DEVILS IN THE DETAILS: AN ESSAY EXAMINING THE SIGNIFICANCE OF JURISDICTIONAL DEFAULT RULES IN THE MERGERS AND ACQUSITIONS CONTEXT

Choice of law is one of those concepts that law school professors love to focus on in different courses. However, the concept raises the question: does choice of law make a practical difference? The short answer is no. Generally speaking, laws between U.S. states rarely diverge to the degree that would prompt individuals to sue exclusively in state X over state Y. Differences in laws between U.S. states carry de minimis value and only become a heightened concern on a specific case by case basis. There are exceptions to this general rule. In the realm of mergers and acquisitions (“M&A”), U.S. state laws and court opinions addressing “sandbagging,” waiver of jury trial, and non-compete provisions are several of these exceptions. For example, it is universally agreed in the M&A world that Delaware, New York, and California are, respectively, “pro-sandbagging,” neutral/ambiguous toward sandbagging, and “anti-sandbagging.” But why are there differences and why do they matter? This Essay attempts to answer these questions as well as provide an analysis of the three aforementioned provisions found in M&A agreements nationwide.

First, this Essay will outline its scope and goals accompanied by a brief foundation of mergers and acquisitions. Second, it will demonstrate the effect of a jurisdiction’s default rule in an M&A deal followed by a detailed discussion of each M&A provision—sandbagging, waiver of jury trial, and non-compete—and various jurisdictional default responses. Third, it will put forward alternative theories and reasons why Delaware, New York, and California approach sandbagging, waiver of jury trial, and non-compete provisions in their respective ways.

INTRODUCTION

Before this Essay continues with its analysis of the above-mentioned M&A provisions and varying jurisdictional treatment of those provisions, a brief foundation of M&A is needed. The terms mergers and acquisitions are often

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1 Generally, the term “sandbagging” refers to the contract provision that addresses the impact and result of one party’s pre-closing knowledge of a breach of another’s warranty in an agreement. Aleksandra Miziolek & Dimitrios Angelakos, From Poker to the World of Mergers and Acquisitions, Mtch. B. J. 30, 30–31 (2013).
used interchangeably; however, the two terms are fundamentally different. Without getting into an advanced discussion, an acquisition refers to one business entity buying another either in its entirety or in part. On the other hand, a merger refers to two separate business entities combining together to form a completely new business entity. Therefore, although the two terms are used interchangeably, it is important to know they refer to two different situations and should not be used synonymously.

Broadly defined, mergers and acquisitions are one of many corporate tools at the disposal of corporate officers, boards of directors, and shareholders in stimulating growth for their organizations. While 2016 has been characterized as a “bumpy year” for M&A activity, a recent survey conducted by a “Big Four” accounting firm, Deloitte, LLP, asked 1,000 corporate and private equity investors to weigh in on what they thought 2017 would hold for M&A activity. The survey’s results indicated that roughly 75% of the investors believe M&A activity will increase in 2017 and, more importantly, 64% of the respondents believe respective deal sizes will increase as well. Given the expected increase in M&A activity, this is an opportune time to study M&A transactions and how they may vary from state to state.

This Essay’s scope is primarily centered on the case study of the three M&A provisions—sandbagging, waiver of jury trial, and non-compete—and their respective treatment in Delaware, New York, and California. These three common provisions found in M&A agreements were chosen for examination because they highlight various jurisdictions’ divergent approaches. The jurisdictions of Delaware, New York, and California were chosen because each state is highly representative of its respective category of jurisdiction. Moreover, these three states see their fair share of M&A deals. This Essay

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3 Id.
4 Id. It is also important to note that there are other subgroups of mergers and acquisitions, but this discussion is outside the scope of this Essay. Additionally, this Essay will not weigh the benefits and costs of choosing whether to merge or to acquire.
5 Often majority of shareholders entitled to vote need to approve a merger or acquisition action before the corporate entity can proceed with the action. DEL. CODE ANN. tit. 8, § 271 (Lexis Advance through 81 Del. Laws, ch. 2).
7 Id.
8 In 2011, Delaware alone had roughly more than half of all U.S. publicly-traded companies and 60% of Fortune 500 companies incorporated in its jurisdiction. Doug Bend, The Top 10 Reasons to Incorporate in
does not close the door on mentioning other states’ treatment where relevant and by no means does it intend to provide a state by state legal survey of each state’s approach towards various M&A provisions. This Essay has two simple goals. First, to highlight the importance of considering how a specific jurisdiction’s approach may affect a M&A transaction and negotiation. Second, to answer why Delaware, New York, and California have taken their respective stances. In working towards these goals, this Essay will also answer why a choice of law decision exists to begin with and why there is competition among the states in the M&A realm.

