BRACEWELL

INSIGHTS

Obtaining Diminution in Value Damages for Seller Misrepresentations in M&A Agreements: New Ruling in the Southern District of New York

October 16, 2015

On September 28, 2015, the U.S. District Court for the Southern District of New York issued an Opinion and Order (the Opinion) in favor of our client, Stanley Black & Decker, Inc. (SB&D), in its litigation arising from SB&D's indemnity claims against the sellers of a manufacturing business it had acquired [see *Powers v. Stanley Black & Decker Inc., No 1:2014 Civ. 2052 – Document 69 (S.D.N.Y. 2015)]*. The Opinion entered on pending Cross Motions for Partial Summary Judgment concerning alleged misleading seller representations in the acquisition agreement.

In addition to being a significant victory for SB&D and the Bracewell team, the court's Opinion included a holding that has important implications for M&A practitioners: where sellers had breached their representations and warranties to SB&D in the purchase agreement, a provision prohibiting recovery for "consequential damages" and "lost profits" did not prevent SB&D from recovering damages based on the diminished value of the acquired business. Both buyers and sellers should be mindful of the SDNY's opinion when negotiating the consequential damage waivers that are customarily included in acquisition agreements, especially in light of the widespread use of New York law and inclusion of Manhattan forum selection clauses in those documents.

The case arises from SB&D's acquisition of Powers Fasteners, Inc. (PFI), a manufacturer of industrial anchoring and fastening product, which closed in May 2012. At closing, the parties paid $16.5 million of the purchase price into a joint escrow account to support the sellers' indemnification obligations under the purchase agreement. The purchase agreement contained customary provisions requiring the escrowed amount to be released incrementally to sellers on prearranged dates, less the amount of any indemnity claims by SB&D and holdbacks for pending claims.

Soon after the closing, SB&D informed the sellers that it believed they had breached multiple representations and warranties in the purchase agreement related to PFI's financial condition, liabilities, taxes, legal proceedings and intellectual property. Accordingly, SB&D refused to instruct the escrow agent to release any of the escrowed funds to the sellers on the first and second scheduled release dates. In response, the sellers sued SB&D claiming that it had improperly failed to release the escrowed funds, and SB&D brought counterclaims against the sellers for breach of the sellers' representations and warranties.

One of the breaches asserted by SB&D involved the sellers' failure to disclose ongoing litigation in Canada regarding the imposition of anti-dumping duties on Chinese-made products that a

subsidiary of PFI was importing into Canada from the United States. For this breach, SB&D sought indemnification under the purchase agreement for the diminished value of PFI as a result of its exports to Canada being subject to anti-dumping duties. The sellers countered that damages of this type were foreclosed by the damages limitations in the purchase agreement, which provided that indemnifiable losses may not include "any lost profits, consequential damages, punitive damages or opportunity costs…"

The court agreed with SB&D. Citing the Second Circuit's decision in *Schonfeld v. Hilliard, 218 F.3d 164 (2009)*, the court noted that two general types of damages are available to an injured party under New York law for breach of contract: "(1) general or market damages and (2) special or consequential damages." Following *Schonfeld*, the court held that diminution in value is a form of "general" damages falling into the first category, while the "consequential damages" foreclosed by the purchase agreement fall within the second category. The court further cited its decision in *Gusmao v. GMT Group, Inc., 06 Civ. 5113 (GEL), 2008 WL 2980039 (S.D.N.Y. 2008)* and the Second Circuit's decision in *Merrill Lynch & Co. v. Allegheny Energy, Inc., 500 F.3d 171, 186 (2007)* for the proposition that where "a party purchased a company on the basis of inaccurate warranties, the injured party is normally 'entitled to the benefit of its bargain, measured as the difference between the value of [the company] as warranted by [sellers] and its true value at the time of the transaction." The court expressly found that the purchase agreement indemnified SB&D for its losses on the basis that "but for the [sellers'] misrepresentations, it would have spent materially less" for PFI. With respect to the purchase agreement's prohibition on recovery for "lost profits," the court was dismissive, noting that the sellers "do not seriously argue that the diminution of value damages sought by SB&D are "lost profits" and "any such claim would be specious" because "diminution of value, a backward-looking measure of damages, is fundamentally different from lost profits, a forward-looking measure."

The court's Opinion included a number of guideposts for M&A practitioners seeking to negotiate clear remedies and communicate the scope of potential liability to their clients. Most importantly, the transaction parties should understand the precise scope of liability to which they are agreeing and should draft clearly to reflect that understanding. Prohibitions on "special damages" should not be expected to preclude recovery for the diminished value a business. Simply put, the parties should expect that damages for diminution in value will be permitted unless specifically foreclosed.