In Bradley E. Julius v. Accurus Aerospace Corporation, C.A. No. 2017-0632-MTZ (Del. Ch. 2019), the Delaware Court of Chancery (the “Court”) granted summary judgment on behalf of a target company dismissing the purchaser’s breach of contract claims in connection with an asset purchase agreement and on behalf of the purchaser dismissing the target company’s breach of contract claims in connection with the asset purchase agreement and related escrow agreement. The Court found that the contracts were unambiguous and the language in the contracts was clear and therefore there were no genuine disputes of material fact to litigate.

ZTM, Inc. (n/k/a BKJ Holdings, Inc.) (the “Target”) was a manufacturer of airplane parts for commercial aviation and military customers. In particular, Target had various contracts to manufacture airplane parts for its largest customer, the Boeing Company ("Boeing"), with some of the contracts set to expire at the end of 2016. In early 2016, a private equity firm focused on aerospace industry investments expressed interest in purchasing the Target. Liberty Hall Capital Partners, L.P. (the “Purchaser”) began its due diligence process of the Target, including reviewing projections prepared by the Target for the years 2016 through 2019. The forecasts had information about the number of contracts for manufacturing airplane parts,
contract expiration dates, number of parts the Target would have the opportunity to re-bid on (as was customary in the airplane manufacturing industry) when the contracts expired and projected sales, including information specific to its agreements with Boeing. The Purchaser acquired Target in mid-2016 pursuant to an Asset Purchase Agreement (the “APA”) and the Purchaser and Target entered into a related Escrow Agreement (the “Escrow Agreement”). At the time of the acquisition closing (the “Closing”), Target had flagged the number of its contracts with Boeing that were set to expire at the end of 2016 and had disclosed to the Purchaser that the Target would be able to re-bid for certain new contracts with Boeing. After Closing, the Purchaser and the Target discovered that certain airplane part contracts with Boeing were not available for re-bidding because Boeing had already contracted with other suppliers as early as 2013 and 2014 without the Target’s knowledge.

The Purchaser sued Target alleging that it breached several representations and warranties clauses in the APA. Since the Purchaser claimed that the losses for Target’s breach of contract exceeded the amount of funds held in an escrow account pursuant to the Escrow Agreement it withheld the funds in such account. The Target countersued alleging that the Purchaser was breaching the covenant of good faith and fair dealing and breaching the Escrow Agreement by wrongfully withholding funds in the escrow account at the time of the lawsuit.

The Purchaser alleged that the Target breached four APA provisions, which required Target to: (i) disclose all material issues with respect to any of its customers as of Closing, (ii) disclose if any customer had terminated or materially changed its business relationship with the Purchaser as of December 31, 2015, (iii) confirm no material adverse effect as of December 31, 2015, and (iv) confirm that none of the representations and warranties contained any untrue statements of fact (a catch-all provision).

As to the Purchaser’s first breach of contract claim, the Court ruled that Target and Boeing had a good working relationship at Closing and therefore there was no issue the Target was required to disclose. The Court also concluded that as of December 31, 2015, the Target was unaware that Boeing had contracted with another supplier as early as 2013 and 2014 and therefore the Target did not breach its second disclosure requirement under the APA. With regard to the third breach of contract claim, the Court concluded that the triggering event for the material adverse effect disclosure was the loss of the option to re-bid on the Boeing contracts and not that the Target failed to disclose that information to the Purchaser as of December 31, 2015. Finally, the Court decided that since the Target did not breach the representations and warranties in the three claims, the Target could not have been in breach of the catch-all representation and warranty provision because the representations and warranties were all true based on the Court’s analysis. Of importance is that the Court arrived at its conclusions by interpreting the terms of the contract based on plain language meaning. The Court did not allow the Purchaser to introduce extrinsic evidence, like the projections it reviewed during the due diligence process, to analyze the provisions of the contract. The Court emphasized that a contracting party was responsible for including explicit language in a contract to protect itself from risk of loss.
In response to Target’s claims that the Purchaser breached implied and express covenants when it withheld the escrow account funds, the Court shut down both arguments. Since the Purchaser filed claims against the Target in good faith and because the Escrow Agreement set out mechanics for withholding funds in case of a lawsuit, the Court held that the Purchaser was not breaching the implied covenant of good faith and fair dealing nor breaching the terms of the Escrow Agreement. The Court concluded that if a contract specifically contemplates that a party may take action and then the party takes such action, there is no basis to conclude that the contract has been breached by doing what the objective terms of the contract authorizes. The Purchaser believed it was entitled to the funds in dispute and could therefore keep the funds in the escrow account while the lawsuit made its way through the court.

Opinion

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