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"Con Ed" Damages in Canadian Public M&A: Revisiting *Cineplex v Cineworld* in Light of Recent Delaware Case Law

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What is a spurned seller's recourse when a buyer walks away from a deal in breach of the purchase agreement? In private M&A, the answer is reasonably straightforward: sue the buyer to close the deal or to recover damages. In public M&A, however, the answer is murky at best.

The problem arises from the manner in which public deals are typically structured. When negotiating with a potential acquirer, the board of a public target company functions effectively as the bargaining agent for its numerous and dispersed shareholders, who cannot feasibly participate in the negotiations or sign the purchase agreement. As a consequence, the target (not its shareholders) is party to the purchase agreement and is, absent any special provisions to the contrary, the only party that can sue the buyer for a breach. Where specific performance (usually the preferred remedy) is unavailable to the target, it must seek redress against the buyer through a damages claim.

If a buyer walks away from a deal, however, the target's damages would not be expected to include the premium that was otherwise payable to its shareholders since only the shareholders (not the target) were entitled to receive the deal proceeds. In fact, until the Ontario Superior Court's surprising ruling in *Cineplex v Cineworld* (December 12, 2021) that a target company may recover lost-synergy damages from a failed deal, in Canada most buyers facing such a lawsuit could have credibly argued that the only damages recoverable by a target would be the target's out-of-pocket costs for the failed transaction. As a consequence, a target may rightly be concerned that the merger agreement it inked with the buyer is nothing more than an option for the latter to walk away from the agreement, where the monetary cost for doing so is a potential damages award of a magnitude far less than that of the premium the buyer avoided paying.

To respond to this low-price "option problem," a target may insist that the purchase agreement require the buyer to be liable for lost premium if the buyer wrongly exits the deal (a so-called *Con Ed* provision, named after the 2005 decision of the U.S. Court of Appeals for the Second Circuit in *Consolidated Edison, Inc. v Northeast Utilities*). The enforceability of such a provision, however, is unclear. Cineplex hinted at an endorsement of a form of *Con Ed* provision, but ultimately held back from issuing firm guidance. More recently, in a first for Delaware, the Court of Chancery addressed the enforceability of a *Con Ed* provision head-on in *Crispo v Musk* (October 31, 2023), a case that may prove instructive for Canadian boards seeking to solve the option problem.

Summary Takeaways

- In Canada, it is possible that a court would uphold a target's right to recover lost-shareholder premium on the basis of a *Con Ed* provision which simply affirms that a buyer's liability for breach of the purchase agreement may include lost premium.
- However, *Crispo* suggests that a target company seeking to hold a buyer liable for lost-premium damages should contractually confer on its shareholders by way of the purchase agreement clear third-party rights to recover lost premium from a defaulting buyer.
- The risk of conferring third-party rights on shareholders to recover lost-premium damages is that the target loses control over the litigation. Maintaining control over the litigation by establishing an agency or trust relationship with its shareholders could allow the target to pursue claims and deal with the proceeds in an orderly fashion.
- Given market resistance to *Con Ed* provisions in Canadian public M&A agreements, consider instead a reverse-termination fee. While it does not solve the "option problem," it can at least price it appropriately.

Crispo v Musk

Background

Crispo was a side story to the Twitter-Elon Musk merger saga in which Musk's holding companies agreed to acquire Twitter, Inc., and then refused to close the deal. In proceedings brought by Twitter shareholder Luigi Crispo seeking specific performance or damages in the alternative, the Court held that Crispo lacked standing to seek specific performance but left open the possibility that Crispo had standing to sue for lost-premium damages on the basis of the lost-premium provision contained in the merger agreement (described below). The Court permitted supplemental briefings on the lost-premium point and held Crispo's damages claim in abeyance. Subsequently, Musk agreed to close the merger, rendering Crispo's lost-premium claim irrelevant. Crispo then filed a "mootness fee" petition in which he argued that his stockholder litigation to recover the lost premium helped sway Musk to ultimately close the deal. On a petition for a mootness fee, the plaintiff must demonstrate that its claim was "meritorious when filed." In *Crispo*, the Court of Chancery was asked to consider whether Crispo, a non-party to the merger agreement, asserted a valid claim for lost-premium damages.

Lost-premium provisions are unenforceable by a target under Delaware law

The Musk-Twitter merger agreement included a relatively common formulation of a *Con Ed* lost-premium provision, providing that if the agreement is terminated because of the buyer's intentional breach, the target's damages "would include the benefits of the transactions contemplated by this Agreement lost by the Company's stockholders… (taking into consideration all relevant matters, including lost stockholder premium, other combination opportunities and the time value of money)."

Notwithstanding the clear language entitling the target to lost-premium damages, the Court held that Twitter had no right or expectation to receive the merger consideration—the merger agreement contemplated that the deal consideration would be payable at closing directly to Twitter stockholders ("no stock or cash passes to or through the target"). Where a target has no entitlement to the premium on consummation of the deal, the Court continued, it "has no entitlement to lost-premium damages in the event of a busted deal." Accordingly, a lost-premium provision that defines a buyer's damages to include lost premium cannot be enforced by the target. However, the Court noted, such a provision could be enforceable if the parties intended to convey third-party beneficiary status to stockholders for purposes of seeking lost-premium damages.

A lost-premium provision may (or may not) confer third-party rights on stockholders

The Twitter merger agreement expressly excluded third-party rights in favour of shareholders except in limited circumstances not relevant to the analysis. For the Court, this suggested that the parties did not intend to confer third-party beneficiary rights on shareholders for the purpose of recovering lost premium. However, the Court also noted that another "objectively reasonable interpretation" of the agreement was that, by expressly referring to lost-premium damages in the contract, the parties did intend to confer third-party beneficiary rights on shareholders for such damages. However, even if they did, under the merger agreement a claim for lost-premium damages would not "vest" until Twitter's right to seek specific performance was unavailable.

