

Milbank

June 30, 2009

Corporate Governance Group Client Alert

BEIJING FRANKFURT HONG KONG LONDON LOS ANGELES MUNICH NEW YORK SINGAPORE TOKYO WASHINGTON, DC

DELAWARE COURT DISMISSES SELLER'S ATTEMPT TO REQUIRE HEDGE FUND TO FINANCE ITS CONTROLLED LLC'S OBLIGATIONS UNDER ASSET PURCHASE AGREEMENT

The demise of the LBO market has generated significant litigation brought by jilted sellers (or their shareholders) left standing at the altar. Another recent example of this phenomenon is *James Cable, LLC v. Millennium Digital Media Systems, L.L.C.*,¹ in which the Delaware Court of Chancery dismissed a spurned seller's claim that buyer's owner had an obligation to fund buyer's purchase of assets from seller. Consistent with a decision from earlier this year involving a proposed buyout of Alliance Data Systems by an "assetless shell" controlled by the Blackstone Group,² the Court refused to impose contractual obligations on a parent company that was not an actual signatory to the underlying purchase agreement, despite the fact that the parent was actively involved in the negotiations and was no doubt looked upon by seller as standing behind the deal. Vice Chancellor Lamb, focusing on the sophistication of the parties, concluded that it was unlikely that they would neglect to negotiate and document such an important aspect of the transaction as a funding obligation on the part of parent.

Background

On October 31, 2007, two Delaware limited liability companies engaged in the cable television and internet service businesses, James Cable, LLC and Millennium

¹ *James Cable, LLC, v. Millennium Digital Media Systems, L.L.C.*, (d/b/a Broadstripe), *Highland Capital Management, L.P.*, and *Highland Capital*, C.A. No. 3637-VCL (Del. Ch. June 11, 2009).

² *Alliance Data Sys. Corp. v. Blackstone Capital Partners V L.P.* and *Aladdin Solutions, Inc.*, C.A. No. 3796-VCS (Del. Ch. Jan. 15, 2009). See our previous Client Alert discussing the *Alliance Data* decision entitled "Delaware Chancery Court Respects 'Corporate Formalities' in Determining that Only the Signatories to a Merger Agreement are Bound by its Terms," dated February 12, 2009. The Court's decision in *James Cable* does not refer to the earlier *Alliance Data* decision.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided at the end of this alert.

In addition, if you would like copies of our other Client Alerts, please visit our website at www.milbank.com and choose the "Client Alerts & Newsletters" link under "Newsroom/Events."

This Client Alert is a source of general information for clients and friends of Milbank, Tweed, Hadley & McCloy LLP. Its content should not be construed as legal advice, and readers should not act upon the information in this Client Alert without consulting counsel. © 2009 Milbank, Tweed, Hadley & McCloy LLP. All rights reserved. Attorney Advertising, prior results do not guarantee a similar outcome.

www.milbank.com

Digital Media Systems, L.L.C. (doing business as Broadstripe), entered into an asset purchase agreement (“APA”) whereby Broadstripe agreed to buy substantially all of the assets of James Cable. The APA did not contain a financing condition for the benefit of Broadstripe and, in fact, Broadstripe represented in the APA that it had the financial wherewithal to consummate the transaction. Although Highland Capital, a hedge fund that controlled Broadstripe,³ was not a party to the APA and did not undertake any written obligation to James Cable to finance the transaction, it was actively involved in the negotiation of the transaction and, during those negotiations, Broadstripe “communicated to James Cable that Highland was the source of Broadstripe’s financial capability.”

Not surprising, during the period between October 2007 and February 2008, the value of cable companies declined significantly. In February, Broadstripe informed James Cable that it would be unable to deliver the purchase price and close the transaction by the end of the month as planned. In response, James Cable demanded “adequate assurances” that the deal would close. While refusing to provide such assurances, Broadstripe and Highland told James Cable that it had “no reason to be insecure.”

Unsatisfied with this response, on March 20, 2008, James Cable filed its original complaint seeking a declaration that Broadstripe had committed “a material, anticipatory breach and repudiation of the APA.” At the hearing, Broadstripe indicated a willingness to close the transaction, stating through its counsel that “the representation [in the APA] about its financial capability was true when made and that it then had the financial capability to finance the deal through existing equity investors, *such as Highland Capital*, new equity investors, and through the debt markets.” [emphasis added] On this basis, the Court denied James Cable’s motion to expedite and encouraged the parties to set a closing date.

Nevertheless, the relationship between the parties continued to deteriorate and, on April 16, 2008, Broadstripe sent a letter to James Cable purporting to terminate the APA on the ground that James Cable had materially breached certain of its covenants in a manner which impacted the purchase price calculation. James Cable responded in kind, demanding that Broadstripe rescind its letter or else it would treat Broadstripe’s repudiation as a breach of the APA. When Broadstripe refused to rescind its letter, James Cable filed an amended complaint, this time adding Highland as a defendant and (in the Court’s words) setting forth “a panoply of creatively crafted claims” against Highland “in an attempt to reach the deeper pockets of that company” to fund the purchase.⁴

James Cable’s claims against Broadstripe were automatically stayed, however, when on January 2, 2009, Broadstripe filed for Chapter 11 bankruptcy protection. As the only remaining active defendant, Highland moved to dismiss James Cable’s claims as to Highland’s alleged obligation to fund the transaction. The Court, siding with Highland, dismissed all of James Cable’s claims against Highland.

The Court’s Analysis

Rejecting James Cable’s assertion that it had relied on Highland to backstop Broadstripe’s obligations under the APA, the Court found no factual basis – either in the deal documents or in the actions of the parties – to support a Highland funding obligation. Summing up James Cable’s claims, the Court stated that “[t]he

³ It is interesting to note that James Capital also is controlled by a fund, GoldenTree Asset Management.

