

Delaware Supreme Court Increases Damages from \$1 to \$126 Million, Holds Chancery Misapplied Efficient Breach Doctrine

On May 2, 2019, Justice Traynor authored a unanimous opinion in which the Supreme Court of Delaware, sitting *en banc*, reversed a decision by Vice Chancellor Laster of the Delaware Court of Chancery awarding Leaf Invenergy Company (“Leaf”) \$1 in nominal damages for breach of an LLC Agreement in favor of an award equal to *126 million times that amount*, holding, among other things, that the Court of Chancery had misinterpreted the doctrine of “efficient breach.”

Leaf Invenergy Co. v. Invenergy Renewables LLC, No. 308, 2018, 2019 Del. LEXIS 226 (Del. May 2, 2018), involved an LLC Agreement governing Leaf’s membership interest in Invenergy Wind LLC (“Invenergy”) – a developer and operator of wind energy facilities. In particular, the LLC Agreement contained a clause prohibiting Invenergy from conducting a “Material Partial Sale” (a defined term) without Leaf’s consent *unless* Invenergy paid Leaf a premium called a “Target Multiple” (another defined term). In 2015, Invenergy closed on a \$1.8 billion asset sale that undisputedly constituted a Material Partial Sale without first seeking or obtaining Leaf’s consent and without paying Leaf the Target Multiple. Leaf sued for breach of the LLC Agreement, seeking the amount of the Target Multiple as damages.

The Court of Chancery initially found that Leaf and Invenergy contemporaneously understood the clause at issue to guarantee that Leaf would receive the Target Multiple if Invenergy engaged in a Material Partial Sale without Leaf’s consent. But midway through the litigation, and after Vice Chancellor Laster had ruled in Leaf’s favor on liability, Invenergy switched gears, arguing that, despite the breach, Leaf was not entitled to damages because the Material Partial Sale that had been conducted without Leaf’s consent had not harmed Leaf. Following a trial on damages, the Court of Chancery agreed with Invenergy and held that Leaf had failed to prove any actual damages.

Although he acknowledged the well-settled rule that breach of contract damages are based on the non-breaching party’s expectation interest, Vice Chancellor Laster ultimately disregarded the parties’ subjective expectations, instead concluding that Leaf could not recover damages unless it showed that it had suffered harm as a result of the Material Partial Sale or that it would have secured additional consideration given the opportunity to negotiate for its consent. Reasoning that In-

Invenergy likely would not have agreed to undertake the Material Partial Sale if it had been structured to pay Leaf the Target Multiple at closing and that the deal as it was actually structured did not make Leaf any worse off, the Court of Chancery concluded that only nominal damages were appropriate.

As the Supreme Court explained, the Court of Chancery's analysis only took into account Invenergy's breach of the *consent* portion of the clause at issue, and not its breach of the *payment* portion of the clause. Rather, the Supreme Court held, in determining the amount of damages that would return Leaf to the position it would have been in absent Invenergy's breach, the Court of Chancery should have considered the breach to be the *combination* of the Material Partial Sale *and* Invenergy's failure to obtain consent for such transaction *and* Invenergy's failure to pay Leaf the Target Multiple at the closing of such transaction. The Supreme Court concluded that, when the breach is considered as a whole in this way, the amount that would most aptly repair it is the Target Multiple.

The Supreme Court also rejected the Court of Chancery's reliance on the concept of "efficient breach" as a justification for awarding only nominal damages to Leaf. As the Supreme Court explained, the concept of efficient breach applies where it is economically rational for a party to breach a contract because the breach will yield economic benefits to the breaching party that *exceed* the value of the damages it will be required to pay to the non-breaching party. The concept *does not* justify modifying the *amount* of damages to which a non-breaching party is entitled; rather, such damages must be calculated based on the degree of injury suffered. The Supreme Court held that the Court of Chancery had misapplied the efficient breach concept by reconsidering its damages calculation based on perceived efficiency.

In light of this ruling, LLC members would be wise not to ignore provisions in LLC Agreements requiring payments to other members in the event their consent for a major transaction is not obtained, as creative *post hoc* arguments regarding efficiency are unlikely to allow the breaching members to avoid such payments.