SIGNIFICANT 2019 DECISIONS AFFECTING PRIVATE COMPANY M&A

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Significant 2019 Decisions Affecting Private Company M&A

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This newsletter is our sixth annual review of significant state court decisions relevant for private company M&A transactions and related governance matters and disputes.

Julius v. Accurus Aerospace Corp., No. CV 2017-0632-MTZ (Del. Ch. Oct. 31, 2019)

In focusing representations and warranties on changes to customer contracts since the balance sheet date, the buyer failed to allocate to sellers the risk of a key customer having taken action prior to the balance sheet date, which prevented the key customer contract from being renewed and resulted in a significant decrease in future revenue of the acquired business.

The Facts

Julius v. Accurus Aerospace Corp. involved a hearing on cross motions for summary judgment in a post-closing indemnity dispute relating to the July 2016 acquisition of Accurus Aerospace, an aerospace parts business. The dispute stemmed from the failure of Accurus' principal customer, The Boeing Company (Boeing), to allow Accurus to re-bid for the opportunity to supply Boeing a number of high-revenue parts (the Lost Parts), when the existing supply sub-contracts expired at the end of 2016.

The court noted that, as is common practice in the aviation parts industry, Accurus and Boeing were party to a Long Term Agreement (the LTA) and specific parts would be identified in sub-contracts to the LTA. When a sub-contract for specific parts was expiring, Accurus historically was afforded the opportunity to re-bid and, if it won the contract, would enter into a new sub-contract with Boeing.

Prior to and during due diligence and negotiation of the Asset Purchase Agreement relating to the sale of Accurus (the APA), Accurus was in contact with Boeing regarding the sub-contracts for parts that were expiring, and submitted re-bids for certain of those parts. The sellers (Sellers) shared with the buyers (Buyers) a projection spreadsheet (the Projection Spreadsheet) that included all parts and indicated whether Accurus would have an opportunity to re-bid on parts for which the applicable sub-contracts were expiring. The Lost Parts were among those for which it was indicated there would be an opportunity to re-bid.

After the closing under the APA, Boeing sent an award letter to Buyers that indicated that the Business had won contracts for certain parts, but not for others, including the Lost Parts. The Lost Parts represented about 10% of the total projected sales in subsequent years pursuant to the Projection Spreadsheet. During the discovery process of the litigation, it was determined that the contracts for the Lost Parts had been awarded by Boeing to other suppliers sometime in 2013 and 2014. Thus, at the time of the APA, and unbeknownst to Buyers or Sellers, the Business had already lost the opportunity to re-bid on those parts.

The parties provided for an indemnity escrow under the APA. Buyers submitted an indemnity claim for losses due to the lost opportunity, and demanded that the escrow funds remain in the escrow pending resolution of the claim. When the

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escrow period ended, Sellers initiated litigation for release of the escrow funds, and Buyers counterclaimed for breach of representations and warranties under the APA.

The Alleged Breached Provisions of the APA

Buyers alleged that Sellers breached the representations and warranties in Section 3.7(a), 3.25(a), 3.25(d) and 3.28 by failing to notify Buyers that Boeing had awarded the Lost Parts to other suppliers in 2013 and 2014, which resulted in the Business not having the ability to bid on the Lost Parts.

Section 3.7(a) contained an absence of changes representation, which provided that since December 31, 2015 (the Balance Sheet Date), operations had been conducted in the ordinary and usual course of business, and there had not been any event, occurrence or development that had had, or could reasonably be expected to have had, a material adverse effect.

Section 3.25 set forth representations relating to customers and suppliers. Section 3.25(a) provided that since the Balance Sheet Date:

> "no customer, distributor, or supplier of the Business has terminated or materially reduced or altered its business relationship with Seller or Seller Subsidiary or materially changed the terms on which it does business with either, or threatened that it intends to cancel, terminate, or otherwise materially reduce or alter its business relationship with either."

Section 3.25(d) provided that Sellers had disclosed to Buyers any "material disputes, complaints, or issues" with respect to any customers or suppliers, and the manner in which Sellers proposed to resolve them. Section 3.28 set forth an SEC Rule 10b-5-type representation, to the effect that there were no material misstatements or omissions in the representations and warranties under the APA or other transaction documents.

The APA contained a standard integration clause, which provided that the transaction documents constituted the entire agreement and understanding of the parties, and superseded all prior agreements, undertakings, negotiations and communications. The APA did not contain any express representations or warranties relating to the projections. Buyers initially argued that the Projection Spreadsheet was a part of the APA, but later conceded that it was not, and thus Sellers were not liable for inaccuracies in the projections.