I. SANDBAGGING, WAIVER OF JURY TRIAL, AND NON-COMPETE—WHY DO THE DIFFERENCES MATTER?

To illustrate the importance of these three provisions and their respective treatment, what follows is a hypothetical demonstrating the effect of sandbagging. Imagine in the eleventh hour of a several yearlong negotiated asset purchase agreement to acquire assets from Business S that Business B finds an inaccuracy during their due diligence of Business S’s corporate records. At this point, Business B must decide whether to disclose the inaccuracy to Business S, which may further prolong the negotiations and the overall timetable of the already lengthy deal, or to continue to closing and not inform Business S of the inaccuracy. For obvious reasons, the former is undesirable to Business B, especially given the facts. However, the aftermath of the latter raises a couple of questions. While inaccuracies in corporate records do not always cause noteworthy issues, it may turn out that the inaccuracy causes a significant misrepresentation or breach of warranty by Business S in the asset purchase agreement. Should Business S be liable to Business B for damages sustained from the misrepresentation or breach? Should Business S be liable to Business B if Business B knew about the misrepresentation or breach ahead of time and chose not to disclose it to Business S, who might have been able to remedy it before the closing of the deal?

Although this illustration may appear trivial on its face, the answers to the questions above determine whether years of hard work along with millions of dollars go to waste. For example, Jurisdiction X may rule in favor of Business S and force Business B to bear the costs. At the same time, Jurisdiction Y may

rule in favor of Business B and force Business S to remedy Business B’s losses. A real-world example follows demonstrating the monetary impact a default rule may have. In Cobalt Operating, LLC v. James Crystal Enterprises, LLC,9 Delaware’s pro-sandbagging default rule allowed the buyer in an asset purchase agreement to recover at least $12 million from the $70 million purchase price.10 Thus, it is prudent for any business entity and its board of directors contemplating a M&A transaction to be privy to the way its jurisdiction(s) treats certain M&A provisions, especially those entities that have footholds in several different jurisdictions. What follows is a breakdown of the three M&A provisions along with how Delaware, New York, and California treat each one and why.

A. Sandbagging

The term “sandbagging” has been said to be associated with the poker strategy of refraining from raising at first in hopes of being able to raise more steeply later.11 Sandbagging occurs in a deal when a party, almost always the buyer, seeks to recover, usually through an indemnification provision, for a misrepresentation or breach of warranty for an inaccuracy that the party had knowledge of prior to the closing.12 While parties may contract around the action of sandbagging via either pro-sandbagging or anti-sandbagging provisions, it is crucial, especially in high dollar-figure deals, to know what relevant default rules govern a particular jurisdiction are.

In determining whether a jurisdiction is pro-sandbagging or anti-sandbagging, the crux is whether the jurisdiction views the breach of warranty claim as a tort claim or a breach of contract claim.13 This distinction is important because, in a tort claim, reliance is a necessary element.14 If a party knew of the breach of warranty beforehand, it could not argue reliance on the warranty to its detriment.15 This would be an example of an anti-sandbagging jurisdiction. However, if the jurisdiction views the breach of warranty claim as

11 Miziolek, supra note 1, at 30.
12 Id.
13 Id. at 32.
14 Id.
15 Id.
a claim for breach of contract, then a party’s pre-closing knowledge is irrelevant because reliance on the truth of the warranty is not a requirement for recovery. This would be an example of a pro-sandbagging jurisdiction.

Originally, Delaware was considered an anti-sandbagging jurisdiction. However, in 2005 the Delaware Superior Court held in Interim Healthcare, Inc. v. Spherion Corp., that reliance was not a requirement for a breach of warranty claim and, more importantly, that the purchaser in the case had the right to rely on the seller’s warranties. Subsequently, the Supreme Court of Delaware in James Crystal Enterprises, LLC v. Cobalt Operating, LLC affirmed this latter view and rejected the tort approach when it was presented with James Crystal Enterprises’ appeal, which was the real-world example stated earlier. These decisions solidify Delaware, at least for now, as a pro-sandbagging jurisdiction.

