Lost-Premium Damages in M&A: Delaware's New Legal Landscape

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In the event of a buyer's willful breach of a merger agreement, lost-premium provisions allow a target corporation to claim damages that include the lost premium or economic entitlements that its stockholders would have received had the deal closed. In the recent Crispo v. Musk *decision the Delaware Chancery Court held these provisions to be unenforceable under the anti-penalty doctrine. In this Article we challenge the analysis in* Crispo *by arguing that lost-premium provisions are doctrinally defensible, economically sensible, and supported by policy considerations. Lost-premium provisions became enforceable in Delaware from August 1, 2024, following amendments to the Delaware General Corporation Law. But the issue may crop up again in other jurisdictions. This Article explains why courts in other states both can and should uphold lost-premium provisions.*

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Introduction

Merger and acquisition (M&A) transactions with a public target are frequently structured using a direct or triangular merger.[1] Parties typically use a reverse triangular merger when cash is used as the merger consideration: the target corporation merges into a newly formed acquisition subsidiary and survives as a wholly-owned subsidiary of the buyer, while the old target shareholders receive cash in exchange for their shares. Importantly, shareholders are not party to the merger agreement, which is entered into by the merging corporations. This creates a peculiar situation: target shareholders are *economically* the beneficiaries of the merger, since they are the intended recipients of the buyer's promised consideration. Yet, *legally*, they are not contractual parties nor, typically, third-party beneficiaries. Conversely, the target corporation is not the economic beneficiary of the transaction, but nevertheless is a party to the merger agreement.

Typically, only the target company can seek remedies under the merger agreement when a buyer unjustifiably refuses to close an acquisition. However, the target cannot seek damages for the economic benefit of the lost bargain, as the consideration would have been paid directly to the shareholders. Meanwhile, shareholders cannot seek these damages either, as they are neither parties to the contract nor granted other enforcement rights. With both the target and its shareholders devoid of the most economically meaningful remedy, it becomes easier for buyers to unjustifiably walk away from merger agreements.

M&A practitioners devised a solution to align the economic and legal realities of change of control transactions by inserting "lost-premium"

1. In a direct merger, the buyer and target corporation are combined into a single corporation, with one of the entities surviving (merger) or by way of creation of a new entity (consolidation). In a triangular merger the buyer uses an acquisition subsidiary to merge with the target, with either the subsidiary surviving (forward triangular merger) or the target surviving (reverse triangular merger). Del. Gen. Corp. Law §§ 251, 259 (2024).

provisions in merger agreements.[2] In their most common formulation, these provisions stipulate that in the event of a buyer's qualifying breach of the merger agreement, the target corporation can claim damages that include the lost premium that its shareholders would have received had the deal closed. Given that shareholders in US listed targets routinely receive premiums in excess of 40% of market price,[3] a target's ability to claim lost-premium damages can be the difference between merely ancillary damages (e.g., recovering transaction costs) and a damages award that might equal almost half of the target's value. Lost-premium provisions serve an important economic function by raising the potential costs for a reluctant buyer who might otherwise breach the contract, thereby acting as a strong deterrent against non-performance.

Despite the widespread use of lost-premium provisions in merger agreements governed by Delaware law, the question of their enforceability had never come before the Delaware courts. This changed in *Crispo v. Musk*.[4] There, to the surprise of many M&A practitioners, the Chancery Court held that such clauses are unenforceable.[5] The decision appears to have had an almost immediate impact, with targets involved in ongoing mergers experiencing negative share price returns.[6] Commentators have indicated that removing this form of protection could result in "too many breaches," since in the absence of lost-premium provisions buyers can only be held accountable for comparatively paltry damage awards.[7] Acknowledging these concerns, the Delaware General Assembly quickly moved to amend the Delaware General Corporation Law (DGCL) to restore the legality of lost-premium provisions. The amendments reversing the effect of *Crispo v. Musk* come into effect on August 1, 2024—less than a year after *Crispo* was handed down.[8]

In this Article, we consider the legal and policy issues surrounding lost-premium provisions and argue that their use is both doctrinally defensible and economically sensible. We suggest that other state courts should not follow *Crispo*. Contrary to the Chancery Court's analysis, we argue that lost-premium provisions are not unenforceable under the "anti-

2. *See infra* Part I.

3. *See* G. Alexandridis, D. Petmezas & N.G. Travlos, *Gains from Mergers and Acquisitions Around the World: New Evidence*, 39 FIN. MGMT. 1671, 1672 (2010) (calculating the average premium for public targets to be 45.79%).

4. 304 A.3d 567 (Del. Ch. 2023).

5. *See infra* Part III. Chancellor McCormick has elsewhere noted the importance of constructive commentary, and our Article should be taken in this vein. *See* Chancellor Kathaleen St. Jude McCormick & Robert Erikson, *Delaware's Approach to Specific Performance in M&A Litigation*, 20 N.Y.U. J.L. & BUS. 7, 22 (2023).