Court's Finding that Sellers Did Not Breach the APA

Section 3.25(d)

The court noted that whether this Section was breached turned on whether the lost opportunity to bid constituted a material "issue" with Boeing. In considering the definitions of "issue" in two dictionaries, the court held that there needed to have been an actual dispute or question raised by Accurus or Boeing that Accurus or Boeing intended to resolve. The court noted that when the Accurus had been about to lose the opportunity to bid on other parts in 2015, Accurus had engaged with Boeing to try to secure the opportunity to re-bid. The court noted that this created an "issue" between Accurus and Boeing.

The court contrasted that situation with the facts surrounding the Lost Parts. The court held that no "issue" arose in connection with the Lost Parts because neither Boeing nor Accurus raised any problem or made any inquiry about the Lost Parts when they were awarded to third parties in 2013 and 2014; Accurus was not even aware that this had happened. Rather, Accurus and Boeing continued their relationship without any dispute, until concerns were raised after the APA closing. Therefore, there was no "issue" that resulted in a breach of the APA.

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Sections 3.7(a) and 3.25(a)

The court held that there was no breach of these Sections because they only applied to events occurring after the Balance Sheet Date. The loss of the opportunity to re-bid on the Lost Parts occurred in 2013 and 2014. Accordingly, the court held that the lost opportunity could not give rise to a breach of Sections 3.7(a) and 3.25(a).

Section 3.28

The court held that there was no breach of Section 3.28 because Sellers made the other representations and warranties truthfully at the time the APA was entered into. The court noted that none of the representations and warranties relied on by Buyers required Sellers to notify Buyers that Boeing had awarded the Lost Parts to other suppliers, or guaranteed that Accurus would have the opportunity to re-bid on the Lost Parts.

Accordingly, the court held that Buyers were not entitled to indemnification because Sellers had not breached the APA. The court also held that Buyers must release the escrow funds, although their prior refusal to do so did not constitute a breach of the APA or the escrow agreement because Buyers acted in good faith in bringing an indemnity claim.

Takeaways

Representations and warranties allocate risk, and Buyers here had failed to allocate the risk of the lost opportunity to Sellers. The crux of Buyers' problem was the way the representations and warranties were drafted: while changes under customer contracts arising between the Balance Sheet Date and closing may have been adequately covered, those arising before the Balance Sheet Date were not. This was particularly problematic where Accurus was heavily dependent on one customer, Boeing, and the business with Boeing was periodically coming up for renewal.

The court's decision suggests that Buyers could have addressed the problem by including in the APA provisions such as the following:

- a representation and warranty by Sellers that all parts for which Accurus had lost the opportunity to re-bid were as set forth on a schedule to the APA; and/or
- an indemnification provision relating to any parts for which Accurus had lost the opportunity to re-bid.

The decision is therefore a reminder that when diligencing target companies, buyers should consider carefully what are the material risks of the target's business, and then draft the representations, warranties and indemnities with granularity to address those risks. In *Julius*, there was a gap in the drafting that turned into a material issue after closing.

It is worth noting that a knowledge-based representation, which is often a compromise solution to address risk allocation in representations and warranties, would not have produced a different result. A representation calling for disclosure of parts for which, to the knowledge of Sellers, the opportunity to re-bid had been lost would not have been breached because Sellers were unaware that the opportunity had been lost. Instead, the Buyers in this case could have insisted that Sellers retained the risk of any re-bidding opportunity having been lost, whether or not they had made the necessary inquiries and knew about them.

A second point worth noting is the court's summary rejection of Plaintiff's claim that the APA's 10b-5 representation had been breached. The court held that it was not because none of the other representations had been breached. To the extent the court suggested that a breach of another representation was required in order to find a breach of the 10b-5 representation, that requirement would eviscerate any independent protection provided by the 10b-5 representation. In this regard, practitioners should take note that a 10b-5 representation may not give them the type of extra protection that it is often thought to bestow.

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Kotler v. Shipman Assocs., LLC, No. CV 2017-0457-JRS (Del. Ch. Aug. 27, 2019)

Failure to ensure that parties execute and deliver the same version of an agreement can lead to a finding that a binding contract has not been formed.

In *Kotler v. Shipman Associates, LLC*, the Delaware Court of Chancery held that a contract was unenforceable because the "fully executed" agreement with "wet signatures" that was in the possession of plaintiff Stacey Kotler did not express defendant Shipman Associates' consent to the material terms. Instead, the court held that the evidence supported defendant's argument that, notwithstanding the fact that a signature of an authorized company representative was attached to the agreement plaintiff offered, defendant believed that the parties had agreed to different terms. Accordingly, the court found that no binding contract was formed.

