder damages under such circumstances.⁶⁰

Because the court based its decision solely on the particular language of the agreement that was before it, the court in *Con Ed* did not address the assumptions underlying the Traditional Paradigm. Indeed, there was no need to consider the traditional model because the contract language actually *established* an express third-party right on behalf of NU's shareholders. Accordingly, it seems a tenuous conclusion that the court's decision necessarily undermined the continued viability of the Traditional Paradigm or a target's ability to secure the remedy of specific performance. Nowhere in the opinion does the court suggest that it is establishing a broader principle about the availability of shareholder damages or specific performance. The court did not discuss shareholder damages or specific performance generally from a conceptual or legal standpoint. Nor did the court address what might have resulted had the agreement not designated NU's shareholders as express third-party beneficiaries. From the perspective of NU, the contract may have been *too* clear. The court found that the parties went to "pains"⁶¹ to limit the rights of the shareholders and the consequences of Con Ed's breach. In our experience, many merger agreements do not contain such express provisions from which the inferences made by the

58. See *supra* notes 29–35 and accompanying text.

59. See *supra* notes 47–48 and accompanying text.

60. See *supra* notes 36–40 and accompanying text.

61. *Consol. Edison, Inc. v. Ne. Utils.*, 426 F.3d 524, 528 (2d Cir. 2005) ("Here, the parties to the Agreement clearly created a third-party right, but just as clearly they took pains to assure that the right was limited to a right to collect the shareholder premium if and when the merger happened, not a right to sue to compel completion of the merger or for damages resulting from a party's refusal to merge.").

court can be drawn. Thus, for practitioners to expand the court's ruling beyond the specific facts and circumstances of the case may be to stretch the opinion beyond its intended reach.

In addition to the specific contract provisions at issue in *Con Ed*, there were other circumstances that could have contributed to the court's decision. It does not appear that the court was searching vigorously for an avenue to reach a different result as to the availability of shareholder damages.⁶² Given the size of the merger premium, which amounted to \$1.2 billion, a damages award that contemplated the shareholders' expectancy could have crippled or at least significantly impaired Con Ed. The size of the damages award being claimed could have influenced the court to attempt to find contractual support for a decision to deny the shareholders the right to recover the merger premium, particularly where Con Ed had apparently viable claims of its own pending against NU with the possibility of a damages payment to Con Ed.⁶³ The court may also have had concerns about standing, and specifically whether NU would be the proper party to bring the shareholders' claim for damages if such damages were found to be allowable (especially in light of the district court's holding on this issue⁶⁴). In other words, the express introduction of the shareholders as intended third-party beneficiaries may have suggested to the court that shareholder damages might not be the same as NU's damages and that NU was essentially providing that the shareholders were responsible for their own "collection."⁶⁵

Additionally, NU had declared the merger agreement "effectively terminated" and counterclaimed for damages only. By doing so, NU waived any argument for specific performance of the merger agreement and conceded that money damages were the appropriate remedy for breach. Had NU sued for specific performance of the merger agreement instead of declaring an effective termination and asserting a damages claim, the technicalities of the termination and third-party beneficiary provisions of the merger agreement may not have been scrutinized.

62. As discussed in the remainder of this part below, there was ample precedent and support for the court to reach a different conclusion, at least as to the damages question. The court went out of its way to be clear that it was searching the whole contract to confirm that intent was "manifested in the overall context and scheme of the Agreement"—possibly to make a convincing argument that extrinsic evidence was not needed to confirm the intent of the parties. *See id.* at 529.

63. As a postscript to the *Con Ed* case, NU recently agreed to pay Con Ed \$50 million to settle the merger litigation. *See* Settlements and Verdicts, Energy Buyout Fails, <http://www.lawyersandsettlements.com/settlements/11291/consolidated-edison-northeast-utilities.html> (last visited Jan. 23, 2009). Previously, the court had denied NU's motion for summary judgment on several of Con Ed's claims against NU. *See* *Consol. Edison, Inc. v. NE. Utils.*, No. 1:01-cv-01893, slip op. at 1 (S.D.N.Y. Feb. 1, 2008).

64. *See supra* notes 21–25 and accompanying text.

65. The facts and events surrounding *Con Ed* also illustrate the potential danger in introducing shareholders as express third-party beneficiaries—including emboldening the plaintiffs to try to disrupt any settlement efforts. *See In re Enron Corp.*, 292 B.R. 507, 513–14 (S.D.N.Y. 2002) (finding that the parties manifested in the contract their intent to provide a separate right of action for the shareholders). There is a question whether the court in *Con Ed* would have read the contract so literally had Rimkoski not sought to supplant himself for NU on behalf of the shareholders.

B. A BROAD PRECLUSION OF SHAREHOLDER DAMAGES IS INCONSISTENT WITH THE ASSUMPTIONS INHERENT IN THE TRADITIONAL PARADIGM, WHICH HAVE BEEN IMPLICITLY APPROVED IN *TYSON* AND CAN BE RECONCILED WITH TRADITIONAL CONTRACT LAW PRINCIPLES

While *Con Ed* may be effectively limited to its facts, there may also be precedential grounds for not drawing a distinction between the damages of the target corporation and those of its shareholders. Based on the seminal merger case of *IBP, Inc. v. Tyson Foods, Inc.*,⁶⁶ it seems clear that at least some courts would be reluctant to limit shareholder damages under the Traditional Paradigm. In *Tyson*, the Delaware Court of Chancery ordered Tyson Foods to complete its agreed acquisition of IBP after Tyson attempted to back out of the merger.⁶⁷ Among the considerations that the court weighed in determining to award specific performance was the potential magnitude of any damages award, clearly evidencing that the court contemplated an expectancy-based damages award for the benefit of IBP and its shareholders.⁶⁸ The *Tyson* court stated:

In addition, the determination of a cash damages award will be very difficult in this case. And the amount of any award could be *staggeringly large*. No doubt the parties would haggle over huge valuation questions, which (Tyson no doubt would argue) must take into account the possibility of a further auction for IBP or other business developments. A damages award can, of course, be shaped; it simply will lack any pretense to precision. An award of specific performance will, I anticipate, entirely eliminate the need for a speculative determination of damages.⁶⁹

The IBP-Tyson merger agreement contained a third-party beneficiary provision that followed the Traditional Paradigm; yet the Delaware Court of Chancery contemplated an expectancy-based award of damages that would have compensated IBP's shareholders for their damages. The court in *Tyson* therefore seems to have fundamentally assumed that the damages of the corporation and those of its shareholders should be viewed collectively for enforcement purposes. Thus, *Tyson* is arguably the only actual precedent addressing the validity of shareholder damages (albeit in dicta) in the context of a public company merger. The availability of shareholder damages, which support the implicit assumptions of the Traditional Paradigm, were confirmed by Delaware Vice Chancellor Leo Strine, the judge who decided *Tyson*, at a continuing legal education conference in January 2008.⁷⁰ As observed by Vice Chancellor Strine, the assumption that shareholder damages may be available in the event of a breach reflects a logical and practical understanding by the parties to merger agreements and provides for an orderly dispute

66. *IBP, Inc. v. Tyson Foods, Inc.* (*In re IBP, Inc. S'holders Litig.*), 789 A.2d 14 (Del. Ch. 2001).