6. Dhruv Aggarwal, Albert H. Choi & Geeyoung Min., *Contractual Remedies in Mergers: Lessons from Crispo v. Musk* 3 (NW. L. & Econ. Res. Paper, Working Paper No. 2024), https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1383&context=law_econ_current [https://perma.cc/ZY8Y-QEV2].

7. *Id.*

8. *See infra* Part II.

penalty doctrine" of contract law. We reach this conclusion for several reasons. First, the unconscionability and fairness concerns underlying this doctrine are difficult to justify in the M&A context. Second, a target *does* have an expectation interest related to consideration paid as part of a deal. The target corporation's own loss is best assessed by its shareholders' loss, since the consideration payable most accurately represents the value and substance of the corporation's bargain. The buyer in breach is not paying a penalty: damages payable under the loss-premium provision is not grossly disproportionate to the loss. This understanding of the anti-penalty doctrine reflects practical realities: there is no other reliable alternative way to calculate a target's damages in a busted deal.

In advancing this argument, this Article proceeds in three further parts. Part I provides background to *Crispo* and explains the nature and origins of lost-premium provisions. Part II discusses the Delaware legislature's response, focusing on the recent amendments to § 261 of the DGCL. Part III analyses the legal arguments and policy considerations raised in the *Crispo* decision. This Part argues that, contrary to the Chancery Court's findings, lost-premium provisions do not run afoul of the anti-penalty doctrine. Our analysis in this section is principally of academic interest in Delaware, since the DGCL has been amended to undo the effects of the *Crispo* decision in the state. However, our analysis remains of practical interest for jurisdictions outside Delaware, where legislatures have not yet intervened and where courts might draw on the analysis of *Crispo* to invalidate lost-premium provisions. The Article concludes by affirming these provisions as an appropriate contractual mechanism that best aligns the legal and economic realities of typical cash-out mergers.

I. Delaware Chancery Rejects *Con Ed* "Lost-Premium" Provisions

Crispo came before the Delaware Chancery Court in "a curious procedural context," well after it seemed like the dust had settled following an unsuccessful class action claim involving the same parties.[9] Elon Musk and his affiliated companies[10] (Defendants) attempted to back out from a signed agreement (Merger Agreement)[11] to purchase Twitter (now X) in July 2022. Predictably, this sparked a flurry of litigation that included a class action by Luigi Crispo (Plaintiff), a Twitter shareholder.

The Plaintiff sought specific performance and (alternatively) damages, on the basis of having standing to enforce the agreement as a third-

9. Crispo v. Musk, 304 A.3d 567, 570 (Del. Ch. 2023).

10. X Holdings I, Inc. and X Holdings II, Inc.

11. Agreement and Plan of Merger, SEC (April 25, 2022), https://www.sec.gov/Archives/edgar/data/1418091/000119312522120474/d310843ddefa14a.htm [https://perma.cc/2N4U-E48Z].

party beneficiary.[12] The Plaintiff also, even more ambitiously, claimed that Musk was a controller of Twitter and breached fiduciary duties owed to Twitter shareholders.[13] The Chancery Court dismissed the specific performance claim for lack of standing, finding that the Plaintiff did not satisfy the test for third-party beneficiary status.[14] The Court also dismissed the claim for breach of fiduciary obligations to Twitter shareholders, conducting a fact-specific inquiry to determine that Musk did not exercise sufficient control to give rise to fiduciary obligations.[15]

Because it remained to be seen whether the deal would close, the Court in *Crispo* did not initially need to rule on whether the Plaintiff and class of shareholders could alternatively claim as third-party beneficiaries for damages under the Merger Agreement, since.[16] Rather than ruling on an issue that might not materialize, the Court decided to hold the damages issue in abeyance and postpone its adjudication for a later date following supplemental briefing from the parties.[17] On the eve of "the corporate law trial of the century" in October 2022[18]—Twitter's claim against Musk and his affiliated companies for breach of contract and specific performance of the merger[19]—and with most legal commentators grimly assessing Musk's chances of success, the Defendants changed course and the Twitter acquisition was consummated in late October 2022. However, instead of being a natural end to the story, the Plaintiff in *Crispo* initiated a petition for mootness fees (of $3 million) on the basis that his earlier lawsuit causally contributed to the acquisition closing, and therefore constituted a corporate benefit to Twitter.