The Facts

The Company engaged Kotler as a salesperson to sell cosmetics. Several years after Kotler was first promised an equity award, Kotler and the Company commenced negotiation of a warrant to purchase five percent of the equity of the Company. Due to poor record-keeping practices of the parties, the majority of records regarding the negotiations, including email correspondence between the parties, was lost. The evidence provided to the court of the terms of the warrant consisted of drafts retained by the parties, including a purported "fully executed" agreement provided by Kotler, and the parties' testimony. The court noted that none of the parties had a clear memory of what happened in connection with the negotiation and execution of the warrant.

The parties negotiated heavily over non-compete and non-solicitation provisions; the Company proposed a perpetual non-compete and non-solicit, which Kotler sought to either exclude or significantly cut back. The parties exchanged drafts over nine months, but, for example, a draft prepared by the Company did not contain any reference to the draft previously proposed by Kotler and contained the same misspelling of her name as the prior draft prepared by the Company.

The court found that: (i) the Company sent a draft that it presumed was the execution version of the warrant to Kotler; (ii) Kotler revised this draft, including correcting the spelling of her name and limiting the scope of the non-compete and non-solicit provisions; (iii) Kotler executed the version with her revisions and sent a hard copy to the Company's president, who had been negotiating on behalf of the Company, without advising him that she had made significant revisions; (iv) Kotler sent either a blank counterpart signature page or a hard copy of the unexecuted version with her revisions to the Company's CEO for execution; (v) the Company's CEO spoke to the Company's President, who confirmed that the CEO should execute and return the counterpart signature page to Kotler; (vi) the CEO signed and returned a counterpart signature page to Kotler; and (vii) Kotler attached the counterpart signature page executed by the Company's CEO to the version with Kotler's revisions.

The parties believed they had executed a final agreement, but each party believed its version controlled. About a week later, Kotler and the Company's President agreed that the warrant should represent five percent of the outstanding equity of the Company instead of the five percent of the fully diluted capitalization. The Company's counsel prepared a revised draft of its version of the warrant that attempted to include all new changes, but notably it did not contain all of the revisions to the non-compete and non-solicitation provisions that Kotler included in Kotler's version of the warrant.

The court determined that Kotler revised this latest version of the warrant, including to limit the non-compete provision. Kotler then attached the executed counterpart signature pages that she had in her possession but did not circulate any final copy to the Company.

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The Court's Decision

The court invoked well-settled contract principles that "to form an enforceable contract, the parties must have a meeting of the minds on all essential terms", and noted that manifestation of intent to be bound is based on objective evidence. The court held that even though Kotler produced a purported fully executed version of the warrant, evidence showed that the parties were operating off different versions of the agreement, and accordingly Kotler failed to satisfy her burden of proving the existence of a valid agreement.

Takeaways

Parties should incorporate into the signing process the clear sign-off by other parties to a mutually agreed final version of the contract. In addition, taking the basic step of circulating a complete executed version to all parties would significantly help to avoid disputes such as those arising in *Kotler*.

S'holder Representative Servs. LLC v. RSI Holdco, No. CV 2018-0517-KSJM (Del. Ch. May 29, 2019)

Where buyer agreed that sellers retained ownership over pre-merger attorney-client communications, sellers' failure to segregate privileged communications from computers and servers transferred to buyer did not waive privilege.

Shareholder Representative Services LLC v. RSI Holdco, LLC, or *SRS v. RSI Holdco*, provides clarification to the guidance in *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLP*[1] regarding the steps that sellers need to take in order to preserve ownership and control of the attorney-client privilege associated with pre-transaction communications between the seller team and company counsel in an M&A sale transaction. *Great Hill* held that the privilege passes to the surviving company in a merger, pursuant to Section 259 of the Delaware General Corporation Law, and if sellers wish to retain ownership and control of the privilege, they must do so contractually. *Great Hill* left open the question of what steps the sellers must take to segregate and exercise control over privileged communications, including electronic communications residing on the surviving company's IT systems, to prevent a waiver of privilege after closing. *SRS v. RSI Holdco* held that no additional steps will be required if appropriate contractual language is included in the merger agreement.