Ultimately, the Court did not have to conclude which of these two interpretations was correct because it needed to determine only whether Crispo's claim for lost premium was meritorious when filed. Either Crispo "did not have third-party beneficiary status" or "his third-party beneficiary rights had not yet vested"—either way his claim lacked merit.

The Law in Canada

Cineplex remains the law in Canada. When Cineworld Group plc wrongfully terminated its agreement to acquire Cineplex Inc., Cineplex argued that it was entitled to seek as compensatory damages the value of the premium that would have been paid to its shareholders had the deal closed. The Court rejected this claim on the basis of the expectancy principle: "Quite simply, the losses that Cineplex seeks to recover are those of the shareholders, not Cineplex." The parties' arrangement agreement did not contain a clause that resembled a lost-premium provision purporting to provide for damages equivalent to lost-shareholder value or any other form of *Con Ed* provision.

The Court also considered whether Cineplex's shareholders were granted third-party beneficiary status under the arrangement agreement. The agreement had a third-party beneficiaries clause similar to the one at issue in *Crispo*, which disclaimed the Cineplex shareholders as third-party beneficiaries under the agreement except for the purpose of receiving the deal consideration on closing. On a plain reading of the third-party beneficiary provision, the Court held that the contracting parties had not intended to confer third-party rights on Cineplex's shareholders for the purpose of enforcing payment of lost premium.

Lost-Synergy Damages as an Alternative to Lost-Premium Damages?

Although the Court in *Cineplex* did not award lost-premium damages, it did find that Cineplex was entitled to damages as compensation for loss of synergies that Cineworld projected to be realized in Cineplex following the acquisition. The Court found that, unlike lost premium, Cineplex was entitled to expect such synergies and could therefore use them as a basis for compensatory damages. The Court awarded Cineplex $1.2366 billion in lost-synergy damages as a present-value calculation of Cineworld's projected annual synergies, an amount that was notably close to the quantum of Cineplex's lost-premium claim. An appeal of the decision was expected; however, Cineworld subsequently commenced Chapter 11 proceedings, putting an end to the litigation and Cineplex's damages award. Whether lost-synergy damages will be readily available to a spurned target remains an open question.

Takeaways for *Con Ed* Provisions in Canadian Public M&A Agreements

1. An Ontario court might enforce a contractual claim for lost premium (a *Con Ed* provision)

The *Cineplex* decision hints at a possible means by which a target could contract for a right to recover lost-premium damages: "There is nothing in the agreement that entitled Cineplex, *as the contracting party*, to recover the loss of the consideration to shareholders if the Transaction was not completed." This statement suggests that an Ontario court might take a different view from *Crispo* and give effect to a provision entitling a target to recover damages based on lost-shareholder premium. However, given that both *Cineplex* and *Crispo* are rooted in the same principle that a target cannot claim in damages an award for lost consideration that it was never entitled to receive under the transaction, it is also possible that a Canadian court could find that a lost-premium provision, without the conferral of third-party rights on shareholders, is unenforceable by a target.

2. A target might consider appointing itself shareholders' agent or trustee to enforce rights

In *Cineplex*, the Court noted that the target was named as the agent of its shareholders for the purpose of enforcing their right to receive the deal consideration on closing. Cineplex, however, "was not appointed as *agent* for the purpose of enforcing their rights against Cineworld if it failed to close." The contrast was significant for the Court: "If the parties had wanted to appoint Cineplex as the shareholders' agent to enforce their rights on Cineworld's failure to close, they could have done so." In contrast, the Court in *Crispo* suggested that such an arrangement rests on "shaky grounds" because "there is no legal basis for allowing one contracting party to unilaterally and irrevocably appoint itself as an agent for a non-party for the purpose of controlling that party's rights." In the Canadian context, possible workarounds to potential agency issues might be to formally appoint the target as shareholder agent by way of the court-approved interim order (if the transaction is structured as an arrangement) or to establish a trust relationship between the target (as trustee) and its shareholders (as beneficiaries).

Whichever way a target company obtains control over lost-premium litigation, certain features of the relationship between the target and its shareholders should be addressed in the agreement. Should the target retain discretion to proceed with the lost-premium litigation? Should the target retain discretion to determine whether settlement or litigation proceeds should be retained by the company or distributed to shareholders? If the proceeds are to be distributed to shareholders, should the right to receive the proceeds trade with the shares or be fixed in advance? Ironing out these details in the agreement and ensuring adequate proxy disclosure will be critical to insulate the target from potential shareholder claims based on the exercise of its discretion. Examples of these arrangements can be found in some U.S. and Canadian public acquisition agreements.

3. Consider other means of recourse against a buyer if *Con Ed* damages are resisted, such as a reverse-termination fee

Con Ed provisions are often resisted by buyers in Canadian public M&A and are accordingly rarely seen in Canada (reportedly only 2% of all public deals in a recent American Bar Association study of Canadian transactions included such a provision [available to ABA members here]). In the absence of a *Con Ed* provision and a viable means to a specific-performance remedy, a reverse-termination fee of sufficient magnitude might be a suitable, negotiable alternative. A reverse-termination fee should be appropriately estimated to align with the principles of compensatory damages to minimize the risk that it is rejected as an unenforceable punitive damages claim. Tying the fee to lost-opportunity cost or a similar measure may prove a reasonable basis to set the amount. While a reverse-termination fee may reduce the agreement to an option on the target, *Cineplex* suggests that a Canadian court is unlikely to grant an award for lost premium in the absence of a properly constructed *Con Ed* provision. Put simply, a termination fee may be better than nothing.

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