Like its predecessor decision, *Crispo* came before Chancellor McCormick, who applied the usual mootness fee tests. These include: whether the Plaintiff's lawsuit was meritorious when filed, whether the Defendants took action prior to the lawsuit being resolved that produced a benefit to the corporation, and whether the Plaintiff's suit was causally related to this resulting corporate benefit.[20] The first prong of the mootness test necessitated the most analysis: because the Court had already dismissed the Plaintiff's other causes of action pertaining to specific performance and breach of fiduciary duties, the Court had to determine whether the Plaintiff's

12. Crispo v. Musk, No. 2022-0666, 2022 WL 6693660, at *3-4 (Del. Ch. Oct. 11, 2022).

13. *Crispo*, 304 A.3d at 571; *Crispo*, 2022 WL 6693660, at *1.

14. Plaintiff advanced a "textual argument" and a "precedent-based argument." *See Crispo*, 2022 WL 6693660, at *5.

15. *Crispo*, 2022 WL 6693660, at *12-16.

16. *Id.* at *11; *Crispo*, 304 A.3d at 571.

17. *Crispo*, 2022 WL 6693660, at *11.

18. Andrew K. Jennings, *101 Lawyers: Attorney Appearances in Twitter v. Musk*, 73 DUKE L.J. ONLINE, 77, 80 (2023).

19. Twitter, Inc. v. Elon R. Musk, No. 2022-0613 (Del. Ch. Oct. 3, 2022).

20. United Vanguard Fund, Inc. v. TakeCare, Inc., 693 A.2d 1076, 1079 (Del. 1997) (citing Allied Artists Pictures Corp. v. Baron, 413 A.2d 876, 878 (Del. 1980)).

alternative claim for damages as a third-party beneficiary was meritorious when filed.[21]

Ultimately, the Court found that the Plaintiff had no rights under the contract as a third-party beneficiary and therefore could not have had a meritorious claim at filing. First, this was because the Merger Agreement had a "No Third-Party Beneficiaries" provision,[22] which expressly disclaimed Twitter shareholders' third-party beneficiary status apart from three specific carve-outs that were not applicable.[23] Second, the Court analyzed the "Lost-Premium" provision in Section 8.2 of the Merger Agreement. This provision stated that termination would not relieve the Defendants from liability for damages in the case of knowing and intentional breach, which "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 . . . ."[24] The main question at issue before the Court was whether this provision, read independently or in conjunction with the "No Third-Party Beneficiaries" provision, conferred standing on the Plaintiff at the time that the lawsuit was filed. The Court found that it did not, which was sufficient to fully dispose of the issue before it, namely the Plaintiff's mootness lawsuit.[25]

The Court's analysis extended, however, to consider the legality of lost-premium provisions more generally. Lost-premium provisions are also known as "*Con Ed*" provisions because practitioners began to include them in merger agreements following the Second Circuit's decision in *Consolidated Edison Inc v. Northeast Utilities* (hereinafter "*Con Ed*").[26] This decision held that, following a buyer's wrongful failure to consummate a merger, shareholders of the target did not have standing as third-party beneficiaries to recover lost-premium damages from the buyer, nor could the target itself seek lost-premium damages on their behalf.

In its analysis, the Court drew on a well-known article by two M&A practitioners[27] that describes the three main types of lost-premium provisions that arose in response to *Con Ed*.[28] The first type designates target shareholders as third-party beneficiaries that can claim against the buyer.

21. *Crispo*, 304 A.3d at 572.

22. Agreement and Plan of Merger, supra note 11, at § 9.7.

23. *Id*. at Section 8.3(c). One of the carve-outs, "Company Related Parties," was defined to include shareholders with reference to a different context, protecting them from liability in the case of a lawsuit from Musk and his affiliated companies (as the buyers) in the event of an intentional breach of the merger agreement by Twitter. *Id*.

24. *Id*. at Section 8.2.

25. *Crispo*, 304 A.3d at 586.

26. 426 F.3d 524, 524 (2d Cir. 2005).

27. Victor I. Lewkow & Neil Whoriskey, *Left at the Altar: Creating Meaningful Remedies for Target Companies*, M&A LAWYER (Oct. 2007).

28. *Crispo*, 304 A.3d at 580-82.

This approach was not widely adopted in practice because of the "potential proliferation of lawsuits" that could be launched against a buyer alleged to be in breach, and also because "those lawsuits would undermine the ability of the target board to control the litigation asset," meaning that shareholder suits could hinder the target board coming to a favorable settlement with the buyer.[29] The second type of lost-premium provision designates the target corporation as agent for the shareholders to recover damages on their behalf. But this approach was also not widely adopted because of persisting uncertainty surrounding the legal validity of a unilateral appointment as agent.[30]

The third and "most popular" type of lost-premium provision is exemplified in Section 8.2 of the Twitter-Musk Merger Agreement: a target's damages are defined to include lost shareholder premiums, and shareholders are not designated as third-party beneficiaries.[31] Under this approach, the target corporation is the only party which can claim damages against a buyer for wrongful breach of a merger agreement, and these damages are measured with reference to the premium that the target board negotiated on the shareholders' behalf. The initial *Crispo* decision from 2022 considered this approach when disposing of the Plaintiff's specific performance claim, noting that it was endorsed by a leading M&A treatise and used by transactional attorneys.[32] The Court, however, had not yet commented on its validity.