67. *See id.* at 82–84.

68. *See id.* at 83.

69. *Id.* (emphasis added).

70. Leo Strine, Vice Chancellor, Del. Court of Chancery, Remarks at Securities Regulation Institute Seminar at the Northwestern University School of Law (Jan. 24, 2008) ("M&A Trends and Developments") (audiotape available at <http://www.eondirect.com/northwestern/PublicSite/ViewCourses.asp>).

resolution procedure. Given its limited purpose in the context of the corporate law and practicalities relating to public company mergers, typical “no third-party beneficiaries” language in this context should not be read to restrict damages absent a clear expression of intent to the contrary in the contract.⁷¹

If one accepts as valid the Traditional Paradigm’s implicit recognition that company and shareholder damages are effectively one and the same, it is then possible to reconcile the fact that shareholders are not actual third-party beneficiaries to a merger agreement with basic principles of contract damages.⁷² “[D]amages for breach of contract are intended to restore the aggrieved party to the same economic position he or she would have enjoyed had the contract been performed.”⁷³ If we accept that a corporation’s shareholders are the primary economic beneficiaries of any merger and that the claims of the shareholders in this context are essentially one with those of the target corporation, it is consistent with contract damages principles to allow the recovery of the shareholders’ expectancy damages.

Additionally, an argument under the prevention doctrine or the implied covenant of good faith and fair dealing might also be more persuasive in the context of a merger agreement following the Traditional Paradigm (as it was for the district court in *Con Ed*). Under the Traditional Paradigm, the contract does not define the rights of the shareholders, nor does it expressly limit recourse to damages incurred by *the parties*. It is not contractually evident that the target would be unable to collect damages sustained by its shareholders as a result of the buyer’s frustration of the closing conditions or other breach or wrongful termination. Thus, where not undermined by any express contract provision, an argument based on the prevention doctrine would likely have more force.

When a question was raised about the impact of the *Con Ed* decision, Vice Chancellor Strine made the following statement:

I don’t understand what the purpose of a board of directors negotiating a cash-out merger for its stockholders is if it is not . . . to obtain, as an instrument of the stockholders, the profits of the contract. And I always thought the . . . third-party beneficiary [provision] was not designed to deprive the corporation of remedies pursued in good faith by the directors on behalf of the stockholders, but designed to deal with the cacophony that could arise with individual shareholders trying to enforce a contractual right. . . . I really don’t have difficulty conceptualizing that the contract was negotiated for the benefit of the stockholders as it must be by the directors. . . . that in order to . . . honor the expectations of the parties you have to recognize that was its purpose and to allow the board of directors as an instrument for those stockholders to collect.

Id.

71. As discussed herein, it is debatable whether the merger agreement in *Con Ed* contained a clear expression of an intention to the contrary.

72. A principle of contract damages is that the damages for breach of contract are measured by the injury to the non-breaching parties to the contract. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981) (providing that “the injured party has a right to damages based on his expectation interest as measured by (a) the loss in the value to him of the other party’s performance caused by its failure or deficiency, plus (b) any other loss, including incidental or consequential loss, caused by the breach, less (c) any cost or other loss that he has avoided by not having to perform”).

73. *Belanger v. Boise Cascade Corp.*, 968 F.2d 254, 258 (2d Cir. 1992); see also *Crossett-W. Lumber Co. v. Sudden & Christenson*, 286 F. 482, 486 (9th Cir. 1923) (“Damages for breach of contract should be such compensation as will restore the injured party to the same pecuniary condition that he would have been in, had the contract been performed.” (internal quotation marks omitted)).

C. THE AVAILABILITY OF SHAREHOLDER DAMAGES AS A GENERAL PRINCIPLE IS CONSISTENT WITH CORPORATE LAW AND WITH A DIRECTOR'S FIDUCIARY DUTIES

The notion that *Con Ed* broadly precludes shareholder damages is called further into question when considered against the backdrop of fundamental principles of corporate law, and particularly the law with regard to fiduciary duties of corporate directors. Regardless of any disclaimer of third-party beneficiary rights in the merger agreement, it is the shareholders, as the intended beneficiaries of the merger consideration, who stand to suffer the most monetary harm should the merger fail.⁷⁴ When considering a potential sale or business combination, directors generally have a fiduciary duty to act in the best interests of the corporation's shareholders.⁷⁵ It is perhaps most apparent in the context of a large public company that the broad, amorphous shareholder base generally has no ability to negotiate a sale on its own behalf; thus, the corporate board, as stewards of the corporation acting on behalf of its owners, negotiates the agreement for the shareholders.⁷⁶ The board is elected by the shareholders to provide this service, among others.

The fact that the interests of shareholders are typically paramount is even more evident in the case of a cash merger or other change-in-control transaction. In this context, the sole duty of corporate directors when negotiating the sale of "control" of the company is, in nearly all cases, to *obtain the best value reasonably available to its shareholders*.⁷⁷ One of the primary considerations for a target company's board of directors when evaluating a proposed transaction under *Revlon* is the fairness of the process to the company's shareholders.⁷⁸ It is, in part, for this reason that tar-

74. We believe this is why the vast majority of merger litigation cases involving alleged buyer breach or wrongful termination settle before a final adjudication on the merits. See *supra* note 55.

75. See PATRICIA A. VLAKAKIS, TAKEOVER LAW AND PRACTICE 2006 18 (2007) (published as part of the 24th Annual Securities Regulation Institute).

76. See Heath Price Tarbert, *Merger Breakup Fees: A Critical Challenge to Anglo-American Corporate Law*, 34 LAW & POL'Y INT'L BUS. 627, 708 (2003).

77. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) [hereinafter "*Revlon*"].

78. See, e.g., *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 44-45 (Del. 1994) (applying *Revlon*). Most states follow *Revlon* or similar doctrine. See DENNIS J. BLOCK, NANCY E. BARTON & STEPHEN E. RADIN, THE BUSINESS JUDGMENT RULE 726 (5th ed. 1988) (observing that "[c]ourts in jurisdictions other than Delaware for the most part have reached conclusions similar to those reached in Delaware regarding the doctrine announced in *Revlon*"). Some states, however, have adopted so-called "corporate constituency" statutes. See Guhan Subramanian, *The Drivers of Market Efficiency in Revlon Transactions*, 28 J. CORP. L. 691, 705 & n.80 (2003). These "third generation" anti-takeover statutes were adopted in response to increased hostile takeover activity in the 1980s and 1990s and were primarily designed to provide target boards latitude to consider the impact of an unsolicited takeover proposal on constituencies of the corporation in addition to its shareholders, such as employees and customers. See Rivka Weill, *Declassifying the Classified*, 31 DEL. J. CORP. L. 891, 927 (2006). However, with the exception of the few states with such statutes (such as Pennsylvania) that have expressly rejected the *Revlon* doctrine, it is generally unsettled whether courts will interpret these statutes to apply equally to situations involving a negotiated "change in control" (in *Revlon* terms). See Subramanian, *supra*, at 705 n.80.

