JUST DESERTS…DELAWARE COURT OF CHANCERY ORDERS CLOSING OF CAKE SUPPLIER ACQUISITION

On April 30, 2021, then-Vice Chancellor Kathaleen McCormick of the Delaware Court of Chancery struck a "victory for deal certainty" in *Snow Phipps Group, LLC v. KCake Acquisition, Inc.* (Del. Ch. April 30, 2021), in ordering specific performance to compel the investment funds of Kohlberg & Company, LLC (the "buyers") to close the $550 million acquisition of DecoPac Holdings Inc. ("DecoPac"), a supplier and marketer of cake decorating products, upon finding that the buyers breached their obligation to use reasonable best efforts in connection with the debt financing for the acquisition.

BACKGROUND

On March 6, 2020, as the COVID-19 pandemic began to take hold in the United States, the parties entered into a stock purchase agreement for the sale of DecoPac, and the buyers obtained a debt commitment from lenders for the portion of the purchase price that was expected to be financed. Amid government stay-at-home orders and an anticipated decline in sales for decorated cakes, the Court found that the buyers "lost their appetite" for the deal and "set on a course of conduct predestined to derail [the debt financing]" in order to avoid closing. Prior to engaging with DecoPac's management team regarding DecoPac's future performance, the buyers after receiving advice from their litigation counsel, began independently developing pessimistic financial models regarding DecoPac's future performance based "on uninformed (and largely unexplained) assumptions that were inconsistent with real-time sales data." Only after preparing these pessimistic financial models did the buyers engage with

DecoPac's management team regarding its March 2020 and expected future performance.

Before receiving DecoPac's forecasts, which were dismissed as "illogically optimistic" within 17 minutes of receipt and never shared with the lenders, the buyers provided the lenders with the buyers' pessimistic model along with demands for changes to the commitment letter. The lenders rejected buyers' demands and indicated that they remained willing to fund the transaction under the terms of the existing commitment letter.

On April 1, the buyers conveyed to the sellers that the debt financing was no longer available despite the lenders' indications to the contrary. Afterwards, the buyers sought alternative debt financing by engaging an investment bank to conduct a general market check using the buyer's pessimistic model and contacting one existing lender of DecoPac to determine its interest in providing debt financing. After four days, and no other efforts, the buyers told the sellers on April 5 that they were unable to obtain alternative debt financing. On April 8, the buyer's counsel informed the sellers that the buyers would not proceed to closing because, among other things, the debt financing remained unavailable.

In assessing whether buyers breached their obligation under the stock purchase agreement to use reasonable best efforts to arrange and obtain the debt financing, the Court noted that such obligation prohibited the buyers from modifying the terms of the debt commitment letter "if doing so would jeopardize [debt financing or the closing]". Under Delaware law, the obligation to use reasonable best efforts generally requires that a party take reasonable steps to solve problems and consummate its obligations, and courts have looked to whether a party had reasonable grounds to act as it did and sought to address problems with its counterparty.

The Court concluded that the buyers failed to use reasonable best efforts to obtain debt financing, noting that the buyers had relied only on their internally developed models in their post-signing efforts to secure debt financing and that such models were not a "genuine effort to forecast DecoPac's performance," but rather were "predestined to reflect a covenant breach." The Court also noted that the buyers' efforts to secure alternative financing were "unreasonable for similar reasons" where the buyers had spent only four days inquiring and had neglected to make any efforts to find alternative financing in the five weeks prior to the expiration of the debt commitment letter.

Ultimately, the Court granted specific performance of buyers' obligations to close the acquisition despite a provision in the stock purchase agreement that such remedy would only be available if the full proceeds of the debt financing *have been funded* to the buyers, relying on the "prevention doctrine." The prevention doctrine provides that "where a party's breach by nonperformance contributes materially to the non-occurrence of a condition of one of his duties, the non-occurrence is excused." In granting specific performance, the Court found that the non-occurrence of debt financing was "due materially to [the buyers'] failure to move forward toward a final credit agreement."

SHEARMAN & STERLING

OUR VIEW

The Court's decision in *Snow Phipps* reinforces deal certainty for sellers by signaling to buyers that contractual language rendering specific performance unavailable if debt financing is not funded may not be an "out" where a buyer's actions have materially contributed to the debt financing not being available. Sellers and buyers should be aware of the limitations in relying on exceptions to remedies of specific performance, particularly where conditions are within a party's control.

We welcome the opportunity to discuss any questions you might have regarding these issues.

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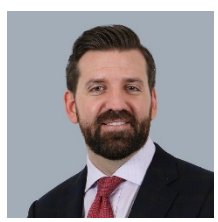

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