The Facts

SRS v. RSI Holdco resolved a privilege dispute in an action brought by Shareholder Representative Services LLC (SRS), in its capacity as stockholders' representative, against RSI Holdco, LLC (Holdco) for failure to make certain payments following Holdco's acquisition of Radixx Solutions International, Inc. The merger agreement provided that pre-merger privileged communications were assigned to SRS at closing. In connection with the litigation, Holdco sought to use certain emails it found on the computer systems of the surviving company following the merger, claiming that the privilege had been waived (or did not apply).

The Court's Decision

Rejecting Holdco's arguments, the court held that the language in the merger agreement operated to preserve the sellers' privilege over the emails and the sellers did not need to take extra steps after closing to preserve the privilege.

[1] 80 A.3d 155 (Del. Ch. 2013).

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Language in the Merger Agreement

Section 13.12 of the merger agreement provided that any privilege relating to deal-related communications survived the merger closing, and was assigned to and controlled by the stockholders' representative. Each of the parties to the merger agreement was obligated to take the necessary steps to ensure such survival and such assignment to and control by the stockholders' representative. Section 13.12 also provided that Holdco and certain related parties, successors and assigns would not use or rely on these privileged communications in any post-closing action or claim against or involving any of the parties to the merger agreement (the "non-use" obligation).

The court noted that Section 13.12 appeared to follow *Great Hill* and that by preserving privilege, assigning control over it to the stockholders' representative, and prohibiting use of privileged communications in any dispute among parties to the merger agreement, Section 13.12 prevented Holdco from doing exactly what it was trying to do in the litigation.

The court rejected Holdco's argument that post-closing conduct waived privilege, finding it contrary to the plan language of the merger agreement. The court noted that Section 13.12 applied to privileged communications prior to the closing date, regardless of any post-closing waiver.

The court also rejected Holdco's argument that a contractual provision could not immunize a privilege from waiver. The court noted that while this issue was not resolved in *Great Hill*, Holdco's argument would undermine the guidance in *Great Hill* and was not supported by any precedent.

Takeaways

Provisions intended to preserve pre-closing attorney-client communications have become common since the *Great Hill* decision. While some sellers try to negotiate for very expansive protections around pre-closing privileged communications, overly broad provisions can be problematic for buyers because it can prevent buyers from accessing information that may be needed in ordinary course operations of the surviving company. The *SRS v. RSI Holdco* decision will enable buyers to push back on such broad covenants as unnecessary.

Sellers, on the other hand, have little practical ability to enforce control over privileged communications. It is not market practice, or practicable, for deal parties to undertake a detailed search of computers and servers in connection with closing, expunge all privileged communications and deliver them electronically to the sellers. After *SRS v. RSI Holdco*, sellers should no longer be at risk of buyers arguing that failure to undertake such an exercise constitutes a deemed waiver of the privilege.

Vintage Rodeo Parent, LLC v. Rent-a-Ctr., Inc., No. CV 2018-0927-SG (Del. Ch. Mar. 14, 2019)

When an acquiror failed to extend the expiration date of a merger agreement, the target company validly terminated the merger agreement, even though public statements and other actions taken by both acquiror and target evidenced an intent to close after the expiration date.

The Facts

The Vintage Rodeo case arose from the termination by Rent-A-Center, Inc. (Rent-A-Center) of its merger agreement with Vintage Rodeo Parent, LLC (Vintage) pursuant to which Vintage had agreed to acquire Rent-A-Center. Vintage sued, seeking to set aside Rent-A-Center's termination and to specifically enforce the transaction.

Vintage and Rent-A-Center both owned and operated stores offering consumer goods to the public on a "rent-to-own" basis. Given the overlap in their businesses, the parties anticipated there could be a lengthy antitrust review by the Federal

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Trade Commission (FTC). The merger agreement provided for an initial six month period during which the parties were each obligated to use commercially reasonable efforts to obtain FTC approval and close the merger.

The merger agreement also provided that if the FTC review process was still ongoing at that time, each party had a unilateral right to extend the expiration date for a specified period. To take advantage of this extension right, the merger agreement required that a party deliver a notice of the extension before the initial six month period expired. If the expiration date was not extended, either party could elect to terminate the agreement at will by giving notice.

The merger agreement also provided for a reverse break fee of $126.5 million (15.75% of the transaction's equity value) payable by Vintage to Rent-A-Center under certain circumstances if the deal did not close, including if FTC approval had not been obtained and the merger agreement was terminated by either party following the expiration date.

Roughly two weeks before the initial expiration date, Rent-A-Center's board met and, at counsel's prompting, evaluated its potential options if Vintage failed to extend the agreement. Rent-A-Center's board determined that in the event that Vintage did not extend the expiration date, it would terminate the merger agreement. Following the meeting, Rent-A-Center continued to work with Vintage towards a closing, including participating in discussions with the FTC and participating in integration planning meetings.

