

Petition for Specific Performance Denied by Delaware Chancery in United Rentals/Cerberus Case

"Forthright Negotiator Principle" Found to be Dispositive

Last week, the Delaware Chancery Court denied a petition by United Rentals, Inc. ("URI" or "United Rentals") seeking an order for specific performance to enforce the terms of a merger agreement entered into between URI and entities controlled by Cerberus Capital Management, L.P. ("Cerberus").¹ In an opinion by Chancellor William Chandler, the Court found that (1) the language in the merger agreement regarding remedies was ambiguous; (2) extrinsic evidence of the negotiation process did not indicate a common understanding of the parties as to the availability of specific performance as a remedy; and (3) under the "forthright negotiator principle," because Cerberus understood the merger agreement to preclude the remedy of specific performance and URI knew or should have known of this understanding but did not clearly communicate its disagreement, URI could not successfully assert the availability of specific performance as a remedy.

The Dispute

United Rentals, a Delaware corporation, is a major equipment rental company, consisting of an integrated network of over 690 rental locations throughout the U.S., Canada and Mexico. Cerberus is a leading private equity firm. On July 22, 2007, URI entered into an Agreement and Plan of Merger with RAM Holdings, Inc. and RAM Acquisition Corp., both new Delaware corporations formed by Cerberus, under which RAM Holdings agreed to acquire URI. As a result of the merger, the stockholders of URI would have been entitled to receive \$34.50 per share in cash for a total transaction value of approximately \$7 billion, including the repayment or refinancing of URI's existing debt. The merger agreement is governed by Delaware law.

In mid-November, Cerberus notified URI that it did not intend to proceed with the transaction, citing difficulties in the financing markets, and offered to explore a transaction at a reduced price.

While this case has garnered much public attention, both from M&A deal professionals as well as the general business media, it is, as Chancellor Chandler pointed out, unlike other recent highly publicized disputes over M&A transactions. Cerberus did not allege that United Rentals had experienced a "material adverse change," which would have entitled Cerberus to terminate the merger agreement without liability. Instead, Cerberus sought to exercise what it believed to be its contractual right to walk away from the deal, subject only to an obligation to pay United Rentals a \$100 million termination fee.

United Rentals believed that the merger agreement entitled it to a remedy of specific performance under which Cerberus could be forced to close the transaction, and, on November 19, 2007, United Rentals filed suit in the Delaware Chancery Court seeking an order from the Court specifically enforcing the merger agreement.

¹ As is customary in acquisitions by private equity firms, Cerberus was not a party to the merger agreement and it was not a defendant in the Delaware litigation. However, the remedy sought by URI would have required the Cerberus entities that were parties to the merger agreement and defendants in the litigation to, *inter alia*, obtain financing from Cerberus.

The case centered on whether plaintiff URI could show that the merger agreement permits the remedy of specific performance under these circumstances. Two provisions of the merger agreement were primarily at issue:

- A specific performance clause (Section 9.10(b)) under which URI is entitled to enforce specifically the terms and provisions of the merger agreement to force the Cerberus entities to consummate the merger if financing is available but is not drawn down by the buyer in breach of the merger agreement. The last sentence of Section 9.10 further provides that “[t]he provisions of this Section 9.10 shall be subject in all respects to Section 8.2(e) hereof....”
- An exclusive remedies clause (Section 8.2(e)) which limits the parties’ remedies to termination of the agreement and payment of a termination fee under various circumstances. It provides, among other things, that “[i]n no event shall the Company seek equitable relief [which would include specific performance] or seek to recover any money damages in excess of [the termination fee]” from the buyer.

Thus, as noted by the Court, the merger agreement was conflicted in that it seemingly purported to both provide for and preclude the remedy of specific performance.

