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Delaware vs. New York Governing Law — Six of One, Half Dozen of Other?

While it is true that the laws of these two leading states for transaction agreements are often very similar, there are certain situations where the selection could be outcome-determinative in the event of a post-signing or post-closing dispute.

Among the many legalese-heavy paragraphs appearing under the "Miscellaneous" heading at the back of transaction agreements is a section that stipulates the laws of the state that will govern the purchase agreement as well as disputes relating to the deal. Often, it is coupled with a section that dictates which courts have jurisdiction over these disputes. While the state of incorporation or headquarters of one or both parties is sometimes selected, anecdotal as well as empirical evidence suggests that a healthy majority of larger transactions choose Delaware or New York law. Reasons cited include the significant number of companies incorporated in Delaware, the well-developed and therefore more predictable legal framework in these jurisdictions, the sophistication of the judiciary in these states, the perception of these being "neutral" jurisdictions in cases where each party might otherwise favor a "home" state, and the desired alignment with the governing law of related financing documents (usually New York).

In choosing between these two states, parties often wrestle with the question of whether there really is a practical difference. While the outcome on most issues that may arise is unlikely to differ significantly between Delaware and New York, discernible gaps have developed between the states on some recurring transactional issues. Some of these differences are only applicable in the public company context, while others only matter in private transactions with post-closing indemnification. Because there is no perceptible pattern of one state being generally pro-buyer or pro-seller on these matters, favoring one state over the other based on these disparities ultimately will depend on the specific circumstances of the transaction which may implicate one or more of these issues where the result may diverge.

Below is a very brief, by necessity generalized, and non-exhaustive outline of some of these distinctions that buyers and sellers may wish to consider before selecting one of these two states:

- *Statute of Limitations* — In Delaware, the statute of limitations, or deadline, to bring breach of contract claims is three years while in New York it is six years. Moreover, while parties often seek to contractually adjust these deadlines by agreeing to a specified survival period after which post-closing indemnification claims based on breaches of representations and warranties may not be brought, there are questions about the effectiveness of a contract provision purporting to shorten (in NY) or extend (in both states) the generally applicable three- or six-year deadline.
- *Sandbagging* — Parties often expressly provide in the contract whether the buyer is entitled to seek indemnification for breaches of representations and warranties as to which it had knowledge prior to signing or closing the transaction. Absent an express provision, pre-closing knowledge of a breach generally is not a bar to seeking recovery under Delaware law. New York law is less clear, particularly if the knowledge arose from disclosure by the seller.
- *Best Efforts* — A party often will insist that the other party agree to a "best efforts" covenant where it wants to secure the highest possible standard of performance if an outcome cannot be assured (for example, in seeking regulatory approvals). However, while some cases applying New York law have interpreted this standard (and related standards) as requiring "reasonable" methods or a "high standard of care", other cases have gone as far as holding such a covenant to be unenforceable absent explicit objective standards against which the performance is judged. Delaware law, while less developed, appears more consistent on this issue — in the leading case (*Hexion*), the court found that a "reasonable best efforts" standard (presumably intended as something less than "best efforts") required the promising party to take meaningful commercially reasonable and advisable steps to enhance the likelihood of a successful outcome.

- *Shareholder Damages in Public Merger* — In the event a buyer wrongfully walks away from a public company acquisition, there is an open question whether the target shareholders (either directly or through the target) can assert their damages, most obviously the lost premium, resulting from the buyer's breach. In its 2005 *Con Ed* decision, the Second Circuit suggested that under New York law those damages were not collectible as the shareholders were not parties to the agreement and that the seller's damages claim could very well be limited to its out-of-pocket costs in pursuing the failed merger. By contrast, Delaware decisions in related circumstances (including the *IBP* case) and comments from the bench by Delaware judges suggest that the outcome under that state's law could very well be different.
- *Specific Performance* — Many transaction agreements provide that an aggrieved party is entitled to seek specific performance of the breaching party's obligations rather than being limited to asserting monetary damages. New York law generally requires only showing entitlement to the remedy by a preponderance of the evidence. Delaware law requires a showing at the higher standard of clear and convincing evidence. By contrast, Delaware generally respects a contractual stipulation that a breach will cause irreparable harm (a necessary finding for a specific performance remedy), while New York cases suggest that such a contract provision will not by itself necessarily establish evidence of irreparable harm.
- *Good Faith Negotiations* — Parties sometimes will leave certain items to be resolved post-signing or even post-closing under an explicit commitment to enter into "good faith" negotiations to reach definitive agreement. Under New York law, even an express duty to negotiate in good faith is largely unenforceable (i.e., the allegedly breaching party won't be forced into an agreement) if material open terms remain outstanding at the time of the good faith commitment. By contrast, under Delaware law such an explicit obligation is likely to be held enforceable even if material terms remain to be negotiated.
- *Disclaimer of Reliance* — Sellers often seek to include in the purchase agreement a statement that the buyer is not relying on any extra-contractual representations in entering into the agreement. One of the purposes of this provision is to defeat post-closing fraud claims by the buyer as reliance is a necessary element of fraud. In Delaware, a general disclaimer of reliance is usually sufficient to defeat a fraud claim, while in New York the courts appear to question boilerplate disclaimers and instead require that the disclaimer be specific enough in covering the representation that is the subject of the extra-contractual fraud claim.
- *Fraud Claim* — Most purchase agreements state that monetary caps on indemnification claims for representation and warranty breaches do not apply in instances of fraud. Under Delaware law, a fraud claim can be premised on representations within the contract and therefore the fraud exception can be impactful. There are cases in New York, however, that suggest that fraud claims can only be based on conduct and statements outside of the contract, and not on contractual representations. Therefore, even with the fraud exception, a buyer's recovery may be limited by the contractual cap even when the contractual representation was knowingly false (i.e., fraudulent).

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During the course of negotiations, dealmakers frequently will view the choice between New York and Delaware as the governing law for acquisition agreements as being of little practical consequence. While it is true that the laws of these two leading states for transaction agreements are often very similar, there are certain situations, some described above, where the selection could be outcome-determinative in the event of a post-signing or post-closing dispute. Despite it being hard to predict at the outset which state's laws ultimately will be more favorable, a party may wish to evaluate the choice in light of specific circumstances of the transaction to determine whether its potential interests may be better served by selecting one over the other.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

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