Vintage neglected to deliver an extension notice by the expiration date. Within a few hours thereafter, Rent-A-Center delivered a termination notice to Vintage and a demand for payment of the reverse break fee.

Vintage filed suit claiming that Rent-A-Center's termination was ineffective. Vintage argued that the parties' continued joint efforts to close the transaction even when it was clear that the transaction would not close until after the initial expiration date made it unnecessary to comply with the formal extension notice requirements. Vintage also argued that Rent-A-Center had breached its obligation to use commercially reasonable efforts to close the transaction, rendering Rent-A-Center ineligible to invoke its termination right on both contractual and equitable estoppel grounds, because Rent-A-Center chose not to inform Vintage of its determination that it was in Rent-A-Center's interest not to close and instead continued to act as though it were willing to close.

The Court's Decision

The court found that since the notice provision was "clear and unambiguous," the court would enforce the provision. The court held that the conduct Vintage based its arguments on, namely (i) Rent-A-Center's entry into a joint timing agreement with Vintage and the FTC, under which they agreed not to close the deal for a specified period of time, which made it practically impossible to close before the initial drop-dead dead, (ii) the parties agreeing on an updated financial model that contemplated a closing after the initial expiration date and (iii) public statements by both parties indicating that they anticipated the closing would occur after the initial expiration date, was not sufficient to extend the agreement given the specific notice requirements under the merger agreement.

The court further found that Rent-A-Center's overt actions both before and after it had decided to terminate the agreement were consistent with its obligation to use commercially reasonable efforts to close the merger.

The Court distinguished prior cases (e.g. *Williams Companies. v. Energy Transfer Equity, L.P.* and *Hexion Specialty Chemicals., Inc. v. Huntsman Corp.*) where a party to a merger agreement that was obligated to use its reasonable best efforts to achieve a condition precedent to the contemplated merger stayed silent when the party became aware of a problem that threatened the condition precedent. The court noted that the defendants in those cases were aware of a "problem" that would result in a failure to obtain a condition precedent, and chose not to alert and to work with their counterparties to find a solution. In contrast, the court found that in this case there was no comparable "problem" and that a commercially reasonable efforts clause did not impose an obligation to inform the other party of its contractual rights.

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The court did not decide on whether the reverse break fee was payable and questioned whether it would be enforceable under the implied covenant of good faith and fair dealing. Specifically, the court questioned whether the parties intended for the "enormous" reverse break fee to be payable in a situation where the termination was due to an inadvertent failure to extend the expiration date. Rather than further litigate this point, the parties subsequently settled the case, with Vintage agreeing to pay Rent-A-Center $92.5 million.

Takeaways

Parties should be scrupulous in observing contractual formalities, such as notice requirements, as Delaware courts will typically enforce unambiguous contract language. In particular, parties should not passively assume that notice is not required because the other party has not given any indication that it may terminate if given the chance. Moreover, even if a party believes that the other party will extend an acquisition agreement, it should ensure it adequately considers its options if the agreement is not extended. In this case, because Rent-A-Center had considered its position in advance, it was able to take advantage of its termination right and ultimately collected a substantial settlement.

Parties should be explicit as to whether an inadvertent failure to extend the expiration date of a merger agreement is intended to trigger a reverse break fee. Reverse break fees are typically intended for situations where an acquiror either refuses to close, or is unable to close due to a regulatory or other issue. What was unusual in this case is that the target was able to terminate when the acquiror was still committed to the deal, and the target was also able to claim it was owed a reverse break fee. The failure to include language addressing such a situation left Vintage in a very weak negotiating position and resulted in a very large settlement in favor of Rent-A-Center.

Leaf Invenergy Co. v. Invenergy Renewables LLC, 210 A.3d 688 (Del. 2019)

Contractual provision specifying that without the prior written consent of an investor, the company could not enter into a specified M&A transaction, unless the investor received a target return on its investment, entitled the investor to the target return when consent was not obtained, and not some other measure of damages resulting from a company "efficient breach."

Background

The *Leaf* case involves an appeal from a Delaware Court of Chancery's award of nominal damages to an investor to compensate it for the company's breach of the investor's consent right with respect to an M&A transaction (referred to as a "Material Partial Sale").