We believe that mainstream and historical merger philosophy would in fact be highly critical of such an interpretation. Moreover, in most states with such statutes, there is no relative "weighting" of the constituencies protected and the interest of the seller's shareholders are, therefore, still an important

get company boards routinely obtain fairness opinions prior to executing a merger agreement.⁷⁹ Given that a merger agreement is negotiated by a target company's board primarily with these fundamental duties and objectives in mind, it would be challenging to rationalize why the shareholders' expectancy or harm should not be considered when determining damages in the event of a buyer's breach or wrongful termination.⁸⁰ Moreover, the plaintiffs' bar and the courts regularly scrutinize transactions on the basis of whether the transaction (or process) was fair to the company's shareholders.⁸¹ This well-established legal standard, therefore, arguably calls into further question the notion that shareholder damages should be generally precluded simply because the deal has terminated (as shareholder interests were paramount up until the moment of termination).⁸²

D. THERE ARE VALID GROUNDS FOR A COURT TO REACH A DIFFERENT RESULT UNDER THE *CON ED* FACTS

From a strict constructionist standpoint, it is hard to argue that the Second Circuit did not reach a rational conclusion, especially considering that the court believed it was not permitted to consider extrinsic evidence of the parties' intent unless it found the contract to be ambiguous on the issues presented (which it did not).⁸³ Contracts drafted under the Traditional Paradigm disclaim third-party

part of any court's (or plaintiff's) analysis in reviewing a change-in-control transaction—most likely even in the few states that reject the *Revlon* doctrine. Given the paucity of case law interpreting these statutes and given that most states look to Delaware for guidance on corporate (and, in particular, merger) doctrine, coupled with recent shifts of managerial oversight and general corporate governance influence from the board to the shareholders, we believe that most seller boards outside of Delaware would be wary of structuring a change-in-control process that did not heavily weigh the fairness of the transaction to the shareholders. Accordingly, in our experience, deal advisors typically recommend that seller boards structure and negotiate the change-in-control transaction in a manner designed to maximize value to the seller's shareholders. Additionally, there would be obvious complications in securing a shareholder vote absent such circumstances. Accordingly, we find that shareholder interests are a primary motivating factor for the seller board in structuring and negotiating the terms of a friendly merger, particularly terms designed to create certainty of closure and, ultimately, the transfer of fair value to the seller's shareholders.

79. See VLAKAKIS, *supra* note 75, at 35–38. It is telling that the corporate board does not get an opinion as to the fairness of the deal to the company or any other constituencies.

80. This is, of course, true only absent a conscious, informed decision to enter into a true “option” deal or an otherwise clear expression of intent to limit damages as the court found in *Con Ed*.

81. See, e.g., *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286 (Del. 1989) (observing that “*Revlon* is merely one of an unbroken line of cases that seek to prevent the conflicts of interest that arise in the field of mergers and acquisitions by demanding that directors act with scrupulous concern for fairness to shareholders”).

82. If a shareholder did not raise, or was not successful in negotiating, the “*Con Ed* issue” in the merger agreement, the buyer will likely maintain it had no intention of providing for the possibility of shareholder damages. A buyer could argue that “a deal is a deal” and the contract speaks for itself, essentially promoting a literal, strict constructionist approach that many courts would find comfort in adopting.

83. See *Consol. Edison, Inc. v. Ne. Utils.*, 426 F.3d 524, 527 (2d Cir. 2005). New York does have well-developed precedent regarding third-party beneficiaries and contractual interpretation generally. See *id.* at 527 (citing *Fourth Ocean Putnam Corp. v. Interstate Wrecking Co., Inc.*, 485 N.E.2d 208, 212 (N.Y. 1985); *Abiele Contracting v. N.Y. City Sch. Constr. Auth.*, 689 N.E.2d 864, 867 (N.Y. 1997); *Meccico v. Meccico*, 558 N.E.2d 668, 669 (N.Y. 1990)).

beneficiary rights, but the point of doing so is typically only to limit *enforcement* rights. While the *Con Ed* merger agreement did not follow the Traditional Paradigm, the parties would likely have added or modified other provisions if the intent was truly to create an “option” deal (or otherwise to limit Con Ed’s exposure in the event of its breach or wrongful termination) by, for example, including a “reverse termination fee” calling for a predetermined amount of liquidated damages as NU’s exclusive remedy and expressly limiting the specific performance remedy to Con Ed.⁸⁴ It is, therefore, justifiable to question the court’s apparent unwillingness to consider the case with a broader view—particularly considering the public availability of other merger agreements memorializing “option” deals from which the parties could have drawn language had they intended to follow an “option” approach.

Moreover, for the reasons discussed in Part IV below, these issues are especially complicated and challenging in the context of a public company merger. The court, therefore, could have been justified in not adhering to strict contract law principles, considering the impact of its decision relative to the fiduciary obligations of NU’s directors and evidence as to the subjective intent of the parties on the issue of shareholders’ damages, as well as traditional industry expectations based on expert testimony.⁸⁵ Presumably, NU was not intentionally trying to limit the scope of potential damages, but likely addressing the technical fact that the target’s board would no longer be around after closing to enforce the shareholders’ rights (while simultaneously confirming that only the company has pre-closing enforcement rights to avoid the agency and collective action problems). Perhaps fortuitously for Con Ed, the contract language itself, viewed in isolation, lent itself to the favorable outcome for Con Ed.⁸⁶

The court could have also more closely analyzed the interplay between the specific performance and termination provisions in the merger agreement in its focus on the contract language. The remedy of specific performance was contractually available in the *Con Ed* merger agreement.⁸⁷ Had NU sued for specific performance, the court’s conclusion regarding damages may have undermined the court’s ability to grant the contractually afforded remedy of specific performance to NU (e.g., there would have been no remaining NU claims of irreparable harm for which money damages would not have been easily calculated and adequate). This result, however, would have been contrary to the intent of the parties in

84. The expense reimbursement provision relating to breach by Con Ed was not liquidated damages, as NU retained the right to pursue actual damages for a willful and material breach by Con Ed. See *Con Ed*, 426 F3d at 531.

85. The concern of straying from well-established contractual interpretation principles and precedent may have deterred the court from taking this path.

86. Under the category of “no good deed goes unpunished,” NU was in all likelihood attempting to make this contract more favorable for its shareholders.

87. See Agreement and Plan of Merger among Consolidated Edison, Inc., Northeast Utilities, CWB Holdings, Inc., and N Acquisition LLC § 8.09 (Oct. 13, 1999), available at <http://www.sec.gov/Archives/edgar/data/1047862/0001047862-99-000009.txt>.

including a specific performance provision in the merger agreement.⁸⁸ The court might have considered the potentially conflicting outcome and determined that there was sufficient ambiguity in the agreement to warrant further evidence of the parties' "intent" with regard to shareholder damages.

III. WHAT LESSONS CAN BE LEARNED FROM *CON ED*?

The court in *Con Ed* did not address broad, substantive principles of corporate merger law, and the decision arguably has little impact on the continued validity of the Traditional Paradigm. Yet, *Con Ed* is a stark reminder to practitioners of the possibility that a court might strictly construe the language of any contract to reach a result that may not accurately reflect the intent of the parties. Some courts may conclude that they are obligated to take such an approach under the weight of binding precedent. When the stakes are as high as they are in the M&A context, parties should take added precaution to ensure that the contract does not lend itself to an interpretation that could yield a result that is not what the parties intended.