As mentioned earlier, New York is a bit more complex in its approach towards sandbagging than Delaware. In CBS Inc. v. Ziff-Davis Pub. Co., the New York Court of Appeals diverged from past court opinions by holding that the breach of contract ideology applied to breaches of warranties and that reliance was still a necessary element of a breach of warranty. However, the court also held that reliance could be found if a party relied on the “express warranty as being a part of the bargain between the parties” rather than if the party relied on the truth of the warranty itself. The court found reliance because the buyer believed it was purchasing the seller’s promise that the warranties made were true. The Second Circuit later clarified the CBS Inc. opinion via its holding in Galli v. Metz. In Galli, the Second Circuit returned to a more tort-esque approach by disallowing the party that knew of the breach

16 Mizolek, supra note 1, at 32.
18 884 A.2d 513, 548 (Del. Super. Ct. 2005) (stating that “[t]o the extent Spherion [the seller] warranted a fact or circumstance to be true in the Agreement, plaintiffs were entitled to rely upon the accuracy of the representation regardless [sic] of what their due diligence may have or should have revealed. In this regard, Spherion accepted the risk of loss to the full extent of its indemnification commitments in the event its covenants were breached.”); see Charles K. Whitehead, Sandbagging: Default Rules and Acquisition Agreements, 36 Del. J. Corp. L. 1081, 1109 (2011).
21 Id.
22 Mizolek, supra note 1, at 33.
23 973 F.2d 145, 150–51 (2d Cir. 1992).
prior to closing to bring a breach claim post-closing. To reconcile the differences between these two cases, the Second Circuit in Rogath v. Siebenmann and the Southern District of New York in Gusmao v. GMT Group, Inc. found a middle ground by requiring a close examination of “the extent and source of the buyer’s knowledge.” This means that if the seller is the source of the information that notifies the buyer of a breach before closing between the seller and the buyer, then New York courts view the buyer as having waived his/her right to recovery from that breach post-closing. However, if the seller is not the source of the information that notifies the buyer of the breach, then New York courts view the seller’s warranty or representation as part of the bargain between the parties and allows the buyer to recover, because New York courts do not view receiving information about a breach from a third-party pre-closing as a waiver. Thus, New York can be best described as a neutral/ambiguous toward sandbagging jurisdiction given its special nuanced approach.

California, on the other hand, requires buyer’s reliance to make a breach of warranty claim. California courts have long held and affirmed this rule. Despite the Grinnell and Kazerouni cases and a strong history supporting anti-sandbagging provisions, one Northern District of California decision held that California does not require a buyer to show reliance if a pro-sandbagging provision is drafted into the M&A deal that expressly states the buyer’s knowledge does not affect buyer’s reliance. This means that if the parties in a M&A deal agree that the buyer’s knowledge will not adversely affect his or her

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24 Id. at 151 (stating that “[w]here a buyer closes on a contract in the full knowledge and acceptance of facts disclosed by the seller which would constitute a breach of warranty under the terms of the contract, the buyer should be foreclosed from later asserting the breach.”); Miziolek, supra note 1, at 33.
25 129 F.3d 261 (2d Cir. 1997).
27 Rogath, 129 F.3d at 264, Miziolek, supra note 1, at 33–34.
28 See Rogath, 129 F.3d at 264 (citing Galli 973 F.2d at 151).
29 Cho, supra note 11.
31 Telephia, Inc. v. Cuppy, 411 F. Supp. 2d 1178, 1188 (N.D. Cal. 2006) (stating that “Telephia argues that it need not prove reliance because of the terms of the SPA. In § 6.1, the SPA states that ‘[n]o information or knowledge obtained in any investigation pursuant to this Section 6.1 shall affect or be deemed to modify any representation or warranty contained in this Agreement’ . . . In addition, § 10.1 of the SPA provides, ‘No investigation made by or on behalf of the Company [Telephia] with respect to Criterion or the Securityholders shall be deemed to affect the Company Affiliates’ . . . reliance on the representations, warranties, covenants, and agreements made by Criterion.’”).
ability to seek indemnification because of a misrepresentation or breach of warranty of the seller, then the courts applying California law will honor the parties’ agreement. Thus, except in the unique circumstance described above, California has solidified itself as an anti-sandbagging jurisdiction.

