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The Significance of the **Choice of Law Provision** in M&A Contracts

There are certain key differences between Delaware and New York law.

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SHUTTERSTOCK

How meaningful is the "choice of law" provision in an M&A contract? While it may seem like an unimportant or technical issue that matters mostly to the lawyers, some significant differences in the applicable legal standards on key issues could lead to drastically different business results. Thus, deal participants will want to consider the potential impact and relative importance of these issues before proposing or agreeing to the choice of law.

In the vast majority of M&A transactions involving sophisticated parties, the transaction agreements are typically governed by the laws of either Delaware or New York. This is due to the fact that both jurisdictions have long-standing reputations for presiding over cases involving highly complex and sophisticated commercial issues, and are well-regarded for their judges and court systems. Additionally, these jurisdictions are attractive to parties because Delaware is home to many target companies involved in M&A transactions, and New York's courts are well-known for giving utmost deference to contract terms. However, as discussed below, Delaware and New York apply different legal standards with respect to several important issues in the M&A context that

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deserve attention in deciding which law to choose.

Specific Performance

The seller's ability to compel a buyer to perform its obligation to consummate the closing of an M&A transaction is of primary importance to the seller. One of the most highly negotiated sets of provisions in any M&A contract are the remedies available to a seller should a buyer fail to close the transaction after the closing conditions are satisfied. Sellers often negotiate for a package of protections, including provisions related to reverse-break-fee triggers, the availability of damages for willful breach, and specific performance of certain obligations of a buyer. A common specific performance provision involving a buyer that is financing some portion of the acquisition with debt will include various hurdles that a seller must overcome before specific performance will be available to the seller for buyer's failure to close. Some of these hurdles include a requirement that the seller irrevocably confirm in writing that it is ready, willing and able to consummate the closing if the financing sources fund; and that the debt financing has been funded or will be funded.

Despite all of those highly negotiated provisions, the choice of law in the M&A contract could add further limitations on the seller's ability to obtain specific performance of the buyer's obligation to close the transaction. As a general matter, Delaware law requires that parties establish the elements necessary to obtain specific performance by a standard of "clear and convincing evidence," while New York law requires that a claimant only satisfy a lower standard of "preponderance of the evidence." However, even though Delaware subjects its claimants to a higher evidentiary standard, for the reasons described below it is more difficult in practice for a seller to be awarded specific performance against a buyer for its failure to close in New York than in Delaware under the same set of circumstances.

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One of the requirements for a party to be awarded specific performance in both jurisdictions is that no other remedy (e.g., a damage award) will adequately compensate that party for the other party's breach, and that the relevant breach will cause irreparable harm if specific performance is not awarded. In order to satisfy that requirement, well-crafted M&A contracts provide that the parties agree that monetary damages would not be an adequate remedy for breach, and that the relevant party would incur irreparable damages if the M&A contract is not performed. Delaware courts respect the parties' contractual stipulation that irreparable harm would occur upon a breach and that agreement alone suffices to demonstrate irreparable harm. Even though New York courts generally enforce contracts as written, they will not accept this contractual stipulation as a substitute for proof of irreparable harm. While New York courts may consider the contractual stipulation as evidence, they look beyond the contractual stipulation to determine whether, as a matter of fact, irreparable harm would indeed occur. Furthermore, in the absence of such a stipulation, New York courts are generally less willing than Delaware courts to find, as a matter of fact, that irreparable harm would occur.

Additionally, from a process perspective, Delaware courts tend to expedite their review of specific performance cases involving M&A transactions, and the entire litigation can often be conducted in a matter of months. New York courts do not have expedited processes for these types of proceedings (meaning the case could take years to litigate) and are generally more skeptical of awarding specific performance in these types of situations.

Post-Closing Seller Liability

Another area of significance in an M&A contract for the acquisition of a privately-held business is the package of post-closing recourse available to a buyer against the seller for breaches of representations and warranties. Private M&A contracts typically

contain provisions setting parameters and thresholds around when and to what extent a buyer may make claims. Regardless of the applicable statutes of limitations, often the contract itself will contain prescribed agreed-upon time limitations on when specific types of claims may be made. In Delaware, the default statute of limitations for breach of contract claims is three years, which, if expressly stated in the M&A contract, may be shortened or extended for up to twenty years (as long as the underlying transaction involves at least $100,000). In contrast, under New York law, the default statute of limitations is six years. Like Delaware, the New York statute of limitations may be shortened if the shortening of the time period is expressly provided in the contract by clear and explicit language. Unlike Delaware, however, New York's six-year time period cannot be extended beyond six years under any circumstance.

But perhaps no post-closing liability issue is more important to the seller of a privately-held business than the carve-outs from the contractual limitations in the indemnity and exclusive remedy provisions of the M&A contract. In most highly-negotiated transaction agreements for the sale of a privately-held business, the sole carve-out is typically limited to "fraud." If not defined in the M&A contract with specificity, fraud can be interpreted by courts in many different ways. For purposes of this article, references to fraud will refer to the tort claim for common law fraud. To prove a fraud claim, Delaware law requires the claimant to prove the occurrence of fraud by the "preponderance of evidence," while New York law requires the higher standard of "clear and convincing evidence."

A key element of mounting a fraud claim is to establish that the buyer "relied" on the inaccurate statement or omission. Under Delaware law, it is permissible for a buyer to disclaim reliance on extracontractual representations and warranties—thus limiting the entire universe of representations and warranties in question to those expressly set forth in the acquisition agreement. In New York, similar disclaimers of reliance on extracontractual representations and warranties will be respected, but the disclaimers must be very specific as to the particular types of representations and warranties; a broad boilerplate disclaimer will not suffice. In addition, although quite technical, under Delaware law, the M&A contract must clearly state that the buyer itself acknowledges that it is not relying on any extracontractual representations or warranties, and it will not be sufficient for the seller simply to disclaim the making of any extracontractual representations or warranties. Conversely, New York courts do not seem to be as focused on this requirement, and have permitted non-reliance in situations where the M&A contract only contains one-way disclaimer language from the sellers' perspective.

Unlike Delaware, however, New York recognizes an exception to these reliance disclaimers in circumstances where the mispresented facts were within the exclusive knowledge of the seller, or where the truth could only have been discovered through extraordinary effort or great difficulty—and for purposes of this analysis, the New York courts will take into account the buyer's level of sophistication and access to information. In practice, this exception to the reliance provisions under New York law seriously calls into question the extent to which a seller can comfortably rely on the disclaimer and reliance provisions in the M&A contract.

Conclusion

As should be evident from the discussion above, the choice of law provision can have a potentially significant (and often unintended) impact on several important deal terms. Neither jurisdiction is the "better" choice on its face, as each set of laws has its advantages and disadvantages for both buyers and sellers, depending on the issue. A seasoned and well-informed deal practitioner should consider all of these factors in the context of the transaction when selecting the choice of law provision.