Delaware Chancery Court Rejects Attempt to Hold Private Equity Owner Liable for Failure of Closing Condition

The Delaware Chancery Court has rejected an attempt to hold a private equity owner liable where its subsidiary could not obtain regulatory approval for a proposed merger. The decision in *Alliance Data Systems Corp. v. Blackstone Capital Partners V L.P. (ADS)* affirms that private equity investors do not impliedly incur obligations to their acquisition targets other than as clearly and specifically set forth in the purchase and sale documents. As such, it is a reminder that parties to a complicated business transaction can rely on the Delaware courts to enforce the terms of the transaction as written.

The *ADS* case involved the proposed acquisition of Alliance Data Systems by Aladdin, a merger subsidiary established and owned by Blackstone Capital. Aladdin agreed to purchase Alliance for $7.8 billion, with an $1.8 billion equity commitment from Blackstone and $6.6 billion in debt commitments. Blackstone also agreed to act as guarantor of a $170 million "business interruption fee" (*i.e.*, breakup fee) payable in the event of a breach of the merger agreement by Aladdin. Blackstone was not a party to the merger agreement.

During the due diligence phase of the transaction, controversy developed over an Alliance subsidiary and regulated bank holding company, World Financial. Transfer of the bank's ownership required regulatory approval from the Office of the Comptroller of the Currency (OCC). Concerned about the capitalization of World Financial, the OCC informed Blackstone that it would only approve the proposed acquisition if Blackstone would agree to provide a facility of up to $400 million to guarantee World Financial's regulatory capital in case of losses. Blackstone refused. Aladdin proposed other options, including various guarantees that Aladdin would fund itself without Blackstone's direct participation. But the OCC refused to approve any acquisition which did not include an obligation by Blackstone to fund a shortfall in World Financial's capital. Lacking this approval, the merger could not close by the "drop dead" date of April 18, 2008.

At that point, both parties sent termination notices. Aladdin stated in its notice that the agreement was terminated for failure to meet closing conditions, with no liability of the parties. Alliance, however, claimed that Aladdin's failure to obtain Blackstone's assent to OCC's demand constituted a breach of its obligation to use "best efforts" to consummate the merger, and a separate breach of its "negative covenant" not to permit Blackstone to take any action which would "reasonably be expected to prevent or materially impair or delay the consummation of the [merger]." Alliance sued Aladdin and Blackstone in the Delaware Chancery Court, seeking a declaration of breach and an order that Aladdin and Blackstone are obligated to pay the "business interruption" fee as a result.

The defendants moved to dismiss all of Alliance's claims. That motion to dismiss was granted by Vice Chancellor Strine on January 15, 2009. In his opinion, the vice chancellor rejected Alliance's attempt to hold Aladdin responsible for OCC's refusal to approve the proposed transaction. He noted that nothing in the merger agreement required Aladdin to force Blackstone to do anything – much less provide a $400 million line of credit – to obtain regulatory approval. The vice chancellor observed that while the merger agreement's "best efforts" provision did oblige Aladdin to get Blackstone to take certain specified actions, such as making divestitures in order to obtain antitrust approval for the merger, there was no parallel requirement for OCC approval, even though the parties had contemplated, and discussed the possibility, that the OCC might require capital support for World Financial.

Without an explicit term requiring Blackstone to provide a backstop for World Financial, the vice chancellor found no basis on which to "hook" Blackstone into the merger agreement and impose obligations on the sponsor not explicitly outlined in the merger agreement. Thus, Aladdin's obligation to use its best efforts to "cause to be done" all things necessary to consummate the merger did not extend to causing non-parties to do anything not required by the merger agreement or limited guarantee.

In a similar vein, the vice chancellor also rejected Alliance's argument that Aladdin violated the *negative* covenant that it would not permit Blackstone to take any action "which would reasonably be expected to prevent or materially impair or delay the consummation of the [merger]." Alliance contended that the failure to agree to the OCC's terms was such an action. But Vice Chancellor Strine reaffirmed that, under Delaware law, a negative covenant, by its nature, restricts or prohibits action and does not create an obligation to take any affirmative action. Because Aladdin and Blackstone were not alleged to have taken any affirmative steps to frustrate OCC approval, Alliance had failed to state a claim for breach of any of the merger agreement's negative covenants.

The *ADS* decision affirms that, in any transaction between sophisticated and well-represented parties, the Delaware Chancery Court will respect the terms of the contract and the corporate formalities of the parties to the contract.

For further information concerning the decision, please contact your usual Ropes & Gray attorney.