To the surprise of M&A practitioners who had assumed that Delaware courts would uphold contractual provisions defining a target's damages to include lost shareholder premiums,[33] *Crispo* found such clauses to be unenforceable. Given the widespread use of these kinds of provisions—more than 25% of public M&A deals that closed since January 2022 have included this type of lost-premium provision[34]—the effect of *Crispo* in Delaware, and its influence in other state courts, has been significant.

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29. *Id.* at 581.

30. *Id*.

31. Glenn D. West, *Surprise: Target Company May Not Be Entitled to Expectancy Damages Based Upon the Lost Premium for an Acquirer's Wrongful Failure to Close a Merger*, Weil Global Private Equity Watch (Nov. 23, 2023), https://privateequity.weil.com/glenn-west-musings/surprise-target-company-may-not-be-entitled-to-expectancy-damages-based-upon-the-lost-premium-for-an-acquirers-wrongful-failure-to-close-a-merger [https://perma.cc/2ZHY-K583].

32. Crispo v. Musk, No. 2022-0666, 2022 WL 6693660, at *11 (Del. Ch. Oct. 11, 2022).

33. West, *supra* note 31 (noting that "most practitioners believed Delaware courts would likely view damages measured by the lost stockholder premium as, at least in part, recoverable by a target company when an acquirer wrongly terminated the merger agreement").

34. American Bar Association, Business Law Section, Mergers & Acquisitions Committee, *2024 ABA Public Deal Points Study: Remedies* (March 1, 2024), https://public.tableau.com/app/profile/aba.deal.points/viz/2024ABADealPointsStudy/Home#1 [https://perma.cc/MA49-R4SM].

The Court reached its conclusion based on an analysis of the penalty doctrine—the focus of Part III of this piece. The Court held that lost-premium provisions constitute illegal penalty clauses because the target has no expectation interest in the shareholder premium.[35] Since only Twitter shareholders, but not the target, would receive the premium after closing, the only option for shareholders to enforce a lost-premium provision would be based on third-party beneficiary status under the Merger Agreement. Yet, the Court found that shareholders did not enjoy such status under the specific wording and design of the Merger Agreement.[36]

II. The Delaware Legislature Steps In – DGCL Amendments

In light of practitioner concerns following *Crispo*, the Delaware General Assembly recently passed (and the Governor signed into law) amendments to § 261 of the DGCL, as proposed in March 2024 by the Delaware State Bar Association (Council of the Corporation Law Section). Effective from August 1, 2024, a new § 261(a)(1) allows merger agreements to include lost-premium provisions, thereby enabling parties to contract around *Crispo*'s interpretation of these provisions. § 261(a)(1) lets a target retain lost shareholder premium damages itself, rather than requiring a target to designate shareholders as third-party beneficiaries or act as an agent on the shareholders' behalf, which is in line with the most common approach to how practitioners draft lost-premium provisions.[37] Specifically, § 261(a)(1) allows, "in addition to any other remedies available at law or in equity," merger agreements to contain:

> penalties or consequences [that] may include an obligation to pay to the other party or parties to such agreement an amount representing, or based on the loss of, any premium or other economic entitlement the stockholders of such other party would be entitled to receive pursuant to the terms of such agreement if the merger or consolidation were consummated . . . .[38]

The second DGCL amendment relating to lost premiums is § 261(a)(2), which allows shareholders to make an "irrevocable and binding" appointment of a representative with "sole and exclusive authority to

35. *Crispo*, 304 A.3d at 582-84.

36. *Id.* at 584-85.

37. We have elsewhere endorsed this as an ideal solution. *See* Jonathan Chan & Martin Petrin, *Lost Synergies and M&A Damages: Considering Cineplex v Cineworld*, 100 CANADIAN BAR REV. 274, 300-01 (2022).

38. S.B. 313, 152nd General Assembly, (Del. 2024), available at https://legis.delaware.gov/BillDetail?LegislationId=141480 [https://perma.cc/X5QP-RWSG]. The synopsis to the amendments explains that this provision "confirms that constituent corporations have latitude to allocate the risk of non-performance by provisions expressly set forth in agreements of merger or consolidation." *Id.* at 9.

take action on behalf of such stockholders," such as enforcing a merger agreement, pursuing a settlement, or seeking lost-premium damages as third-party beneficiaries.[39] This amendment solves the multiplicity of lawsuits problem highlighted in *Crispo* that might arise if several shareholders are permitted to sue as third-party beneficiaries in failed deals. Indeed, this is why practitioners have typically shied away from incorporating these types of provisions in merger agreements.