Leaf Invenergy Company (Leaf) invested $30 million in Invenergy Renewables LLC (Invenergy) and obtained the following consent right under Invenergy's LLC Agreement:

> "Without the prior written consent of . . . [Leaf], [Invenergy] shall not:
>
> . . .
>
> (b) participate in or permit a Material Partial Sale, unless the transaction giving rise to the Material Partial Sale yields cash proceeds equal to or greater than the amount that would provide [Leaf], as of the closing of such Material Partial Sale, with cash proceeds equal to or more than their applicable Target Multiple with such Target Multiple to be paid upon such closing of the Material Partial Sale."

Invenergy subsequently effected a Material Partial Sale (referred to as the "TerraForm" transaction) for a purchase price of $1.8 billion without obtaining Leaf's consent and without Leaf receiving its Target Multiple.

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Leaf sued Invenergy in the Delaware Court of Chancery alleging breach of the consent provision by Invenergy and seeking payment of the Target Multiple. The Court of Chancery held at the pleading stage that Invenergy breached the consent provision, so the only issue at trial was the appropriate measure of expectation damages to be awarded. The Court of Chancery noted that throughout most of the litigation, both parties had acknowledged that Invenergy either had to procure Leaf's consent to the Terraform transaction or pay Leaf the Target Multiple. However, the Court of Chancery rejected the role of subjective expectations in assessment of expectation damages, unless those expectations were reflected in a contractual remedial provision, such as a liquidated damages clause. The Court of Chancery held that the reference to the Target Multiple in the above quoted language did not constitute remedial language, but instead merely set forth an exception to the consent right.

The Court of Chancery held that in the absence of a remedial provision, Leaf had to prove that it suffered actual damages. One way it could do so was by proving harm to Leaf's interests. But the Court of Chancery noted that Leaf was actually better off following the TerraForm deal because the deal was good for investors. The Court of Chancery held that another way that Leaf could prove damages was by proving that Leaf could have bargained for additional consideration in exchange for granting its consent, which the Court of Chancery reasoned Leaf would have been unable to do. The Court of Chancery viewed Invenergy's failure to obtain Leaf's consent as an "efficient breach" of its contractual obligation, and awarded Leaf nominal damages of $1.00.

The Delaware Supreme Court reversed the Court of Chancery and instead awarded Leaf damages of an amount equal to the Target Multiple, which was $126.1 million.

Holding and Analysis

The Delaware Supreme Court found that the consent provision imposed an unambiguous, affirmative obligation on Invenergy to either obtain Leaf's consent or pay the Target Multiple if it chose to effect a Material Partial Sale. The Court of Chancery had characterized the payment of the Target Multiple as an "exception" to Invenergy's obligation to obtain consent that Invenergy could either elect to take advantage of or instead opt to pay damages for an efficient breach of its obligation to obtain Leaf's consent. Under the Court of Chancery's approach, since Invenergy's only obligation was to obtain Leaf's consent, Leaf's damages should only be those flowing from Invenergy's failure to obtain Leaf's consent, which were nominal.

The Supreme Court rejected this interpretation, reasoning that the consent provision was "logically equivalent" to a provision stating that if Invenergy conducted a Material Partial Sale without Leaf's consent, then Invenergy must pay Leaf the Target Multiple. The Supreme Court reasoned that the breach arose from the combination of Invenergy's failure to obtain consent and its failure to pay the Target Multiple, since, for example, if Invenergy had structured the TerraForm transaction so that Leaf received the Target Multiple, there would be no breach. The Supreme Court found that the Court of Chancery's approach only partially remedied the breach since it ignored the obligation to pay the Target Multiple.

The Supreme Court rejected the Court of Chancery's reliance on two earlier Court of Chancery decisions, one of which was inapposite and the second of which reached a correct outcome but through flawed reasoning. The first decision did not even consider whether the stockholders had a right to a liquidation preference in the absence of an affirmative stockholder vote. And the second decision, *In re Appraisal of GoodCents Holdings, Inc.*,[2] involved a claim by holders of preferred stock that they were entitled to a liquidation preference in a merger, where the target company's charter had the following language:

> "Without the affirmative vote of the holders of a majority of the . . . Preferred Stock, the corporation shall not . . . effect any merger or consolidation . . . unless the agreement or plan of merger . . . shall provide that that the

[2] 2017 WL 2463665 (Del. Ch. June 7, 2017)

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> consideration payable to the stockholders of the corporation . . . shall be distributed to the holders of capital stock of the corporation in accordance with [the liquidation preference clauses]"

In rejecting the claims of the holders of preferred stock, the court in *GoodCents* reasoned that the above language created the right to a class vote and not a right to the liquidation preference in a merger. The Supreme Court in *Leaf* held that the outcome of the *GoodCents* case was correct because the preferred stockholders appeared to have voted to approve the merger. However, it rejected the reasoning in *GoodCents* that the charter provision would not lead to damages in the amount of the liquidation preference in the absence of consent.

