Delaware Holds Target Cannot Recover Lost-Premium Damages

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The Delaware Court of Chancery, in an October 31, 2023 decision,[1] held that a so-called "Con Ed provision"—defining a target company's damages against a defaulting buyer to include a lost merger premium—is unenforceable by the target company on the ground that such damages are not expectation damages, but rather a penalty. The decision arose in a claim for a mootness fee by a plaintiff who sued Elon Musk while he was balking at closing the Twitter merger. Chancellor McCormick held that because only target stockholders—and not the target itself—receive a premium when a merger is consummated, the target has no entitlement to lost-premium damages if the merger fails. As a result, the court found, lost-premium damages are enforceable only if the merger agreement conveys third-beneficiary status to the target stockholders, which the Twitter merger agreement did not clearly do.

Chancellor McCormick considered the possibility that the Twitter agreement might be interpreted as granting stockholders third-party beneficiary status for the limited purpose of seeking lost-premium damages at a time when specific performance was no longer available—that is, only after the merger agreement was terminated. The court held, however, that even under this interpretation the plaintiff lacked standing, since the merger was ultimately consummated. Because the plaintiff would have lacked standing under either interpretation, his claim was not meritorious when filed and he was not entitled to a mootness fee.

Con Ed provisions began to be used following the Second Circuit's 2005 decision in *Consolidated Edison, Inc. v. Northeast Utilities*,[2] which held that target stockholders lacked status to pursue lost-premium damages for breach of a merger agreement as a result of the standard no third-party beneficiaries provisions in those agreements. The Court of Chancery discussed the three approaches parties have used to hold buyers liable for lost-premium damages. One was to explicitly grant target stockholders third-party beneficiary status. This, however, proved unpopular because it had the potential to disintermediate the target's board in negotiations to enforce a merger agreement and

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1 *Crispo v Elon Musk et. al.*, C.A. No. 2022-0666-KSJM (Del Ch. Oct. 31, 2023).

2 426 F.3d 524 (2d Cir. 2005).

because it could lead to a proliferation of stockholder lawsuits. The second was to make the target the agent of its stockholders for purposes of recovering lost-premium damages. But this approach, according to the court, rested on "shaky ground" because there was no legal basis for a contracting party unilaterally to appoint itself as the agent of a non-party for purposes of controlling that party's rights. The third approach, by far the most common, was simply to define the target's damages to include the lost premium. It was this approach that was used in the Twitter merger agreement and held unenforceable by the court.

What, then, should merger parties do to ensure the potential for lost-premium damages, which acts to deter a buyer from backing out of a merger? It appears that some form of express grant of third-party beneficiary status to stockholders will be necessary to address the concern raised in Chancellor McCormick's decision. However, both buyers and targets share an interest in limiting the rights of stockholders directly to enforce the merger agreement. This is what led some parties to use the second approach described above: coupling the stockholders' third-party-beneficiary status with an exclusive grant of agency to the target to enforce the stockholders' rights on their behalf.

As the Court of Chancery observed, however, it is far from clear that the target company has the power to appoint itself as the exclusive agent for its stockholders. The appointment of an agent usually requires the consent of the principal. One way to address that point would be for consent to be given by the stockholders in connection with their vote to adopt the merger agreement (or, if the transaction takes the form of a tender offer, in the letters of transmittal). Another might be to include in the target company's charter the right of the target to act—or to appoint a third party to act—as the agent of the stockholders in these circumstances.

As with the original *Con Ed* holding, Chancellor McCormick's decision in *Crispo* will likely lead initially to a variety of contractual responses and, one hopes in relatively short order, a common approach, taking into account the considerations outlined above.

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