The Court’s Findings

Interpretation of Merger Agreement. United Rentals sought summary judgment to have the Court declare, based solely on the language of the merger agreement, that it was entitled to the remedy of specific performance. URI argued that the merger agreement, on its face, allows for specific performance as a remedy. In seeking to harmonize the seemingly conflicting provisions, URI argued, among other things, that the provisions were, in fact, not in conflict because the Section 8.2(e) phrase “in excess of the [termination fee]” modifies both “equitable relief” and “money damages.” It asserted that this reading is required in order to render Section 9.10(b) meaningful and not “merely surplusage” in violation of longstanding principles of contractual interpretation.

In contrast, Cerberus argued that the relationship of these clauses is clear in that Section 9.10 is “subject to” Section 8.2(e) and that therefore specific performance is not permitted. It argued that Delaware law specifically permits contracting parties to establish supremacy and subservience between provisions and where the terms of one provision are expressly stated to be “subject to” the terms of a second, the terms of the second provision will control, even if the terms of the second provision conflict with or nullify the first provision.

After reviewing these and other arguments put forth by the parties, the Court concluded that both interpretations of the merger agreement were reasonable. As a result, it determined that summary judgment was inappropriate and a trial was necessary in order to consider extrinsic evidence of the negotiation process and determine the meaning of the merger agreement.

Extrinsic Evidence of the Negotiation Process. The Court undertook a painstaking review of the negotiation process, including analysis of each draft of the merger agreement exchanged by the parties, as well as other communications and notes of the parties and their counsel. As a result, the Court found that the extrinsic evidence was not clear enough to conclude that there was a single, shared understanding of the parties with respect to the availability of specific performance under the merger agreement.

Application of the Forthright Negotiator Principle. Because review of the extrinsic evidence did not result in the finding of an obvious conclusion, the Court applied the “forthright negotiator principle” to determine the proper interpretation of the contract. Under this principle of contract interpretation, where the extrinsic evidence does not lead to a single, commonly held understanding of a contract’s meaning, a court may consider and enforce the subjective understanding of one party if it has been “objectively manifested and is known or should be known by the other party.” In this case, the Court found that Cerberus and its counsel understood the merger agreement to preclude the remedy of specific performance and effectively communicated that

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understanding to URI. It also found that URI knew or should have known of Cerberus's understanding and if URI disagreed with that understanding, it "had an affirmative duty to clarify its position in the face of an ambiguous contract..." and failed to do so.

It was these findings that ultimately proved dispositive and led to the Court's conclusion that the merger agreement does not allow a specific performance remedy.

Lessons of United Rentals/Cerberus

Certain aspects of this case are instructive and worth noting:

- While the Court was willing to overlook the fact that Cerberus's interpretation of the merger agreement made the Section 9.10(b) specific performance clause in favor of URI extraneous, it seems likely that if that clause had, in fact, been deleted from the contract, this case would not have wound up in court. When faced with a similar situation, counsel for buyers negotiating M&A deals would be better served to insist on the deletion of such a clause rather than attempting to neuter it. Indeed, the customary practice in deals of this sort is to avoid any possible ambiguity on this point by expressly providing that specific performance is *not* available against the buyer.
- The structure where a private equity buyer's liability for breach of a merger agreement is limited to a negotiated termination fee has become common in recent M&A transactions. The Court's willingness to enforce such a limitation, even in the face of ambiguous contractual language, appears to implicitly validate such agreements.
- A party should not expect to enforce an interpretation of an agreement which is not clear on its face, even if reasonable, if it knows that the other party has a different view, but fails to effectively communicate its interpretation to the other party. While all highly negotiated agreements contain some arguably ambiguous provisions, if a particular clause is important to a party but is not clear on its face, that party should seek to clarify the provision through the negotiation process rather than silently rely on the belief that its interpretation is reasonable.
- This case serves as a reminder that if a contract is ambiguous, a court will look to extrinsic evidence to interpret the agreement. This includes a review of all communications between the parties, such as draft agreements, e-mails, conversations and notes. Deal professionals and counsel should be aware that these communications are subject to discovery and disclosure at trial and can be used as evidence of the parties' intent.

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