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Say What You Mean and Mean What You Say: Chancery Court Confirms Arbitration Award Requiring Seller to Pay Buyer $87 Million for the Acquisition of the Seller's Business

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In a recent order, the Delaware Court of Chancery "reluctantly" confirmed an arbitrator's award arising from a post-closing purchase price adjustment dispute between a seller of a chain of grocery stores and a private equity buyer, resulting in the bizarre result of the *seller* owing the buyer approximately $87 million for the acquisition of those stores.

Background and Analysis

The dispute centered around the definition of "Closing Date Indebtedness" in the governing equity purchase agreement, which broadly included all indebtedness of the target and certain specified subsidiaries, and which was governed by Delaware law. Among those specified subsidiaries was an interest in the target of a three-way joint venture that also ran a grocery store business (the JV). As part of its delivery of the pre-closing purchase price estimates, the seller ascribed no debt to the JV because, according to the court, the target carried the JV interest on its books as an equity investment and did not break out separately the debt that the JV owed. At the closing, the buyer paid the seller approximately $40 million for the business. Following the closing, the buyer prepared its own post-closing purchase price calculations and, to the surprise of the seller, ascribed $109 million of indebtedness to the JV. This was based on a strict reading of Closing Date Indebtedness and, according to the court, disregarded a provision of the equity purchase agreement that required the closing estimates and post-closing estimates to be prepared consistently (the Consistency Provision).

The parties subsequently submitted the dispute to an accounting referee, and then to arbitration, where the arbitrator, focusing upon the plain language of the equity purchase agreement, found that the definition of Closing Date Indebtedness unambiguously required the inclusion of the indebtedness associated with the JV, resulting in the seller owing the buyer $87 million for the acquisition of the seller's business. In so doing, the arbitrator considered the Consistency Provision, but found that it related to the calculation of working capital rather than Closing Date Indebtedness. The buyer then sought to confirm the award in the Delaware Court of Chancery. In confirming the award, the court noted that it would have ruled differently than the arbitrator based on the Consistency Provision, but its hands were ultimately tied because "review of an arbitration award is one of the narrowest standards of judicial review in all of American jurisprudence" and, absent manifest disregard of the law, the decision could not be overturned. Accordingly, the court granted summary judgment in favor of the buyer.

Takeaways

The court's order serves as a stark reminder of the contractarian nature of Delaware law which, as displayed in this dispute, can sometimes be draconian. While the case is currently on appeal, transaction parties are on notice to avoid relying on "intent-based" arguments at all costs, and instead focus on clarity of drafting to align with the intent of the underlying transaction. Instead, sellers and buyers should be precise in drafting provisions and definitions in agreements. Finally, transaction parties should also beware of submitting disputes to arbitrators given the high standard involved with overturning an arbitrator's decisions.

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