

Delaware Supreme Court Rejects Over-Expansive Application of True-Up Provision in Purchase Agreement

Related People:
Matthew J. Rifino

Delaware Law Update

07.21.2017

Chicago Bridge & Iron Co. v. Westinghouse Elec. Co. LLC, et al., No. 573, 2016 (Del. June 28, 2017)

The Delaware Supreme Court reversed the Court of Chancery's entry of judgment on the pleadings based on a flawed interpretation of the purchase agreement that failed to give effect to the agreement in its entirety. Two sophisticated parties carefully negotiated protections within the agreement which one party sought post-closing to limit. The Delaware Supreme Court was unwilling to interpret the unambiguous contract in a manner that created exceptions where none existed, and failed to honor the benefit of the bargain under the agreement's plain terms.

This dispute concerned a purchase agreement between Chicago Bridge & Iron Co. and Westinghouse Electric Co. LLC, by which Westinghouse purchased a subsidiary of Chicago Bridge, CB&I Stone Webster, Inc., for \$0. Prior to the agreement, the parties were involved in the costly design and construction of two nuclear power facilities. The cost of construction caused Chicago Bridge to end its involvement in the projects. Under the purchase agreement, Westinghouse would acquire Stone for \$0, subject to a true-up calculation capable of adjusting the final purchase price based on work undertaken by Chicago Bridge between signing and closing. In the event that the net working capital figure exceeded \$1.174 billion, Westinghouse would owe Chicago Bridge the difference. Alternatively, if the net working capital figure was less than \$1.174 billion, Chicago Bridge would be responsible for the deficiency. In addition to the true-up mechanism, the purchase agreement included several provisions, which affected the outcome of this dispute. First, the parties agreed that no warranty or representation would survive closing. Second, the purchase agreement barred Chicago Bridge from being held liable for monetary damages following closing, absent a finding of fraud. Third, Westinghouse agreed to indemnify Chicago Bridge for any and all claims related to Stone. Fourth, closing was contingent upon Chicago Bridge obtaining valid and enforceable releases from the owners of the nuclear power facilities.

Three days prior to closing, Chicago Bridge supplied Westinghouse with its closing payment statement, which included a net working capital amount \$428 million in excess of the \$1.174 billion target. Westinghouse thereafter proceeded to close on the transaction. Following closing, Westinghouse provided Chicago Bridge with its net working capital calculation based on Stone's

books and records. Westinghouse alleged that Stone's books and records were not GAAP compliant and calculated that the net working capital was negative \$967.5 million, thereby entitling Westinghouse to payment of approximately \$2 billion. Under the purchase agreement, Chicago Bridge was obligated to review Westinghouse's calculations and file an objection, if appropriate. Chicago Bridge timely asserted its objection. Where the parties were unable to resolve their differences, the purchase agreement permitted either party to submit the dispute to an independent auditor.

No party had submitted the dispute to the independent auditor as of the date that Chicago Bridge filed suit. Chicago Bridge sought an order that Westinghouse's claims to the net working capital amount were actually claims for breach of contract, which were eliminated under the terms of the purchase agreement. Westinghouse moved for judgment on the pleadings based on the assertion that the true-up mechanism established a process for resolving all of the parties' claims. The Court of Chancery found that the true-up calculations required the parties to comply with GAAP accounting principles and the authority of the independent auditor extended to all disputes. The Court of Chancery granted the motion, and Chicago Bridge appealed the order on the basis that the Court of Chancery's interpretation of the purchase agreement failed to give effect to its protection from liability and improperly expanded the authority of the independent auditor.

The Delaware Supreme Court held that the purchase agreement was unambiguous, and thus it was obligated to interpret the purchase agreement in its entirety, specifically those provisions affecting the true-up calculation in accordance with the releases and other protections obtained by Chicago Bridge. "Generally speaking, purchase price adjustments in merger agreements account for changes in a target's business between the signing and closing of the merger ... to assure the buyer and seller that the purchase price accurately reflects the target's financial condition at the time of closing." In this instance, the net working capital calculation required use of Stone's financial records that were compiled according to Stone's accounting practices. Both parties were obligated to calculate their figures based on these accounting practices so as to avoid inconsistent treatment. This framework permitted the parties to "account for changes in Stone's business from the time when the [p]urchase [a]greement was agreed on until closing. Thus, keeping all other variables constant in terms of accounting [was] crucial." The Court held that this interpretation of the true-up provision gives effect to the benefit of the parties' bargain, in which Chicago Bridge could continue construction without worry that its activity was to its financial detriment, while Westinghouse was assured that it would not "end up worse off than it was at signing ..."

The Delaware Supreme Court held that the provision appointing the independent auditor limited the auditor's role in resolving disputes. The purchase agreement not only identified the types of disputes that the independent auditor could resolve, but also "limited the scope of the [i]ndependent [a]uditor's review in the limited situation where it was empowered to review anything." These limitations did not extend to assessing whether Chicago Bridge breached the representations and warranties set forth in the purchase agreement.

The Delaware Supreme Court ultimately concluded that the plain meaning of the purchase agreement "does not allow claims that could have been brought as breaches of representations and warranties to be brought as part of the [true-up] ..." Westinghouse received Chicago Bridge's net working capital figure prior to closing, and notwithstanding Chicago Bridge's calculation that Westinghouse owed \$478 million, it elected to close. All representations and warranties terminated at closing, and Chicago Bridge was thereafter protected from liability arising out of the purchase agreement. To conclude otherwise would create an exception to the release from liability where one does not exist and render the protections obtained by Chicago Bridge "meaningless." Accordingly, the Court reversed and remanded the case with the instruction that Westinghouse be enjoined from submitting claims

to the independent auditor and pursuing claims based on Chicago Bridge's alleged breach of its representations and warranties.

This decision highlights the importance of construing specific contractual provisions in the context of the entire agreement. Chicago Bridge purposely negotiated protections in the purchase agreement that terminated the company's involvement in the construction of the nuclear power facilities and relieved it of future liability. These protections underlined the \$0 sale price. While the true-up provision allowed for an adjustment to the final sale price, Westinghouse elected to close on the transaction despite its knowledge of Chicago Bridge's calculation that potentially required Westinghouse to pay \$478 million. All representations and warranties terminated at closing, and Westinghouse was largely left without recourse against Chicago Bridge.