Perhaps the most important lesson that practitioners can learn from *Con Ed* is to be mindful of the special problems that can be created by giving a target corporation's shareholders express third-party beneficiary rights—creating, in effect, a real "*Con Ed* issue." Indeed, some merger agreements drafted subsequent to *Con Ed* have continued to follow the minority *Con Ed* approach, expressly giving shareholders third-party beneficiary rights that arise only *after the merger effective time*.⁸⁹ Presumably, this is intended to be a "belt-and-suspenders" approach to addressing enforcement concerns since the company will be controlled by the buyer after the closing of the transaction. However, as the *Con Ed* court noted, such a provision is not only unnecessary, as the shareholders would always have a claim against the surviving entity under theories of conversion, quasi-contract, implied contract, or accounting—but also risky.⁹⁰ Indeed, it is possible that the *Con Ed* court placed even more emphasis on the nuanced third-party beneficiaries provision given the court's view that the parties would not have needed to rely on the provision to clarify a point that was already "obvious."⁹¹

88. See *Bush v. Brunswick Corp.*, 783 S.W.2d 724, 728 (Tex. App. 1989) (holding, under Texas law, that in interpreting a merger agreement, a court "must examine the entire writing in an effort to harmonize and give effect to all provisions of the contract so that none will be meaningless"); see also *Duthie v. Matria Healthcare, Inc.*, 535 F. Supp. 2d 909, 917 (N.D. Ill. 2008) ("[A] contract is to be read as a whole and should be read where possible so as to reconcile and harmonize all of its provisions.").

89. See, e.g., Agreement and Plan of Merger by and among Frozen, LLC, Hockey Parent Inc., Hockey Mergersub, Inc., and Reddy Ice Holdings, Inc. § 9.4 (July 2, 2007), available at http://www.sec.gov/Archives/edgar/data/1268984/000110465907051661/a07-17958_1ex2d1.htm.

90. See *Con Ed*, 426 F.3d at 529. The operation of corporate merger statutes in and of themselves may be another compelling tool for shareholders stifled by the buyer after closing whereby the shares have been cancelled and converted solely into the right to receive the merger consideration, which liability accrues to the successor corporation after the filing of the certificate of merger.

91. The court, therefore, may have expanded the import of this provision beyond what the parties understood they were doing—especially given that this is a provision that NU would likely have

Giving a target corporation's shareholders standing to enforce the merger agreement also potentially injects other risks and uncertainties into the deal⁹²—including the risk that the court will view such a provision as an express recognition that enforcement rights belong to the shareholders,⁹³ which would extinguish any claim that the company was intended to be the custodian of the shareholders to enforce and collect damages under the contract. It is critical for a lawyer to be clear about what he or she intends upon injecting third-party beneficiary rights into a merger agreement. As in *Con Ed*, if the contract is found unambiguous in the way it defines or limits the rights of the target's shareholders, a court may not consider extrinsic evidence or other relevant factors to determine intent. In *Con Ed*, the parties (NU at the least) may not have intended to exclude shareholder damages, but the court found it was constrained in its ability to find otherwise based on the specific contract language.

On the other hand, given that the *Con Ed* court principally relied on the plain language within the “four corners” of the merger agreement to determine the intent of the parties, *Con Ed* does not appear to question directly the assumptions underlying the Traditional Paradigm. There are arguably more relevant precedent (see, for example, *Tyson*) and other compelling arguments supporting the general proposition that shareholder damages are appropriate in the merger context—which could give a court sufficient grounds for reaching a different conclusion even if presented with an agreement similar to the merger agreement in *Con Ed*.⁹⁴

required only in the belief it was doing the shareholders a favor in clarifying the “obvious.” Clearly, a buyer would not typically have included such a provision absent a seller's request (at least before *Con Ed*).

92. The target's board should be wary of creating potential duties or obligations to its shareholders beyond its fiduciary obligations under the applicable corporate law. For additional discussion regarding potential “agency” issues that could be implicated, see Lewkow & Whoriskey, *supra* note 9, at 4–5. Though beyond the scope of this Article, it is an interesting intellectual exercise to speculate whether shareholder standing would (or should) be appropriate in the context of a friendly tender offer if the bidder failed to complete its tender offer principally due to its wrongful termination of the underlying merger agreement (termination of which, by definition, precluded satisfaction of a condition to the tender offer). Given the parties would have both agreed to put the decision to accept the tender directly in the hands of each individual shareholder by way of the offer to purchase, it is a potentially compelling argument that the parties would have intended for the shareholders to make the decision to tender (through a direct transaction with the bidder involving the actual acquisition of the shares—versus a vote of the “majority of the shareholders” in the merger context coupled with the cancellation of the shares under the merger statute) absent a valid termination of the merger agreement. Thus, it could be said the corporation is not the agent facilitating the transaction on behalf of the shareholders in this context—if a shareholder chooses not to tender, that shareholder remains a target shareholder (at least until a subsequent, separate short-form merger executed solely by the buyer following a successful tender offer). This “second step” is arguably not relevant in the context of a deal wrongfully terminated prior to the completion of the tender offer itself. The potential complexities, however, in deciding which shareholders have standing, as discussed in *Con Ed*, would still be challenging. Regardless, there could be disclosure claims directly against the buyer by the shareholders relating to the tender offer materials. See, e.g., Lewkow & Whoriskey, *supra* note 9, at 4 n.8.

93. A similar conclusion was reached in the *Enron* case. See *In re Enron Corp.*, 292 B.R. 507, 513 (S.D.N.Y. 2002).

94. This assumes a court would, as informally expressed by Vice Chancellor Strine under Delaware law, accept the incongruity in the Traditional Paradigm and not feel compelled to adhere to the *Con Ed* approach. See *supra* note 70.

IV. A SUGGESTED MODEL APPROACH TO THE *CON ED* ISSUE

Even if one concludes that *Con Ed* did not undermine the continued viability of the Traditional Paradigm, there is a valid concern, particularly outside of Delaware, that *Con Ed* could be interpreted broadly by a future court and applied even in the context of a merger agreement more closely following the Traditional Paradigm. Even the court in *Tyson*, which implicitly assumed the validity of shareholder damages under the Traditional Paradigm, did not directly consider and address the third-party beneficiaries provision in the contract (although Vice Chancellor Strine has publicly indicated that he agrees with the basic assumptions of the Traditional Paradigm).⁹⁵ Notwithstanding, until we have clear guidance from the courts regarding the validity of the Traditional Paradigm, practitioners should consider altering their approach rather than taking their chances in court.

The remainder of this Article describes some solutions that have been suggested or used by targets in an effort to avoid the potential complications arising out of the “third-party beneficiary” clauses currently utilized in most merger agreements. We also propose new model contract language that may be used by counsel for target corporations and that may ultimately be more effective than other approaches that have been suggested or used to date—in part, as the model contract language is also designed to preserve the critical balance of leverage in MAC, termination, or renegotiation discussions. Finally, we identify some risks of our model language, or of seeking to provide expressly for shareholder damages, particularly in circumstances where the buyer has more leverage during the merger negotiations.⁹⁶

A. ADDRESSING THE “*CON ED* ISSUE” AS COUNSEL FOR A TARGET CORPORATION

Since *Con Ed*, at least two approaches have emerged as a way for target corporations to address the “*Con Ed* issue.” Under the first approach, the parties include a contract provision purporting expressly to allow the company to seek damages on behalf of its shareholders. Under the second approach, the parties attempt to define the target’s damages to include shareholder damages. In some cases, a combination of these two approaches has been utilized.⁹⁷ In our view, these approaches do not satisfactorily address the “*Con Ed* issue” for several reasons.