⁴ James Cable’s claims against Highland included tortious interference with contractual relations, civil conspiracy, bad faith, promissory estoppel and third party beneficiary rights to a breached contract.

allegations against Highland are conclusory, unsupported by specific facts, and inconsistent with the structure of the APA, which was heavily negotiated by sophisticated parties.” In the Court’s view, these sophisticated parties “negotiated a transaction where the responsibility to arrange financing fell on Broadstripe’s shoulders.” As such, “the amended complaint and its exhibits strongly suggest that James Cable could not have reasonably relied on a promise by Highland to fund.”

According to the Court, “[i]n sophisticated merger and acquisition activity . . . the parties typically reduce even seemingly insignificant matters to writing.” In this connection, the Court observed that the APA stated that “Broadstripe (not Broadstripe and Highland) had the financial capability necessary to fund the purchase price. If James Cable could have convinced Highland to fund the deal, Highland’s obligations would likely have been extensively negotiated and reduced to writing with a substantial amount of detail.” To lend additional support to its conclusions, the Court pointed to “the APA’s integration clause, which states that the written documents executed in connection with the APA ‘constitute the entire agreement between the parties’.”⁵

Notably, the Court was dismissive of James Cable’s claims that Highland’s involvement in the transaction discussions (which is often the case in private equity-sponsored buyouts) supported a finding that Highland had undertaken a funding obligation on behalf of Broadstripe for the benefit of James Cable. The fact that Highland “pitched themselves for purposes of a transaction with James [Cable], and made representations about the advantages of doing a transaction with a company controlled by Highland” amounted, in the Court’s view, only to “an admittedly true statement about the ownership structure of Broadstripe and an allegation that Highland touted its financial capabilities.” Moreover, even though the letter of intent between James Cable and Broadstripe directed James Cable to raise any questions that it had with respect to the financing for the transaction with Highland, this merely “identified Highland Capital as both the primary investor and the source of answers to questions about the financing,” but “does not reflect a promise . . . [or] convey an intent to act in connection with the funding of the transaction.” Accordingly, the Court needed little more than the basics of contract law to make short shrift of James Cable’s claims and find no contractual obligation on the part of Highland to fund the purchase.

Conclusion

The *James Cable* decision serves as yet another reminder of the importance of clear and precise drafting and attention to the basics of contract law in documenting M&A transactions. Each party intended to have obligations under an agreement must become a signatory thereto; mere assumptions regarding the intentions of a non-party will not suffice to create such obligations. This is true even when – as is often the case – private equity sponsors or other controlling shareholders actively participate in deal negotiations and promote the benefits of their involvement in a transaction, while at the same time refusing to take on express contractual obligations. In fact, the Court’s decision in *James Cable* harkens back to Vice Chancellor Strine’s observation in *Alliance Data* that “Delaware law respects corporate formalities, absent a basis for veil-piercing, recognizing that the wealth-generating potential of corporate and other limited liability entities would be stymied if it did otherwise.”

⁵ The Court gave no credence to James Cable’s argument that the integration clause was not applicable to representations made by Highland because Highland was not a party to the APA.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

Beijing

Units 05-06, 15th Floor, Tower 2
China Central Place, 79 Jianguo Road, Chaoyang District
Beijing 100025, China

Anthony Root +86-10-5969-2777 aroot@milbank.com
Edward Sun +86-10-5969-2772 esun@milbank.com

Frankfurt

Taunusanlage 15
60325 Frankfurt am Main, Germany

Norbert Rieger +49-69-71914-3453 nrieger@milbank.com

Hong Kong

3007 Alexandra House, 18 Chater Road
Central, Hong Kong

Anthony Root +852-2971-4842 aroot@milbank.com
Joshua Zimmerman +852-2971-4811 jzimmerman@milbank.com

London

10 Gresham Street
London EC2V 7JD, England

Stuart Harray +44-20-7615-3083 sharray@milbank.com
Thomas Siebens +44-20-7615-3034 tsiebens@milbank.com

Los Angeles

601 South Figueroa Street
Los Angeles, CA 90017

Ken Baronsky +1-213-892-4333 kbaronsky@milbank.com
Neil Wertlieb +1-213-892-4410 nwertlieb@milbank.com

Munich

Maximilianstrasse 15 (Maximilianhoefer)
80539 Munich, Germany

Peter Nussbaum +49-89-25559-3636 pnussbaum@milbank.com

New York

One Chase Manhattan Plaza
New York, NY 10005

Scott Edelman +1-212-530-5149 sedelman@milbank.com
Roland Hlawaty +1-212-530-5735 rhlawaty@milbank.com
Thomas Janson +1-212-530-5921 tjanson@milbank.com
Robert Reder +1-212-530-5680 rreder@milbank.com
Alan Stone +1-212-530-5285 astone@milbank.com
Douglas Tanner +1-212-530-5505 dtanner@milbank.com

Singapore

30 Raffles Place, #14-00 Chevron House
Singapore 048622

David Zemans +65-6428-2555 dzemans@milbank.com
Naomi Ishikawa +65-6428-2525 nishikawa@milbank.com

Tokyo

21F Midtown Tower, 9-7-1 Akasaka, Minato-ku
Tokyo 107-6221 Japan

Darrel Holstein +813-5410-2841 dholstein@milbank.com
Bradley Edmister +813-5410-2843 edmister@milbank.com

Washington, DC

International Square Building, 1850 K Street
Washington, DC 20006

Glenn Gerstell +202-835-7585 gerstell@milbank.com