B. Waiver of Jury Trial

Waiver of jury trial provisions are present in almost all transactional agreements, not just in M&A deals. However, for the purposes of this Essay only pre-litigation jury trial waivers will be addressed due to this Essay’s M&A scope. Technically speaking, the right to a jury trial for civil litigants in federal court is a right protected by the Seventh Amendment of the U.S. Constitution. Thus, one could reasonably believe that waiver of jury trial provisions are constitutional issues. However, the Seventh Amendment does not apply to the states. States are thus allowed to decide whether parties to an agreement can contract away their rights to a jury trial. Although most states allow parties to waive their rights to a jury trial, two states have vehemently opposed such provisions. California and Georgia courts have held that pre-litigation waiver of jury trial provisions are unenforceable.

For Georgia, the seminal case disapproving of jury trial waivers is Bank South, N.A. v. Howard, which dates back to 1994. The underlying case involved a guaranty dispute. However, the guaranty contained a waiver of jury trial provision and the Georgia Supreme Court granted certiorari on that issue alone. The court justified its holding against the waiver by citing to the Constitution of Georgia and the Civil Practice Act, both of which state that the right to a jury trial is a constitutional right. The court also interpreted the

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32 U.S. CONST. amend. VII.
33 Minneapolis & St. L.R. Co. v. Bombolis, 241 U.S. 211, 219 (1916) (stating that “But this affords no ground for the proposition that the [Seventh] Amendment is applicable and controlling in proceedings in state courts deriving their authority from state law, in the teeth of the express and settled doctrine that the Amendment does not relate to proceedings in such courts.”); Nicole S. Magaline, 2 Unique Takes On Jury Waiver Clauses, LAW360 (Mar. 3, 2011, 5:11 PM), https://www.law360.com/articles/229586/2-unique-takes-on-jury-waiver-clauses?article_related_content=1.
34 Magaline, supra note 34.
36 See Bank South, 264 Ga. at 340–41.
37 Id. at 339.
38 Id.
40 Bank South, 264 Ga. at 340.
fact that both the Constitution of Georgia and the Georgia Civil Practice Act only mention jury trial waivers in the context of the beginning stages of litigation as evidence that pre-litigation waiver of jury trial provisions are unenforceable. The court seemed to anchor its view on the premise that since the right to a jury trial was considered a constitutional right, pre-litigation jury trial waivers are subject to heightened scrutiny and fail to pass muster. Thus, a court applying Georgia law will not enforce a pre-litigation jury trial waiver provision.

More recently, the California Supreme Court joined Georgia on this issue in 2005 via its holding in Grafton Partners L.P. v. Superior Court. The underlining dispute in Grafton Partners primarily centered on a breach of contract claim between Grafton Partners and PriceWaterhouseCoopers, LLP, its then auditor. The engagement letter between Grafton Partners and PriceWaterhouseCoopers contained a pre-litigation waiver of jury trial provision, which became the main issue on appeal after the trial court granted PriceWaterhouseCoopers’ motion to strike Grafton Partners’ demand for a jury trial. The California Supreme Court approached the issue in the same fashion as the Georgia Supreme Court. Both courts turned to their respective state constitutions and jury waiver statutes. Since California’s constitution states that the right to a jury trial is one protected by the state and California’s jury waiver statute only makes reference to waivers of juries once litigation has commenced, the California Supreme Court reversed PriceWaterhouseCoopers’ motion to strike and held pre-litigation jury trial waivers provisions unenforceable. Consequently, a court applying California law will not allow a party to a contract or agreement to waive its right to a jury trial before litigation has commenced.

It is important to note that while pre-litigation jury trial waivers are unenforceable in California, pre-litigation jury trial waivers in the context of arbitration agreements are specifically enforceable under California Code of Civil Procedure § 1281.
re County of Orange ruling held that if a waiver of jury trial dispute arises from actions in California to a federal court, then that federal court must apply California law. The Ninth Circuit resolved the discrepancy of treatment between California law and federal law, which allows waivers as long as the waivers meet the “knowing and voluntary” standard, by stating that the federal standard is a constitutional minimum. Thus, any state law that protects litigants’ Seventh Amendment rights to a higher degree than federal law will supersede the federal law in federal court.