The Supreme Court rejected the Court of Chancery's application in *Leaf* of the "efficient breach" concept. The Supreme Court characterized "efficient breach" as a scenario where a party might find it economically worthwhile to breach a contract because the resulting benefits would exceed the damages it must pay. The Supreme Court pointed out that an efficient breach would only occur if the damages award corresponded to the injury suffered and that the "efficient breach" concept could not be used to increase or decrease damages because of a perceived efficiency or lack thereof.

The Supreme Court also considered the Court of Chancery's rejection of the Target Multiple as a contractually specified measure of damages given that it was not included in a remedies or liquidated damages provision. The Supreme Court reasoned that it is not always required to specify the applicable remedy in a remedies provision, analogizing to a sales contract, where the seller fully performs and the buyer does not pay the sales price. In that situation, the appropriate measure of damages would be the sales price, even though it was not specified in a remedies provision. Rejecting the Court of Chancery's position, the Supreme Court found that a liquidated damages clause in the Invenergy LLC Agreement would be superfluous since Invenergy was already contractually obligated to pay the Target Multiple by the consent provision.

Takeaways

The decision provides useful guidance to drafters of consents rights. Language providing that without the consent of specified investors, a target company cannot engage in certain transactions unless the investors receive specified amounts should be interpreted to mean that either consent has to be obtained, or the specified amounts have to be paid. The specified amounts are effectively liquidated damages. On the other hand, language providing simply that specified investors have a consent right leaves open the question as to what the damages will be if consent is not obtained. If the transaction creates value for the investors, it may be that in this latter case, failure to obtain consent may only lead to a nominal damages award. In order to avoid this result, investors negotiating consent rights should therefore consider drafting in a way that provides either for some type of liquidated damages, or that failure to obtain the consent renders the transaction void.

Horton v. Organogenesis Inc., No. CV 2018-0537-KSJM (Del. Ch. July 22, 2019)

Indemnity notice containing brief description of the factual basis of claims for breach of representations and warranties without specifying specific provisions satisfied "reasonable detail" contractual notice requirements sufficient to withstand motion to dismiss; indemnity notice of litigation claim where losses had not yet been incurred was not ripe.

The Facts

The *Horton* case involved an action in the Delaware Court of Chancery stemming from an indemnity claim brought by Organogenesis Inc. (Buyer) in connection with its acquisition of NuTech Medical, Inc. (NuTech) against the sellers.

Buyer acquired NuTech for a combination of cash and stock pursuant to a merger agreement. The merger agreement required the sellers to indemnify Buyer for breaches of NuTech's representations and warranties, and for losses in

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connection with a specified, pending litigation (the MiMedx Litigation), among other things. The merger agreement provided that NuTech's representations and warranties survived for 15 months following the closing. However, the agreement further provided that if, prior to the expiration of this survival period, Buyer delivered a written notice to the sellers' representative of an indemnification claim that stated "in reasonable detail the nature of, factual and legal basis for" the claim, then Buyer's indemnification claims for breaches of representations and warranties would "survive until resolved or judicially determined."

Following the closing of the acquisition, and one day before the expiration of the survival period applicable to claims for breaches of representations and warranties, Buyer notified the sellers' representative that it was seeking indemnification for various breaches of NuTech's representations and warranties, and for losses related to the MiMedx Litigation. Buyer delivered a written notice to the sellers' representative that listed five post-closing "issues", including paragraph-long factual descriptions of each issue and noting that these issues "may involve breaches of representations and warranties in the Merger Agreement." The notice did not indicate the specific representations that Buyer was alleging had been breached by these issues.

When Buyer refused to make a deferred payment required 15 months after closing under the merger agreement, the sellers' representative brought suit. Buyer counterclaimed for indemnification, and the sellers' representative moved to dismiss.

The Court's Decision

The sellers' representative moved to dismiss Buyer's breach of representation claims, in part, on the basis that Buyer's claim notice did not provide sufficient detail to satisfy the "reasonable detail" requirement under the merger agreement. As a result, the sellers' representative contended, Buyer's breach claims expired under the applicable survival period.

The court found that the merger agreement unambiguously required that a party claiming indemnification for breaches of representations and warranties must state in writing and "in reasonable detail" the nature of and the factual and legal bases for the claim.

