



Damage Quantification in Delaware for Breaches of Contract in Post-Merger Litigation

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Editor's note: Arthur H. Rosenbloom is Managing Director of Consilium ADR LLC. This post is based on his recent [paper](#), and is part of the [Delaware law series](#); links to other posts in the series are available [here](#).

Despite vigorous attempts, through judicial decisions,¹ and legislative provision on forum selection and fee shifting provisions² to limit the number of post-merger litigation filings, the fact remains that in 2016, almost a third of the mergers and acquisitions (“M&A”) in Delaware resulted in such filings.³

This [paper](#): (i) describes the kinds of contractual breaches giving rise to post-closing M&A related litigation; (ii) examines contractual provisions that act to expand or reduce the amount of damages; (iii) determines whether tort based claims should be treated differently than those sounding in contract; (iv) reviews Delaware opinions meeting discrete screening criteria and; (v) presents the conclusion that Delaware courts, (or indeed any court) should make findings of fact on whether the damage caused by Target’s breach was transient or permanent in nature measured by whether the breach resulted in permanent damage to Target’s current or future cash flows. In my view, courts should award damages on a dollar-for-dollar in basis for transient damages and on a price earnings (“P/E”) multiple or discounted cash flow (“DCF”) basis where damages are non-transient. Further, I describe which of the holdings in the cases studied could have benefited from that distinction.

Contractual Breaches

Contractual breaches giving rise to litigation complaints typically involve alleged breaches of representations and warranties (“reps”) and occasionally covenants, and may be generally characterized as financial or non-financial in nature. Examples of alleged financial misrepresentations include allegations that following the merger, Buyer discovered that Target’s financial statements failed to comply with generally accepted accounting principles, that its

¹ See *Corwin V KKR Financial Holdings* (125 A.3d, 304 (2015) In re, *Trulia Stockholders Litigations*C.A.NO. 10020-CB) DeL. Ch. (2016).

² Delaware General Corporation Law Sections 102 and 109.

³ See Matthew D. Cain, Jill E. Fisch, Steven Davidoff Solomon, and Randall Thomas, *The Shifting Tides of Merger Litigation*, Vanderbilt University Law School Research Paper Series Working Paper 17-19 and University of Pennsylvania Law School Institute for Law and Economics Research Paper 17-6, February 2017. The authors cite two major factors for the decline in post-merger litigation filings, including holdings that Delaware courts “would no longer countenance merger litigation settlements which did not achieve substantial benefits for shareholders” and the 2015 amendment to the Delaware General Corporation Law explicitly authorizing forum selection bylaws enabling Delaware corporations to halt the filing of M&A related suits in multiple states. The authors caution that the results of their study are preliminary due to the recency of the data.

working capital was less than as represented or that its accounts receivable or inventories were misstated. Examples of non-financial reps include issues of title to tangible and intangible assets, breaches of environmental reps, data on customers, taxes and employment issues, and failures to disclose actual or pending litigation.

Elements That Expand Or Limit The Amount Of Damages

The principal element that should determine the quantum of damages is its transitory or permanent nature based on the effect on Target's cash flows. However, making that determination is not always easy. For example, assume Target was found criminally liable for bribing customers to buy its products. Will that black mark permanently diminish Target's cash flows or end with a firing of the miscreants? The same question would arise in the case of material violations of federal, state or local environmental laws that were capable of remediation.

That said, parties may succeed in drafting battles that minimize or expand their exposures. These include reps that the merger document represents the complete and final document, survival periods for reps that may narrow or expand statutes of limitations, caps that limit the dollar amount of recovery and baskets intended to minimize the size and frequency of smaller claims. In addition, the merger document may contain materiality qualifiers and materiality scrapes that delete the term "materiality" or "material adverse change" or "material adverse effect" in some of the sections of the merger document. Other provisions may bar the imposition, of punitive, incidental, or consequential damages. The merger document may also contain dispute resolution provisions that could include arbitration or mediation.

Whether Cases Sounding In Tort Should Be Treated Differently In Those Sounding In Contract

While torts like civil fraud give rise to possible claims for rescission or rescissory damages, once plaintiffs elect not to pursue such remedies and seek money damages only, it's my view that fraud and contract damages should be treated the same way, economic harm and not the gravity of the alleged misconduct being the only salient element.

Screening Methodology For The Cases Selected

In order for a case to be selected it had to meet four criteria; (i) be a Delaware case or one applying Delaware law; (ii) be final in nature rather than a decision on a dispositive motion because of the presumption of well pleaded matters favorable to either the moving or non-moving party; (iii) arising from alleged breaches of M&A agreements and; (iv) expressly or by inference describing whether damages were computed on a dollar-for-dollar basis, on P/E multiple basis or as a result of a DCF analysis.

Whether the Rationale in Cases in Which Damages Were Awarded Might Have Been More Persuasive If the Court had Observed the Distinction between Transient and Non-Transient Damage To Target's Cash Flows

It is my view that more defensible opinions would have resulted in four of the seven cases studied. In one instance, the distinction would have resulted in some dollar-for-dollar damages when the Court awarded none. For further details, I suggest the reader review the summary of each case contained in the article itself and the details of my analysis respecting which of these could have benefited from specific findings of fact on the transitory or permanent character of the damages.

The complete paper is available for download [here](#).