C. Non-Compete

Similar to waiver of jury trial provisions, non-compete provisions are a metaphoric can of worms. A non-compete provision in a contract or agreement refers to a restrictive covenant on the part of one party to not compete with another party in some stated capacity either post-closing or post-termination of the agreement. The treatment of these provisions vary widely from state-to-state. Moreover, the study of non-compete provisions contains various facets and is multidimensional in nature. Thus, the following provides a brief analysis that focuses on Delaware’s, New York’s, and California’s enforcement of non-compete provisions.

Delaware and New York follow the approach that, as long as a non-compete provision is reasonable, it is enforceable. Both states have repeatedly affirmed this view. Although their tests for reasonableness may

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51 784 F.3d 520, 532 (9th Cir. 2015).
52 County of Orange, 784 F.3d at 531.
53 Id. at 531–32.
55 Id. at 943.
56 Within the category of states that enforce reasonable non-compete provisions, there are subcategories that differ on the appropriate treatment of modification when they are presented with a non-compete provision that is overbroad or overbearing. Id. at 948–49. For example, there is one subsect that follows the “blue pencil” doctrine, which allows the jurisdiction to re-draft an unreasonable non-compete provision to bring it within the spectrum of reasonableness. Id. Conversely, there are other jurisdictions that do not re-draft non-compete provisions and, thus, when presented with an unreasonable non-compete provision, they will not enforce it. Id.
differ slightly,\(^{59}\) the two jurisdictions ascribe to the ideology that parties have the right of freedom of contract.\(^{60}\) This allows parties to an agreement to contract and be bound by restrictive covenants. As recent as 2015, the Court of Chancery of Delaware in *Ascension Insurance Holdings, LLC v. Underwood* stated, “The ability to self-order is the sine qua non of free markets; without the ability to hold and dispose of property, and to agree to be bound contractually, no functional market could exist.”\(^{61}\)

On the other hand, California along with a handful of other states fervently oppose the enforceability of non-compete provisions.\(^{62}\) Section 16600 of California’s Business & Professions Code states, “every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.”\(^{63}\) In *Edwards v. Arthur Andersen LLP*, the California Supreme Court stated that, “[Section 16600] protects Californians and ensures “that every citizen shall retain the right to pursue any lawful employment and enterprise of their choice.”\(^{64}\) In essence, California believes the “right to work” outweighs the right of freedom of contract in the context of non-compete provisions. The *Edwards* decision is also noteworthy because Arthur Andersen argued for the court to adopt a narrow-restraint exception, but the court ended up rejecting the proposition outright and re-affirmed California’s strong stance of non-compete unenforceability.\(^{65}\) However, California does have a small carve out for M&A transactions. Section 16601 of California’s Business & Professions Code states, “Any person who sells the goodwill of a business, or any owner of a business entity selling or otherwise disposing of all of his or her ownership interest in the business entity...
agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the business so sold.” The California Court of Appeal in *Strategix, Ltd. v. Infocrossing West, Inc.*, explained that Section 16601 protects the value of the asset sold, because without Section 16601 the seller would be able to compete with the buyer and reduce the value of property right that buyer had just bought. Thus, California generally speaking does not enforce non-compete provisions.

II. ALTERNATIVE THEORIES TO TREATMENT DISCREPANCY

Having illustrated how Delaware, New York, and California treat sandbagging, waiver of jury trial, and non-compete provisions in the context of M&A deals, this Essay now shifts to examine and advance several alternative theories as to why Delaware, New York, and California have such a divergence of approaches. These theories include a state’s dependence on franchise taxes, the importance of a state’s market size, and the influence of state specific interest groups.

A. Delaware

Delaware’s particular treatment of the three aforementioned M&A provisions can be better understood by acknowledging its dependence on corporate fees and franchise taxes. As Professor William Cary details, shortly before Delaware became home to more than half of Fortune 500 companies, it largely lived in the shadow of New Jersey. Around the 1890s, New Jersey was modern-day Delaware due to its liberal corporate laws, and benefited greatly. During this time, New Jersey was collecting huge sums of money from corporate filing fees and franchise taxes as a result of its liberal corporate laws that by 1902 “it was able to abolish all property taxes and still pay off its entire state debt.” However, after Governor Woodrow Wilson in 1913 enacted the “Seven Sisters Laws,” corporations began to re-incorporate in