It remains to be seen whether other state legislatures will follow Delaware and amend their corporation statutes to allow for merger agreements to include lost-premium provisions.[40] However, courts in other states are likely to turn to *Crispo* when adjudicating lost-premium damages in merger agreements governed by their own jurisdiction. *Crispo* has not yet been cited for its discussion on anti-penalty doctrine by other courts, but it has been cited by for its discussion on third-party beneficiaries.[41]

III. Does the Anti-Penalty Doctrine Apply to Lost Premiums?

In *Crispo*, the Court not only reaffirmed the principle that shareholders generally lack the standing to enforce merger agreements directly, but it also took the notable additional step of declaring that a target cannot enforce provisions that define its damages to consist of, or include, lost stockholder premiums. This latter step is puzzling, both substantively and procedurally. Substantively, it raises questions about why lost stockholder premiums should not be a valid measure of damages for target companies. Procedurally, this declaration was unnecessary for the *Crispo* decision, which did not involve claims by the target company and instead focused on the plaintiff's third-party beneficiary status. In this section, we suggest that claiming damages with reference to lost premiums is a valid and reasonable approach for target company claims.

Doctrinally, we first argue that a target corporation suffers a non-negligible loss when a buyer wrongfully breaches a merger agreement, and the quantum of this loss is most reliably assessed by the stockholders' loss. Lost-premium provisions are not unenforceable penalties, but rather correspond accurately to the damages suffered by the target. Second, we suggest that *Crispo* should have examined the unconscionability rationale underlying the anti-penalty doctrine, rather than primarily focusing on perceived deviance between the target's stipulated damages and its expectation interest. In our view, the scope of anti-penalty doctrine is unlikely to

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39. *Id*.

40. The most likely contenders are arguably states competing with Delaware for corporate charters.

41. Prophet Mortg. Opportunities, LP v. Tr., No. 22 CIV. 9771, 2024 WL 708774, at *9 (S.D.N.Y. Feb. 21, 2024); Davidoff v. Vanguard Grp., Inc., No. 22-CV-5329, 2024 WL 4648169, at *3 (E.D.N.Y. Jan. 31, 2024).

encompass merger agreements given the often-balanced bargaining power and sophistication of parties in M&A transactions. Lost-premium provisions reflect the intent of both parties in a merger to estimate the actual damages suffered, making them conceptually more akin to permissible liquidated damages provisions than unenforceable penalties.

Policy considerations also weigh in favor of lost-premium provisions. First, they promote freedom of contract between sophisticated commercial actors. Second, lost premiums are the most reliable means of calculating damages—the alternative approaches to calculating a target's loss, such as estimating lost synergies or lost future cash flows, are problematic and highly assumption-laden. Third, lost-premium provisions deter inefficient breach of contract by providing targets with an economically meaningful remedy. Allowing their use in merger agreements increases deal certainty.

A. The Anti-Penalty Doctrine

Crispo's reasoning on lost premiums starts with the basic contract law principle that a party cannot receive more than expectation damages, that is an amount that would put it in the same position as if the other party had performed the contract.[42] On the flipside, under what is sometimes called the anti-penalty doctrine,[43] provisions that attempt to contravene this principle are considered unenforceable penalties.[44] Applying these rules to the merger context, the Chancery Court in *Crispo* explained that if the stockholders – but not the target company – have the right to receive merger consideration, "a provision purporting to define a target company's damages to include lost-premium damages cannot be enforced by the target company."[45] Of particular significance to the Court was that under the merger agreement, the cash did not pass through the Target en route to the stockholders, but rather was paid directly.[46] Thus, the Court found that only shareholders, if and when granted third-party beneficiary status, could enforce damages that are defined in this manner.[47]

42. *Crispo*, 304 A.3d at 583, citing *Duncan v. Theratx*, 775 A.2d 1019, 1022 (Del. 2001); RESTATEMENT (FIRST) OF CONTRACTS § 339 cmt. f; DAN B. DOBBS & CAPRICE L. ROBERTS, LAW OF REMEDIES: DAMAGES, EQUITY, RESTITUTION § 12.2(1), at 797-98 and § 12.9(1) at 850-51 (3d ed. 2018); E. ALLAN FARNSWORTH & ZACHARY WOLFE, FARNSWORTH ON CONTRACTS § 12.8, at 68-69 (4th ed. 2019); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 347 (explaining that contract damages are ordinarily based on the injured party's expectation interest).

43. Albert H. Choi, *Deal Protection Devices*, 88 U. CHI. L. REV. 757, 823 n.171 (2021) (citing sources).

44. *Id.*; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 356 (explaining that penalty terms are unenforceable).

45. *Crispo*, 304 A.3d at 584.