95. See *IBP, Inc. v. Tyson Foods, Inc. (In re IBP, Inc. S’holders Litig.)*, 789 A.2d 14, 82–83 (Del. Ch. 2001). See also *supra* note 70.

96. It is important to recognize that an effort to negate a *Con Ed* analysis is not without risk. We believe that most M&A practitioners would agree that provisions of acquisition agreements that address remedies are often intensely negotiated. Unless the target has a strong bargaining position, an effort to provide for the target’s right to collect shareholder damages may lead to a buyer seeking to limit those damages, including express dollar limitations or caps, reverse break-up fees or liquidated damages, limitation of damages in situations in which the breach is for certain purposes, and specific damage measurement requirements. A target’s counsel needs to evaluate the potential risks and rewards before embarking on such a negotiation.

97. For thorough discussions of the alternative approaches, see Lewkow & Whoriskey, *supra* note 9, at 1, 4–6; Miller, *supra* note 9, at 5.

Generally, the first approach entails including a clause providing that the company has the right to sue for damages on behalf of its shareholders, without expressly naming the shareholders as beneficiaries.⁹⁸ However, the law with respect to third-party beneficiaries requires a clear intent to allow the third party to enforce the contract for such party to be an “intended third-party beneficiary”—otherwise, such party may be an incidental beneficiary, with less defined (if any) rights or claims to actual damages.⁹⁹ The first approach also attempts to dance around the agency and collective action risks by not expressly naming the shareholders as express beneficiaries.¹⁰⁰ Thus, it is unclear what rights a provision under this approach has created and how a court would interpret it. This approach could embolden the plaintiff’s bar to exploit its inconsistencies to find an angle for shareholders to gain standing.¹⁰¹ For these reasons, this approach may not achieve its intended goal, which is primarily to clarify that the target’s damages include damages to its shareholders without also creating standing (pre-closing) in the shareholders or causing other adverse consequences to either party.

The second approach simply attempts to clarify that the contract damages include shareholder damages.¹⁰² Essentially, this approach is a more subtle extension of the Traditional Paradigm, as it simply incorporates the principal assumption regarding shareholder damages. The primary risk of this approach, however, is that a court could ignore the necessary assumption that target and shareholder damages are one and the same and could refuse to recognize damages measured by reference to “third-party” damages.¹⁰³ While this risk may be limited

98. Several recent merger agreements purport to address the “*Con Ed* issue” by utilizing language that allows the target corporation to sue for damages on behalf of its shareholders. For example, in Berkshire Hathaway’s proposed acquisition of Russell Corp., the parties utilized the following contract language:

This Agreement and the Confidentiality Agreement . . . except for (i) the rights of the Company’s stockholders to receive the Merger Consideration at the Effective Time in accordance with Section 1.7, [and] (ii) the right of the Company, on behalf of its stockholders, to pursue damages in the event of Parent’s or Merger Sub’s intentional breach of this Agreement or fraud, which right is hereby acknowledged and agreed by Parent and Merger Sub . . . are not intended to confer upon any person other than the parties hereto any rights or remedies hereunder.

Agreement and Plan of Merger by and among Berkshire Hathaway Inc., F Subsidiary, Inc., and Russell Corporation § 7.6 (Apr. 17, 2006) (emphasis in original), available at <http://www.sec.gov/Archives/edgar/data/85812/000119312506081999/dex21.htm>.

99. See *Consol. Edison, Inc. v. Ne. Utils.*, 426 F.3d 524, 527 (2d Cir. 2005).

100. See, e.g., *supra* note 98.

101. This is consistent with the finding in the *Enron* case. See *In re Enron Corp.*, 292 B.R. 507, 513 (S.D.N.Y. 2002).

102. For example, in a recent merger between Abbott Laboratories and S&G Nutritionals, Inc., and KOS Pharmaceuticals, the parties utilized the following language:

[Upon] termination of the Agreement . . . , this Agreement shall forthwith become void and there shall be no liability on the part of any party hereto . . . ; provided, however, that nothing herein shall relieve any party from liability for any willful and material breach hereof, which, in the case of Parent, shall include any liability to the Company for lost shareholder premium.

Agreement and Plan of Merger among Abbott Laboratories, S&G Nutritionals, Inc. and KOS Pharmaceuticals, Inc. § 8.2 (Nov. 5, 2006) (emphasis in original), available at <http://www.sec.gov/Archives/edgar/data/1018952/000095014406010366/g04109exv2w1.htm>.

103. See *Lewkow & Whoriskey supra* note 9, at 5–6.

in Delaware, it is unclear whether a provision following this approach would be respected in other courts. Moreover, a court could read the damages provision as creating third-party beneficiary rights for the shareholders, principally under the potentially mistaken assumption that this is what the parties intended (essentially, finding a conflict with the “no third-party beneficiaries” clause). A creative plaintiff’s attorney could use this potential conflict as an angle to create standing for the shareholders, thus running away with the company’s claims or, at the least, creating confusion and consternation for the court attempting to grapple with the standing issues. Another potential problem with this approach is that a buyer may resist defining damages up front with too much precision (e.g., specifically in reference to recovery of the shareholder premium). Defining damages to include the shareholder premium could pose an unacceptable level of risk for a buyer with concerns about its own solvency in the face of a massive damages award.

The best approach from the target’s perspective may be to articulate clearly the underlying intent and assumptions of the Traditional Paradigm, leaving no possible ambiguity or confusion as to the parties’ intent. The language should also be clear that the parties are not intending to create any standing for shareholders, or to create any other obligation or duty with respect of such shareholders. A suggested model provision is as follows:

Nothing in this Agreement, express or implied, is intended to or shall confer upon any person other than Parent and the Company¹⁰⁴ and their respective successors and permitted assigns any right, benefit, or remedy of any nature whatsoever under or by reason of this Agreement. Notwithstanding the foregoing or anything to the contrary in this Agreement, Parent acknowledges and agrees that in the event of any breach, or wrongful repudiation or termination, of this Agreement by Parent, the actual or potential damages incurred by the Company for purposes of determining any remedy at law or equity under this Agreement would include the actual and/or potential damages incurred by the Company’s stockholders in the event such stockholders would not receive the benefit of the bargain negotiated by the Company on their behalf as set forth in this Agreement; provided, however, that it is agreed that neither this provision nor any other provision in this Agreement is intended to provide the Company’s stockholders (or any party acting on their behalf) the ability to seek (whether in its capacity as a shareholder or purporting to assert any right (derivatively or otherwise) on behalf of the Company) prior to the Closing Date the enforcement of, or directly seek any remedies pursuant to, this Agreement, or otherwise create any rights in the Company’s stockholders under this Agreement or otherwise, including against the Company or its directors, under any theory of law or equity, including under the applicable laws of agency or the laws relating to the rights and obligations of third-party beneficiaries. For avoidance of doubt as to the parties’ intent, the determination of whether and how to terminate, amend, make any waiver or consent under, or enforce this Agreement, and whether and how (if applicable) to distribute any damages award to its stockholders, shall exclusively belong to the Company (acting expressly through its Board of Directors) in its sole discretion.

