NY Stock Purchase Ruling Shows Value Of Proper Disclosures

By **John Lowe and Paul Bartlett** (June 14, 2021)

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In an unusual and somewhat meandering opinion, a New York State trial court held that a buyer was liable for damages for breach of representations and warranties in a stock purchase agreement, despite the seller apparently knowing about the breaches before the SPA was signed.

GBIG Holdings v. Resolution Life LP[1] involved the aborted 2017 acquisition of a Nebraska-based insurance company Lincoln Benefit Life by buyer GBIG Holdings.

The acquisition required the approval of Nebraska insurance authorities.

When that approval was not forthcoming by the drop-dead date, the buyer terminated the SPA and demanded return of its $29 million escrow deposit.

Seller Resolution Life refused, claiming breach of contract and fraudulent misrepresentation and citing breaches of the buyer's regulatory and financial representations in the SPA. Litigation ensued in which each side moved for summary judgment.

In a March decision, the Supreme Court of New York found in favor of Resolution Life, the seller finding that the buyer had breached two representations and warranties it made in the SPA.

One stated that the buyer knew of no fact or circumstance that would render the buyer unable to promptly obtain the necessary government approvals to close the transaction. In the other, the buyer represented that no governmental authority had asserted any material deficiency with respect to the buyer's financial statements.

As it turns out, the buyer was enmeshed in regulatory proceedings in North Carolina and other states that challenged the buyer's organization and mode of doing business and claimed financial impairment. These proceedings had come to the attention of the Nebraska authorities and prevented timely approval of the buyer's acquisition of the company.

The court thus found that the buyer was liable to the seller for breach of its representations and warranties. This is an unusual result, but perhaps not the most unusual aspect of the decision.

On the measure of damages, the seller sought the difference between the price the buyer had agreed to pay for the company in the SPA and the price the seller actually received from a subsequent purchaser in December 2019.

The court disagreed. It found that the reduced price the seller subsequently received for the company had more to do with a decline in the company's performance than with the buyer's breaches of representation.

The court determined that the proper measure of damages was the difference between the

price the buyer agreed to pay in the SPA and the second-place bid in the 2017 auction of the company — i.e., $50 million plus prejudgment interest.

Not a bad payday, but not the hundreds of millions the seller was seeking. In reaching its conclusion, the court cites the seller's prior knowledge of the buyer's breaches of representations and its obligation under New York law to mitigate damages, though the link between these factors and the court's determination is far from clear.

The court refers to the seller's prior knowledge of the buyer's ongoing regulatory issues as "the arresting irony of this case." There is also Socratic irony in the court's failure to discuss how the seller's prior knowledge impacted its reliance on the buyer's representations or the buyer's liability on those representations.

Acquisition agreements often contain provisions stating that knowledge obtained by a party at any time does not impact the counterparty's liability for its representations and warranties.[2] There is no mention in the court's decision if the SPA contained such a provision.

While the reasoning in Resolution is sketchy and case citations scant, there are several takeaways under New York law to be gleaned from the decision.

While it is unusual for a buyer to make extensive representations in a cash transaction, if those representations are materially false, the buyer will be exposed to liability for damages. The buyer's counsel should carefully review those representations with the buyer to address this risk.

Moreover, under New York law, the seller's prior knowledge that the buyer's representations are false will not shield the buyer from liability. In CBS Inc. v. Ziff-Davis Publishing Co.,[3] the New York Court of Appeals held in 1990 that a party is entitled to rely on an express warranty in a contract and to be indemnified for its breach regardless of whether that party believed the warranty to be true.

The court in Resolution appears correct in rejecting the seller's espoused measure of damages—the difference between the SPA price and the subsequent resale price of the company.

In White v. Farrell,[4] a case involving a breach of a contract to purchase real estate, the New York Court of Appeals held in 2013 that the proper measure of damages was the difference, if any, between the contract price and the fair market value at the time of the breach.

The court stated that while a subsequent sale of the property might be evidence of that fair market value if it is proximate in time and market conditions have not changed, it is not controlling. In any event, in Resolution, the resale of the company took place two years after the SPA was signed.

In Ace Securities Corp. v. DB Structural Products Inc.,[5] the New York Court of Appeals held in 2015 that an action for breach of representations and warranties accrues at the time the representations and warranties are made.

Thus, under Ace Securities, the buyer's breach in Resolution occurred on Oct. 1, 2017, when it signed the SPA. Overlaying White v. Farrell on that breach, the measure of damages would be the difference between the SPA price and the fair market value on the date of the

SPA in 2017.

The buyer might argue that difference is zero dollars, but the court's method of using the difference between the SPA price and the second-place bid appears to gain some support from these holdings.

Buyers making extensive substantive representations and warranties may want to consider using reverse termination fees or liquidated damages provisions to prevent exposure to the outcome in Resolution.

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[1] 2021 N.Y.Misc.LEXIS 2556 (Resolution).

[2] See ABA Model Stock Purchase Agreement With Commentary, Second Edition (2010), 299–300.

[3] 553 N.E.2d 997 (N.Y. 1990).

[4] 987 N.E.2d 244 (N.Y. 2013).

[5] 28 N.E.3d 355 (N.Y. 2015).