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69 Id. at 664.
70 Joel Seligman, A Brief History of Delaware’s General Corporation Law of 1899, 1 DEL. J. CORP. L. 249, 268 (1976).
71 Id. at 270 (These seven detailed provisions generally outlawed the trust and the holding company as well as restricted corporate authority.).
Delaware. 72 Delaware’s primary goal for copying New Jersey’s then corporate code was to obtain a new source of revenue for the state and that it did. 73 Franchise taxes alone made up roughly 16% of Delaware’s 2015 state budget, 72 but others have argued that income from corporate fees and franchise taxes to be closer to one-quarter of Delaware’s state budget. 74 Thus, it is reasonable to conclude that some of the legislature’s and judiciary’s actions are motivated with the state budget in mind. This is supported by the fact that Delaware has a population of only 952,065 and is one of the smallest states. 75 With a relatively small population and small land mass, Delaware is limited in sources of revenue.

Another alternative theory for Delaware’s treatment of the three M&A provisions is the “revolving door” movement of interested parties. In Federalism and Corporate Law: Reflections Upon Delaware, Professor Cary proved using hard data that Chief Justices of the Delaware Supreme Court throughout their careers were switching between roles as judges, legislators, and corporate attorneys. 77 He hinted to the development of an unhealthy relationship between the private corporate sector and the Delaware state government. 78 Although this was not occurring all at the same time and by everyone, it is still demonstrates that certain judges and representatives held some bias in favor of corporations, especially if they intended to have a career off the bench.

These two theories help explain why Delaware is pro-sandbagging, permits waiver of jury trial, and permits reasonable non-compete provisions. Delaware is beholden to its Fortune 500 residents and the benefits that relationship produces. In an effort to retain those benefits, Delaware, through its legislature and judiciary promulgated laws and case decisions that favor corporations, especially large corporations. In the M&A context, these corporations would be the typical buyers in a deal and, thus, Delaware’s treatment of the three M&A provisions is clearly pro-buyer.

72 Cary, supra note 69, at 664.
73 Id.
75 Cary, supra note 69, at 697–98.
77 Cary, supra note 69, at 690–92.
78 Id.
B. New York

Contrary to Delaware, New York holds greater leeway in drafting its laws and case decisions because it has a larger population, it is less reliant on franchise taxes, and has a bigger market size. New York has a population of around 19,745,289 and a land area of 47,126.40 square miles. In addition, the New York state budget is far less reliant on franchise taxes and corporate fees for revenue. With around 536,890 employer establishments in New York compared to Delaware’s 24,312, corporations and other business entities have less bargaining power to reject New York law—via threatening to exit the state—than in Delaware. This is especially true given that corporations by their very nature desire to grow and increase their profit margins. For these reasons, New York is less beholden to corporations than Delaware and this is demonstrated in New York’s treatment of the three aforesaid M&A provisions.

As discussed in Part II, New York has a nuanced approach toward sandbagging, permits waiver of jury trial, and permits reasonable non-compete provisions. Although New York and Delaware have real-world differences and their respective approaches on sandbagging differ slightly, they generally appear to approach the three M&A provisions in a similar manner. A possible explanation for this consistency could be the housing and influence of Wall Street along with some of the U.S.’s major financial institutions. Thus, New York’s treatment of the three M&A provisions suggests that it is also a pro-buyer jurisdiction.

C. California

With scarcely any of its budget stemming from franchise taxes and a large market size, California is barely in a position to be influenced by pro-buyer or pro-large corporation forces and of the three case studies carries the greatest amount of independence. California has a population of roughly 39,250,017 and a land area of 155,779.22 square miles. Its projected budget for 2017-2018 estimates around 90.6% of its revenue to be generated from personal

81 QuickFacts: New York, supra note 80.
income taxes, sales taxes, use taxes, and insurance taxes.\(^{83}\) If the rest of California’s sources of revenue were combined, those sources would only make up roughly 9.4% of the budget.\(^{84}\) These other sources would include not only franchise taxes, but also corporate taxes as well as other taxes and fees.\(^{85}\)

In addition, California has roughly 889,646 employer establishments, which is almost double that of New York.\(^{86}\) With population, land area, and employer establishments in mind, California holds by far the largest market size of three and arguably nationwide. As stated previously, a large market size affords a jurisdiction greater bargaining power with corporations, especially when the jurisdiction practically encompasses the entire West Coast of the U.S.