46. *Id.*

47. *Id.*

In essence, *Crispo* concluded that a target cannot claim lost premiums if, under an applicable merger agreement, it is not the party that would receive them. Accordingly, since a target corporation undertaking a merger cannot have expectations to be compensated for such a loss, the Court held provisions that say otherwise to represent an impermissible contractual penalty.[48]

In our view, however, the fact that a target does not expect to receive the buyer's premium does not mean that it does not incur a loss—or lose the benefit of its bargain—in case of a breach of contract by the prospective purchaser. We explain below that because the target's and stockholders' interests converge in cash-out transactions (like the transaction in *Crispo*), the most accurate way to measure the target's loss is with respect to the premium it negotiated. We also disagree with the conclusion that a non-performing buyer incurs a "penalty" if required to pay damages corresponding to previously promised consideration, albeit to the target rather than the stockholders.

Based on our characterization of the target's loss, contractually stipulated lost-premium damages are not disproportionate and do not run afoul of the anti-penalty doctrine. Indeed, lost-premium damages would not even raise any questions if an acquisition were structured differently. For example, in an asset purchase where cash flows through the target before distribution to the shareholders, a wrongfully injured target could claim the full benefit of the bargain, including the change-of-control premium.[49]

B. Lost-Premium Damages Are Doctrinally Defensible

Contract law principles suggest that lost premiums are an appropriate measure for defining a target's own damages. First, a target may have expectations related to consideration/premiums paid as part of a deal. One way to frame a target's damages, and thus its expectations in a merger, is to understand the issue *not* as the target corporation claiming for its shareholders' loss. Rather, in the context of a breached M&A agreement, the corporation's own loss is best assessed by its shareholders' loss, since the consideration payable most accurately represents the value and substance of the corporation's bargain. As the Court in *Crispo* noted, delivering the benefit of consideration for their shares, which obviously includes the all-important premiums, is the target's—and by extension the board's—sole

48. Indeed, a Canadian court has made a similar point in a case involving a failed merger, although it allowed the target to recover based on the novel concept of damages for "lost synergies." *Cineplex v Cineworld*, 2021 ONSC 8016. *See also* Chan & Petrin, *supra* note 37, on which parts of this section are based (criticizing the Canadian court's approach and arguing for specific performance or shareholder loss as the seller or target's damages).

49. *See also* Aggarwal et al., *supra* note 6 (showing that the *Crispo* decision led to changes in merger agreements and an increase in target-friendly non-price terms).

purpose for entering into a merger agreement.[50] In a cash-out transaction in particular, the board's singular goal when negotiating the merger agreement is to achieve the best possible deal for the shareholders. Accepting this characterization of the target's loss, lost-premium provisions do not constitute a "penalty" because the contractually stipulated amount of damages is not larger than the target's loss.

Second, the anti-penalty doctrine is not as strict as *Crispo* suggests. Scholars have noted that it is common for contracting parties to define damages based on certain formulas, which can be enforceable even if they deviate from the normal legal rule or are not precise measure of incurred losses.[51] Contract law "generally attempts to respect the parties' self-determination" in this respect.[52] As the Delaware Supreme Court once put it, remedies for breach of contract are based upon reasonable expectations of the parties ex ante[53] and should give the injured party the benefit of its bargain.[54] Similarly, the *Restatement (First) of Contracts*, which *Crispo* discusses in its analysis, suggests that an agreed-upon measure of damages must be "grossly disproportionate" before it becomes unenforceable as a penalty;[55] a leading treatise defines the threshold as an amount that is "unconscionable."[56] In our view, it is not clear why receiving a bargained-for premium would be an unconscionable amount, particularly given the fact that parties in M&A transactions are typically sophisticated, well equipped with legal advice, of relatively equal bargaining power. Put simply, merger agreements that require stockholder approval do not raise the unconscionability concerns that underpin the penalty doctrine. There is no power imbalance for the doctrine to correct.

In *Crispo*, the Court did not focus on unconscionability and disproportionality concerns. Instead, the Court focused on the fact that the target corporation did not have an expectation interest in the merger consideration. Because the target did not have any expectation interest in the merger, the Court concluded that damages flowing to the target must constitute a penalty.[57] This approach is unsatisfactory for the simple reason it

50. *Crispo*, 304 A.3d at 577 ("In a Delaware corporation, that benefit to stockholders marks the satisfaction of the board's fiduciary obligations to them and is a material part of the parties' purpose in entering into the contract. *Indeed, delivering this benefit to stockholders is typically the target corporation's purpose for entering into a merger agreement.*" (emphasis added)).

51. DOBBS & ROBERTS, *supra* note 42, § 12.2(1), at 798.

52. *Id.* § 12.9(1), at 850.

53. Duncan v. Theratx, 775 A.2d 1019, 1022 (Del. 2001); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 356 (explaining that the objective behind contract remedies is compensatory, not punitive).