104. It would also be appropriate to include directors and officers as express third-party beneficiaries to the extent of the indemnification and insurance provisions in the merger agreement.

Additionally, a practitioner representing a target corporation should always be careful not inadvertently to utilize potentially conflicting language in other contract provisions, such as expressly limiting the damages to those damages *incurred by the parties* in the standard “effect of termination” provision. Though likely to be met with strong resistance, the target could also propose a definition of damages that expressly includes damages *of any kind*, “including consequential damages and any other damages (whether or not communicated or contemplated at the time of execution of the merger agreement)”—to maximize the company’s potential recovery for its own damages, in addition to any stockholder damages.¹⁰⁵

It would also be prudent for a target to state clearly in the contract that the specific performance remedy may be awarded even where an adequate damages remedy may be available under law (or in another provision of the contract itself).

Finally, given the fact that principles of contract law generally require a party to mitigate its damages, it is possible that a court could require a company to re-auction itself or test the market in an attempt to minimize equitably the buyer’s damages payment.¹⁰⁶ In order to avoid this, a target would be well advised to seek a provision disclaiming any obligation to mitigate its (or its shareholders’) damages.¹⁰⁷ These provisions, if reasonable, should be upheld by a pragmatic

105. Consequential damages are generally not available unless such damages were reasonably foreseeable by the parties and can be proven with a reasonable degree of certainty. *See, e.g.*, *Kenford Co. v. County of Erie*, 537 N.E.2d 176, 178–79 (N.Y. 1989) (holding that, as a general matter, a non-breaching party may recover damages beyond those which naturally and directly flow from the breach only when “such unusual or extraordinary damages [were] brought within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting” (internal quotation marks omitted)); *Closterman v. Liberty Mut. Ins. Co.*, No. 93-4458, 1994 U.S. Dist. LEXIS 15444, at *4–5 (E.D. Pa. Oct. 28, 1994). There is authority in some jurisdictions for the proposition that a party seeking consequential damages must identify specific contractual provisions demonstrating that recovery of such damages was contemplated by the parties. *See, e.g.*, *Sweazey v. Merchants Mut. Ins. Co.*, 571 N.Y.S.2d 131, 132 (App. Div.), *appeal dismissed*, 582 N.E.2d 604 (1991) (unpublished table decision); *High Fashions Hair Cutters v. Commercial Union Ins. Co.*, 535 N.Y.S.2d 425, 427 (App. Div. 1988).

A target may claim damages after a failed merger for competitive harm due to disclosure of confidential information, loss of key employees, loss of goodwill (including damage to reputation, loss of contracts, customers, or partners), and the delay or postponement of key operational or strategic initiatives pending the consummation of the merger (which, by their nature, would potentially not be allowed because the amount of the injury and causation would be difficult to prove “to a reasonable degree of certainty”). Given the uncertainty with which each court may view the intent of the parties as to damages absent specificity in the contract (particularly if the court is not experienced in mergers and acquisitions and with the underlying issues and practical realities), a target should expressly clarify that such direct or consequential damages (or, indeed, damages of “any kind”—whether or not direct or otherwise contemplated or communicated at the time of execution of the merger agreement) are potentially available to the target. For a thorough analysis of the law regarding consequential damages, see Glenn D. West & Sara G. Duran, *Reassessing the “Consequences” of Consequential Damages Waivers in Acquisition Agreements*, 63 *BUS. LAW.* 777 (2008).

106. *See* RESTATEMENT (SECOND) OF CONTRACTS § 350 (1981) (noting generally that “damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation”); *see also* *IBP, Inc. v. Tyson Foods, Inc. (In re IBP, Inc. S’holders Litig.)*, 789 A.2d 14, 83 (Del. Ch. 2001).

107. This leaves the question of how damages should be measured; possibilities include, among others, the premium at the time of announcement of the transaction, the loss in market value at the

court.¹⁰⁸ A jilted seller needs to spend its time picking up the pieces, refocusing on its employees and its business, and reconnecting with its shareholders and the analyst community.

B. RISKS OF THE PROPOSED MODEL LANGUAGE

The model approach described in Part IV.A above assumes that an agreement between the buyer and seller has been (or can be) reached regarding the availability of shareholder damages in the event of a wrongful termination or breach by the buyer. However, it is entirely possible that proposing the model language could lead to an impasse during merger negotiations. Indeed, neither buyers nor sellers have historically confronted the availability of shareholder damages during negotiations because the parties often have opposing incentives to preserve some ambiguity in the event of a problem down the road.¹⁰⁹ If target companies are able to swing the balance of certainty regarding shareholder damages (both as to availability and measurement) in their favor, that could have a chilling effect on buyer activity. Buyer boards would reasonably be reluctant to risk their future solvency and prospects in favor of what could turn out to be a bad acquisition decision due to a deteriorating business, an economic downturn, changes in the market, or other conditions that could be outside of either company's control.

Buyers, including strategic buyers, may respond to the proposed language by suggesting "option" deals,¹¹⁰ which have historically been generally reserved for

time of announcement of termination, and the spread between the transaction price and the post-termination market price. See Lewkow & Whoriskey, *supra* note 9, at 9–11.

108. "Because the burden on mitigation is not a duty, a contract provision that waives the mitigation principle is valid." 11 CORBIN ON CONTRACTS § 57.11, at 305 (Joseph M. Perillo ed., rev. ed. 2005). Mitigation is more compelling where there was a real opportunity for the non-breaching party to mitigate the extent of its damages before the final resolution of the dispute. See *id.* at 305–06 (noting that mitigation should not be viewed as a "duty" of the non-breaching party, in part because "[t]he law does not penalize the injured party's inaction; it merely does nothing to compensate for the loss that the injured party helped to cause by not avoiding it"). Clearly, a non-breaching party should not ordinarily be allowed to let damages increase by not preventing losses that are easily avoidable. For example, if a storage facility has a hole in the roof and bad weather is damaging the non-breaching party's goods, such party should have an obligation to move the goods out of the way once notice of the leak is provided, and not expose the goods to additional harm. However, to require a target to go to the extraordinary expense, effort, and distraction to remarket and sell itself after a breach of a merger agreement would surpass reasonable equitable expectations under most circumstances. See *id.* at 302 (noting that under principles of mitigation, a party should not be awarded "damages for losses that could have been avoided by reasonable effort without risk of other substantial loss or injury" (emphasis added)); see also RESTATEMENT (SECOND) OF CONTRACTS § 350 (1981) (noting that damages are not recoverable for losses that the injured party could have avoided "without undue risk, burden or humiliation" (emphasis added)).

109. See, e.g., Robert Hora, *Delaware Court of Chancery Holds that Target May Not Force Private Equity Firm to Proceed with Buyout*, LITIG. CLIENT ALERT (MILBANK, TWEED, HADLEY & McCLOY LLP), Jan. 8, 2008, at 3; David Leinwand & Victor Goldfeld, *Stresses on the New LBO Deal Architecture: United Rentals Goes to Court*, MERGERS & ACQUISITIONS & CORP. GOVERNANCE REP. (CLEARY GOTTlieb STEEN & HAMILTON LLP), Jan. 2008, at 5; Anthony P. Coles, *Is There Such a Thing as a Forthright Negotiator? The Case of United Rentals v. RAM Holdings*, DLA PIPER NEWS & INSIGHTS, Apr. 7, 2008, at 2.