For these reasons, California’s ability to withstand pro-buyer influence is accurately reflected in the jurisdiction’s treatment of the three aforementioned M&A provisions. In many ways, California is a pro-seller or pro-worker jurisdiction. California’s default rules prohibit sandbagging, waiver of jury trial, and generally non-compete provisions, except for the narrow M&A exemption for non-compete provisions.\(^{87}\) The presence and dominance of Silicon Valley may help explain a couple of these approaches. For example, many high-tech firms that call California home benefit tremendously from the free flow of ideas and human capital. This is supported by the fact that the human capital for these high-tech firms is finite and, thus, not easily replaceable due to the highly technical nature of their businesses and specialized knowledge and skill requirements.\(^{88}\) Additionally, the presence of thousands of tech startups also helps rationalize why California leans more towards a seller favorable jurisdiction.\(^{89}\)


\(^{84}\) Id.

\(^{85}\) Id.

\(^{86}\) QuickFacts: California, supra note 83.

\(^{87}\) See Part II, supra.


CONCLUSION

This brief review of sandbagging, waiver of jury trial, and non-compete provisions in Delaware, New York, and California demonstrates the complex impact a governing jurisdiction can have on a M&A deal. Each of these states in one way or another approaches the M&A provisions differently, which ultimately may materially alter a contract or agreement.

At this point, one might be considering why anything stated above is even relevant given that today many business entities have substantial relationships or significant contacts in several different jurisdictions. While such business entities have great flexibility and can be strategic in choosing their choice of law or the governing law of their contracts or agreements, it is always best to be prepared, especially in transactions such as M&A deals that are large in scope and prone to failure.90 Without plunging into a detailed discussion regarding civil procedure, the study of forum selection itself is complex and multifaceted. For example, in Keener v. Convergys Corp., even though the parties selected Ohio law to apply to their employment agreement and expected Ohio law to apply, the Eleventh Circuit affirmed the lower court’s application of Georgia law, which served to invalidate the employment agreement’s non-compete provision.91 The Eleventh Circuit held that Georgia law applied over Ohio law, because Georgia had a “materially greater interest” in applying its law.92 This greater interest stemmed from the employee being a resident of Georgia and non-compete provisions violating long-standing Georgia public policy.93 While most cases and contract disputes do not result in another jurisdiction governing the contract, choice of law or governing law provisions will not always be effective and followed by courts. It would behoove an individual or party drafting a contract or agreement to be aware of the related jurisdiction’s default rules in the unlikely scenario that the jurisdiction invalidates their drafted forum selection clause and applies its default rules to the transaction.

91 342 F.3d 1264, 1266, 1271 (11th Cir. 2003).
92 Keener, 342 F.3d at 1267 (quoting Keener v. Convergys Corp., 312 F.3d 1236, 1241 (11th Cir. 2002)).
93 Id. at 1271.
In conclusion, jurisdictional default rules play a crucial role in every M&A transaction. This Essay’s analysis serves to ensure more M&A deals reach closing and the prevention of future litigation. Once one acknowledges the importance of jurisdictional default rules in the context of mergers and acquisitions, one will have the upper hand in any M&A deal and the ability to forge a truly beneficial agreement. As discussed in Part II, default rules may alter a purchase price by millions as well as dictate the course of negotiations and drafting. For example, a buyer in California will push to have language included in the agreement that expressly states his or her knowledge does not alter his or her reliance on the seller’s representations or warranties while, at the same time, a buyer in Delaware will not even mention this. Similarly, a buyer in California in order to avoid going to trial will negotiate for an arbitration agreement while a buyer in Delaware may just draft a waiver of jury trial provision. This Essay’s analysis also serves to provide a more thorough understanding of jurisdictional default rules to allow for the speculation of their viability as well as to predict how certain jurisdictions may act in the future. As discussed in Part III, there are several interconnected reasons that explain and determine a jurisdiction’s treatment of M&A provisions. The state’s dependence on franchise taxes and corporate fees, the state’s market size, and the state’s special interest groups all play a role in determining whether a jurisdiction adopts pro-buyer or pro-seller stance regarding its default rules as demonstrated via the case studies of Delaware, New York, and California.

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