54. Invenergy Co. v. Invenergy Renewables, LLC, 210 A.3d 688, 695 (Del. 2019).

55. Restatement (First) of Contracts § 339 cmt. g.

56. WILLISTON ON CONTRACTS §65:1 (4th ed. 2024).

57. *Crispo*, 304 A.3d at 584 (citing RESTATEMENT (FIRST) OF CONTRACTS).

ignores practical reality: a target has a significant interest in the bargain it negotiated, and a target may suffer economically meaningful loss when it loses a negotiated change in control opportunity.

There is also a line to be drawn between unenforceable penalties and permissible liquidated damages, which the Delaware Supreme Court once addressed in the context of a termination fee.[58] It seems curious to allow large merger termination fees to be payable to a target—Twitter, for example, negotiated a $1 billion termination fee for its benefit[59]—but disallow lost-premium based payments, based on public policy, in the case of a breach. To be sure, termination fees may be conceptualized as provisions negotiated for the benefit of the target and within the board's business judgment,[60] which is different from damages for lost benefits that would accrue to shareholders. As a matter of economic reality, however, termination fees for a buyer's refusal to close an acquisition are both intended to increase the costs of non-performance for the buyer and incentivize transaction completion. Like lost-premium damages, termination fees paid by buyers to sellers are "an attempt to compensate the seller for the seller's damages if it is left at the veritable merger altar." Their size is only constrained because of their characterization as liquidated damages (making them subject to the anti-penalty doctrine) and because they are similar to termination fees paid by sellers to buyers, which cannot be so large as to violate a seller's directors' fiduciary duties by deterring better subsequent bids.[61] Should courts depart from the holding in *Brazen v. Bell Atlantic Corp*[62] that a termination fee constitutes liquidated damages, then the anti-penalty doctrine would not apply and the parties would be free to agree a termination fee of any size (e.g., a fee equaling lost-premiums) subject to business judgment rule review.[63] From this perspective, the different treatment between termination fees and lost-premium provisions appears tenuous. Intent is central in the doctrinal analysis: provisions which are a "good faith estimation of actual damages sustained" are valid liquidated damages clauses, whereas payment intended to be a penalty is not

58. *See, e.g.*, *Brazen v. Bell Atlantic Corp.*, 695 A.2d 43 (Del. 1997) (upholding a merger termination fee).

59. Agreement and Plan of Merger, supra note 11, Item 1.01.

60. This was the position adopted by the Delaware Chancery Court, not followed by the Delaware Supreme Court on appeal in *Brazen v. Bell Atlantic Corp*., 695 A.2d 43 (Del. 1997). The Delaware Supreme Court instead applied a liquidated damages analysis. *Id*. at 47 ("The Court of Chancery denied the relief sought by plaintiff after concluding that the termination fee structure and terms were protected by the business judgment rule and that plaintiff failed to rebut its presumptions").

61. Brian JM Quinn, *Response to The Cost of Guilty Breach: What Work Is "Willful Breach" Doing?*, 62 B.C. L. REV. E. SUPP. 49, 50-51 (2021).

62. *Brazen v. Bell Atlantic Corp.*, 695 A.2d 43 (Del. 1997).

63. Albert H. Choi, *supra* note 43, at 784-85.

enforceable.[64] If a target may seek compensation based on termination fees, and is relying on a lost-premium provision as a good faith estimate of its damages, the consistent position from a doctrinal and policy perspective is that it should also be allowed to do so via damages provisions for breach of contract that two merging parties negotiated.

C. Lost-Premium Damages Are Supported by Policy Considerations

Policy considerations also suggest that lost premiums are an appropriate measure for defining a target's own damages. There are a long list of policy factors that counsel in favor of recognizing the enforceability of lost-premium provisions: promoting freedom of contract increased deal certainty in the commercial context; recognizing that lost premiums are the most reliable means of calculating damages; and deterring inefficient breach of contract by providing targets with an economically meaningful remedy.

Generally, the right to freedom of contract applies to most private bargaining: "courts are averse to holding contracts unenforceable on the ground of public policy unless their illegality is clear and certain."[65] Respect for freedom of contract also means providing negotiating parties in the transactional context considerable latitude in defining measures of damages. Upholding freedom of contract and allowing lost premiums as a reference point for damages is particularly compelling in the corporate-merger context. First, there is no other equally reliable means of damages calculation, as alternative approaches (discussed below) are problematic and highly assumption laden. Second, the fairness and unconscionability concerns underlying the anti-penalty doctrine are significantly lessened in the M&A context, which is characterized by sophisticated parties and a unique shareholder-board-corporation relationship whereby directors' fiduciary duties, in the context of an all-cash sale of the corporation, are "to secure the highest value reasonably available for shareholders."[66]

This approach still recognizes the fact that the corporation is a distinct legal entity from its shareholders. As an additional benefit, however, it also avoids the significant problem of a multiplicity of actions that would arise if stockholder were given the right to pursue their own claims for breach

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64. Delaware Bay Surgical Services v. Swier, 900 A.2d 646, 650 (Del. 2006).