110. For an example of a strategic deal that employed an "option" structure, see Agreement and Plan of Merger by and among Wm. Wrigley Jr. Company, Mars, Incorporated, New Uno Holdings Corporation and New Uno Acquisition Corporation § 8.2(c) (Apr. 28, 2008), available at <http://www>.

private equity buyers, or other limitations on the damages remedy.¹¹¹ (Even a 3 percent reverse break-up fee is typically preferable to damages that are limited to out-of-pocket expenses.) Moreover, in an auction process with both strategic and private equity participants, strategic buyers may raise the issue of general fair-

sec.gov/Archives/edgar/data/108601/000134100408000796/ex2-1.htm. The Mars/ Wrigley deal was a highly leveraged transaction that also involved third-party equity financing, thus having many aspects of a private equity buyout. It would not be surprising to see a shift to this construct (or a variation of this construct) in similar strategic deals where buyers have sufficient leverage—especially in light of the increased settlement costs (as a percentage of the merger consideration) that strategic buyers have experienced in some of the recent busted strategic deals. *See supra* note 55. For example, The Finish Line, Inc., as part of its settlement of the termination of its \$1.5 billion deal with Genesco, Inc., was required (along with its banker, UBS) to pay \$175 million plus 12 percent of its outstanding common stock. *See id.* The Genesco/Finish Line deal was even more leveraged than the Mars/Wrigley deal, but nonetheless followed the traditional strategic deal construct, including a specific performance right for Genesco, a no “marketing period” to consummate the debt financing, and no liquidated damages provision capping Finish Line’s exposure. *See* Agreement and Plan of Merger by and among The Finish Line, Inc., Headwind, Inc., and Genesco, Inc. (June 17, 2007), available at <http://www.secinfo.com/dsVsf.u5jw.d.htm>. Targets could, however, resist to the extent buyers could reasonably use their own shares as consideration to fill the gap for financing that fails. We believe that the Mars/Wrigley agreement is also a good example of an agreement that attempts to provide absolute certainty on the limitation of remedies and third-party beneficiaries under the “option” deal construct, presumably reflecting some lessons learned from the termination of the highly publicized United Rentals transaction and other recent broken deals. For other examples, see Agreement and Plan of Merger among Ashland Inc., Ashland Sub One, Inc. and Hercules Incorporated (July 10, 2008), available at <http://www.sec.gov/Archives/edgar/data/46989/000089882208000787/mergeragreement.htm>; Agreement and Plan of Merger by and among GSI Group Inc., Eagle Acquisition Corporation, and Excel Technology, Inc. (July 9, 2008), available at <http://www.sec.gov/Archives/edgar/data/873603/000119312508149920/dex21.htm>. Whether this is evidence of a trend is unclear, however, as other recent highly leveraged deals involving third-party equity do not contemplate an option structure, such as the Dow/Rohm and Haas and the Busch/InBev mergers. *See* Agreement and Plan of Merger among The Dow Chemical Company, Ramses Acquisition Corp. and Rohm and Haas Company (July 10, 2008), available at http://idea.sec.gov/Archives/edgar/data/29915/000094787108000395/ss41835_ex0201.htm; Agreement and Plan of Merger by and among Anheuser-Busch Companies, Inc., InBev N.V./S.A. and Pestalozzi Acquisition Corp. (July 13, 2008), available at <http://www.sec.gov/Archives/edgar/data/310569/000119312508151934/dex21.htm>. The Busch agreement also attempts to address the “Con Ed issue” by nuancing the no third-party beneficiaries language to provide for “the right of the Company on behalf of its shareholders to pursue damages (including claims for damages based on loss of the economic benefits of the transaction to the Company’s stockholders)” and clarifying that

the third-party beneficiary rights [of the shareholders] . . . of the preceding sentence may be exercised only by the Company (on behalf of its stockholders as their agent) through actions expressly approved by the Company’s Board of Directors, and no shareholder of the Company whether purporting to act in its capacity as a shareholder or purporting to assert any right (derivatively or otherwise) on behalf of the Company, shall have any right or ability to exercise or cause the exercise of any such right.

Agreement and Plan of Merger by and among Anheuser-Busch Companies, Inc., InBev N.V./S.A. and Pestalozzi Acquisition Corp. § 9.8 (July 13, 2008). This approach may, nonetheless, have unintended consequences by expressly providing that Busch is an “agent” of the stockholders to pursue or collect any shareholders damages. In other words, does this approach create a new fiduciary obligation on the corporation as an agent? Our model approach attempts to address this concern as well.

111. Buyers may also seek to clarify that “buyer’s damages” include the loss of “economic benefits” of the transaction. *See, e.g.,* Agreement and Plan of Merger among Hexion Specialty Chems. Inc., Nimbus Merger Sub Inc., and Huntsman Corp. § 7.2(b) (July 12, 2007), available at <http://idea.sec.gov/Archives/edgar/data/13239/000119312507156392/dex21.htm>.

ness and a “level playing field.” Strategic buyers may argue that they can provide more certainty of closure and be less sensitive to MAC issues given their ability to market any necessary financing for the combined company.

A target could respond, however, that the strategic buyer does not have the structural limitations of the private equity buyer that resulted in the evolution of reverse break-up fees and the so-called “option” deal.¹¹² Moreover, a target could point out the fact that even under the Second Circuit’s holding in *Con Ed*, the buyer is still responsible for damages incurred by the target company itself—which potentially could be shown to be well in excess of a 3 percent reverse break-up fee.¹¹³ A target could also point out that the model approach requires an agreement on the threshold point of the availability of shareholder damages, but still preserves ambiguity on the calculation of damages itself—which, in our view, has historically been the most significant uncertainty helping to preserve the balance of negotiations in any broken deal.

Ultimately, each individual deal remains an exercise of leverage during negotiations.¹¹⁴ It may well be that a target corporation’s board will agree to an “option” deal with a strategic buyer under certain circumstances in light of the concessions received from the buyer in exchange. On the other hand, strategic buyers may accept a push by targets for higher, more meaningful break-up fees,¹¹⁵ pointing to the recent string of broken option deals that left targets as “damaged goods” (from a market perspective) and vastly undercompensated for their losses and the damages to their shareholders.¹¹⁶ Particularly in a strategic deal that is not highly leveraged, targets will also continue to push for the traditional specific performance remedy, which remains the best remedy from the standpoint of the target shareholders since it most fully compensates

112. See *supra* note 110.

113. In *Con Ed*, the only damages sought by NU were approximately \$27 million in out-of-pocket expenses incurred by NU in connection with obtaining various regulatory permits. See *Con Ed*, 426 F.3d at 527 & n.1.