65. 17 AM. JUR. 2D *Contracts* § 178 (1964).

66. RESTATEMENT OF THE LAW, CORPORATE GOVERNANCE § 2.01 (AM. L. INST., Tentative Draft No. 1, 2022). The Reporters' Notes to § 2.01 observe that:

> when a corporation is sold for cash, all of the shareholders will be cashed out and will no longer have any long-term interests in the corporation as shareholders. . . . In those circumstances, courts in traditional jurisdictions that have addressed the issue have generally made clear that the duty of the board is to secure the highest value reasonably available for shareholders, and the board may not balance the interests of shareholders against the interests of other stakeholders. This is the clear holding of Delaware's *Revlon* case and a long line of other cases. *Id.*

of a merger agreement. As we have argued in a similar context,[67] it is not inconsistent to acknowledge that a corporation's loss is relationally independent from its shareholders' loss and yet still best approximated by it. In other words, the loss of consideration payable to shareholders is the most reliable objective measure of the economic value of the corporation's lost bargain.

Crispo's rejection of lost premiums also raises the question of alternatives. If, as is often most practical, stockholders are denied third-party beneficiary status, what should the target claim as damages in case of a buyer's unjustified refusal to close a merger transaction? Without lost premiums, the target might have to rely on more complex and problematic measures, such as loss of future cash flows or lost synergies, along with ancillary damages for transaction costs, unrepaid debt expenses, and similar costs.[68] It could also be the case that a court may simply prefer specific performance as the remedy of choice in claims by targets since they avoid the thorny issue of establishing and calculating damages. Nevertheless, although specific performance is often a suitable and under-awarded remedy,[69] closing the door to target claims for damages goes too far in curtailing contractual choices in transactional settings.

To be sure, awarding lost premiums to the target does not put the shareholders in exactly the same position economically as if a deal had in fact been consummated. This is true because the target's share price increase will not correspond exactly to the amount of damages it receives and, should the board decide to distribute the proceeds, there would be various tax inefficiencies.[70] Nevertheless, defining damages as lost premiums still appears to be the most appropriate solution in the merger context. Based on the above, it is also reconcilable with expectation damages as formulated under contract law principles.[71]

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67. This is the flip side of the well-recognized concept of "reflective loss" in other common law jurisdictions. *See* Chan & Petrin, *supra* note 37, at 297-98.

68. *Id.* at 301.

69. A recent exception is Chancellor McCormick's decision in *Snow Phipps Grp., LLC v. Kcake Acquisition, Inc.*, No. CV 2020-0282-KSJM, 2021 WL 1714202 (Del. Ch. Apr. 30, 2021); *see also* St. Jude McCormick & Erikson, *supra* note 5, at 23-24 (2023) (noting the paucity of specific performance remedies).

70. Ryan D. Thomas & Russell E. Stair, *Revisiting "Consolidated Edison"—A Second Look at the Case that Has Many Questioning Traditional Assumptions Regarding the Availability of Shareholder Damages in Public Company Mergers*, 64 BUS. LAW. 329, 330 n.5 (2009).

71. In ascertaining loss of consideration, one difficulty is setting the date for assessing the value of the residual value of the target shares. On this, *see* Chan & Petrin, *supra* note 37, at 301-02.

Conclusion

In the event of a buyer's qualifying (typically willful) breach of a merger agreement, lost-premium provisions allow a target corporation to claim damages that include the lost premium or economic entitlements that its stockholders would have received had the deal closed. While the Delaware Chancery Court in *Crispo* held these provisions to be unenforceable under the anti-penalty doctrine, in this Article we argue that lost-premium provisions are both doctrinally defensible and economically sensible.

Doctrinally, lost-premium provisions need not constitute a penalty: large termination fees are permitted in the M&A context, indicating that a target's expectation interest consists of much more than ancillary damages (e.g., transaction costs), and the fairness and unconscionability concerns supporting the anti-penalty doctrine are minimized given parties' more balanced bargaining power. Economically, since a target's interests in a cash-out transaction are arguably identical with its shareholders, awarding lost-premium damages best reflects the target's loss. And finally, a host of policy rationales support the enforceability of lost-premium provisions, including: upholding parties' freedom of contract and increasing deal certainty, particularly given the widespread use of lost-premium provisions amongst M&A practitioners; deterring inefficient breach of contract (because without these provisions, buyers do not fully internalize the negative costs/externalities imposed on the target); and the fact that practically, there is no other equally reliable means of calculating a target's damages in a busted deal.

While the Delaware legislature's amendments have, at least for now, settled the issue of lost-premium provisions, the issue may well crop up again in other jurisdictions. Should this occur, this Article has explained why courts in other states without similar statutory provisions still have a credible way of protecting lost-premium provisions and would be well advised to do so.