114. It is also possible parties could agree to fall back on the Traditional Paradigm, with some comfort this would be respected, at least in Delaware. See, e.g., *supra* note 70 and accompanying text. Given that this model has historically been successful in maintaining the settlement leverage between the parties, there is no reason to think rational parties could not agree to follow the model even after *Con Ed*, particularly in Delaware. This model simply spells out in clear detail for a court what the parties intended as to third-party beneficiaries and the availability of shareholder damages, thereby helping avoid unintended (or unexpected) consequences of a literal interpretation of a merger agreement under the Traditional Paradigm or any other approach.

115. As noted above, it is not presently uncommon for parties to agree upon a higher damages cap for “willful” or “intentional and material” breaches other than a simple failure of the financing to be received at closing. See, e.g., *supra* note 102 and accompanying text. The standard reverse break-up fees typically represent just the “option” (or walk away) penalty or the liquidated termination fee in the event the financing just falls through despite the buyer’s efforts. See, e.g., Agreement and Plan of Merger by and among Cobalt Holding Co., Cobalt Merger Corp., and Intergraph Corp. § 8.2(e) (Aug. 31, 2006), available at <http://www.sec.gov/Archives/edgar/data/351145/000095014406008420/g03238exv2w1.txt>.

116. This is apparent in light of the fact that the aggregate decline in share price (e.g., immediate value to the shareholders) was in excess of the negotiated reverse break-up fees, and these damages are in addition to any actual damages the corporation may have suffered. The following table provides

them.¹¹⁷ Targets may argue that if a strategic buyer is financially capable of closing the deal without third-party financing, there is no need for the “option” out since the buyer always has the option of closing. Moreover, to the extent there is a legitimate MAC, the “MAC out” is still a viable avenue for a buyer.¹¹⁸ If no MAC can be shown, there is no reason a buyer should not live up to its

just a few examples of companies whose stock prices plummeted (in 2007) following a failed deal, as is common:

Company	Deal Price	Approx. Stock Price One Month After Termination
United Rentals	\$34.50	\$17.20
Harman International Industries	\$120.00	\$72.65
Acxiom	\$27.10	\$12.80
Reddy Ice	\$31.25	\$23.55

See Agreement and Plan of Merger among RAM Holdings, Inc., RAM Acquisition Corp., and United Rentals, Inc. § 2.1 (July 22, 2007), available at http://idea.sec.gov/Archives/edgar/data/1047166/000101905607000673/ex2_1.htm; Agreement and Plan of Merger among KHI Parent Inc., KHI Merger Sub Inc., and Harman International Industries, Inc. § 2.01 (Apr. 26, 2007), available at <http://idea.sec.gov/Archives/edgar/data/800459/000095013407009341/d45945exv2w1.htm>; Agreement and Plan of Merger by and among Axio Holdings LLC, Axio Acquisition Corp. and Acxiom Corporation § 2.7 (May 16, 2007), available at <http://idea.sec.gov/Archives/edgar/data/733269/000073326907000018/ex2-1mergeragmt.htm>; Agreement and Plan of Merger by and among Frozen, LLC, Hockey Parent Inc., Hockey Mergersub, Inc., and Reddy Ice Holdings, Inc. § 1.5 (July 2, 2007) available at http://idea.sec.gov/Archives/edgar/data/1268984/000110465907051661/a07-17958_1ex2d1.htm. The approximate stock prices one month after termination are derived from <http://bigcharts.marketwatch.com/historical/> (last visited Dec. 29, 2008).

117. Even sellers in private equity buyouts would be prudent to push for specific performance rights, at least with respect to efforts to secure and consummate financing. It could be unrealistic to expect specific performance regarding the consummation of a merger without any financing as money is inevitably needed to finance any private equity or highly leveraged buyout. See *cf.* *Hexian Specialty Chems., Inc. v. Huntsman Corp.*, C.A. No. 3841-CVL, 2008 Del. Ch. LEXIS 134, at *129–30 (Sept. 29, 2008) (ordering specific performance of, among other covenants, a buyer’s efforts to satisfy the conditions for, and enforce the terms of, the debt financing and otherwise to consummate the merger, albeit acknowledging that specific performance of the merger itself was not permitted in accordance with the merger agreement). For a discussion of measures a target board can seek to help create additional deal “certainty” (in particular in leveraged private equity and strategic transactions) based on lessons learned from busted deals following the subprime crisis, see *Thompson & Thomas, supra* note 10, at 15.

As shown in *Huntsman*, the apparent view in Delaware is that parties are free to contract for specific performance in merger agreements. In issuing its specific performance order, the court clearly relied on the parties’ contractual agreement to the specific performance remedy. See *Huntsman*, 2008 Del. Ch. LEXIS 134, at *121–22. See also *Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.*, No. 1668-N, 2006 WL 2521426, at *6 (Del. Ch. Aug. 25, 2006) (“It is imperative that contracting parties know that a court will enforce a contract’s clear terms and will not judicially alter their bargain, so courts do not trump the freedom of contract lightly.” (internal quotation marks omitted)).

118. However, showing that there was a MAC remains a difficult burden, at least in Delaware. See *Huntsman*, 2008 Del. Ch. LEXIS 134, at *52 (finding that no MAC had occurred and commenting that it was “not a coincidence” that Delaware courts have never found a MAC in the context of a merger agreement). *But see cf.* *Genesco, Inc. v. Finish Line, Inc.*, No. 07-2137-III, slip op. at 33 (Tenn. Ch. Dec. 27, 2007) (finding that a MAC had occurred under Tennessee law but going on to rule that

deal given the massive potential harm to the target and its shareholders following a broken deal. If a target has viable strategic alternatives or there are other bidders, a strategic buyer will face an uphill battle convincing a target's board to accept an option deal, even in the face of a compelling value proposition—the potential downside may well outweigh the “option trade-off” for the target under such circumstances.

C. CONCLUSION

Ultimately, the suggested model approach attempts to balance the interests of buyer and seller in maintaining the ambiguity of the actual damages calculation without the incongruity of the Traditional Paradigm—which (as perhaps demonstrated in the *Con Ed* decision) may lead to unintended results.¹¹⁹ Litigation should often be the last resort, but should still be an option for the jilted seller. The *Con Ed* decision may lead some targets to be litigation-averse or to settle for too little, or conversely it may embolden buyers who have a limited view of their potential losses to risk litigation over relatively weak MAC, fraud, or breach of contract claims. The model approach should motivate the buyer and the target to come to the table if possible with generally equal leverage (not considering the merits of any underlying MAC, fraud, or breach claim), as there is no clear direction as to the quantification of any damages in litigation either way but only the agreement that damages (which include company *and* shareholders damages) could be meaningful. The model approach should accomplish this in a manner that minimizes the risk of the adverse consequences of establishing standing or third-party beneficiary rights in the target's shareholders—a fear that may have been a principal reason most precedent has defaulted to the ambiguity (or, in fact, the actual incongruity) in the Traditional Paradigm. Until *Con Ed*, practitioners on both sides of the negotiating table had the luxury of keeping their heads in the sand on this issue. Now, given that remorseful buyers or lenders may point to *Con Ed* in an effort to find an inexpensive way out of the deal, targets need to tread carefully and consider the risks of not modifying their approach in this new world of deal uncertainty.

the cause of the MAC was included within an express carve-out to the MAC definition in the merger agreement).

119. This is in part due to the complexity of even attempting to capture accurately or appropriately such a calculation in a merger agreement. See Lewkow & Whoriskey, *supra* note 9, at 9–11.