The court found that the notice listed five different issues underlying the alleged breaches and provided a paragraph-length description concerning each issue, which provided "reasonable detail" about the nature of and factual basess of Buyer's claims. The court then considered the sellers' representative's argument that the claim notice did not provide reasonable detail for the legal basis of the claims because it did not identify specific merger agreement provisions but merely stated that the issues "may involve breaches of representations and warranties". The court held that the notice sufficiently identified the legal basis of the claims under the "reasonable detail" standard because the sellers were charged with knowledge of their own representations and warranties.

The sellers' representative additionally moved to dismiss Buyer's claim for losses in connection with the MiMedx Litigation as unripe because Buyer had not yet incurred any losses from it. The court held that Buyer must have suffered costs, fees or adverse judgments to be entitled to indemnification. Merely being subject to the litigation is not enough. Accordingly, the court dismissed without prejudice Buyer's claims for indemnification for the MiMedx Litigation as unripe.

Takeaways

Horton dealt with an important issue for private company M&A: what is a sufficient indemnification notice for purposes of extending the survival period for claims and preventing the release of escrow and/or holdback funds? While the fairly brief claims notice given in *Horton* was deemed sufficient for purposes of surviving a motion to dismiss, buyers would be well advised to provide additional legal basis, and not rely on a generic reference to representations and warranties, in case the notice is found deficient at trial. A similar issue regarding sufficiency of an indemnity notice was considered in

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another Delaware Chancery Court decision issued a few days later, *Hill v. LW Buyer*.[3] There, the court noted that the meaning of the term "reasonable detail" in an indemnity notice was a fact-based inquiry. The term could be read narrowly to require only sufficient details to put the other party on "notice," or broadly to require significantly more detail. Buyers should therefore not view the notice provided in *Horton* as setting the appropriate standard to follow in each situation.

Horton also has important implications for the merger agreement drafting stage. The *Horton* merger agreement seems to have conflated the notice required to bring an indemnity claim, and the notice required to extend the survival period and freeze escrow/holdback proceeds. But a merger agreement could have a separate standard for each. The notice required to extend the survival period and freeze escrow/holdback proceeds could be a lower standard, such as merely requiring a buyer to set forth the factual basis of a potential claim in reasonable detail, to the extent known.

Horton also has implications for the losses element of an indemnity claim. The court dismissed Buyer's claim as unripe because Buyer had not yet incurred a "loss," as the court construed that definition in the merger agreement. The circumstances underlying the *Horton* case were perhaps unique in this regard. In most cases in which a buyer is subject to a third-party lawsuit, the buyer will incur expenses, including attorneys' fees, almost immediately upon receiving notice of filing of the lawsuit. In such cases, buyers should take care to plead that they have suffered expenses at the outset of the claim and not rely solely on allegations of potential future loss.

A similar issue arose in the *Hill* case, where an indemnification claim for unpaid VAT and sales and use taxes in certain states was dismissed on summary judgment as unripe because the estimated taxes had not yet been imposed. But there is a difference between the legal/contractual standard for recovery of losses, and what might be sufficient for purposes of a notice of potential losses. It would be to the benefit of buyers to draft merger agreements so that notice setting forth facts reasonably likely to result in loss would be sufficient to extend the survival period and freeze escrow/holdback proceeds, even if no losses have yet been incurred and the amount of losses are not yet estimable. In order to actually recover for those losses, they would then have to be incurred.

Arkansas Teacher Ret. Sys. v. Alon USA Energy, Inc., No. CV 2017-0453-KSJM (Del. Ch. June 28, 2019)

Stockholders may have standing to bring suit for breach of contract and violation of Delaware law even if they are neither parties to the agreement nor express third party beneficiaries.

Background

Section 203 of Delaware General Corporate Law prohibits a stockholder from engaging in a business combination with a company within three years from the date it acquires 15% or more of the company's outstanding voting equity unless the company's board pre-approves the transaction by which the stockholder acquires the initial equity (or another exemption applies). Delek US Holdings (Delek) sought to acquire all of Alon USA Energy, Inc.'s (Alon's) common stock, but was initially only able to acquire 48%. To avoid the three-year standstill imposed by Section 203, Delek requested and Alon's board granted a pre-approval permitting further stock purchases by Delek, on the condition that Delek agree to a broad one-year standstill provision that prohibited Delek from "seeking to" acquire a majority stake.

According to the complaint, Delek violated the one-year standstill agreement when its CEO, who also served on Alon's board, publicly announced Delek's intent to acquire the remaining 52% of Alon's equity and a special committee of independent directors engaged in substantive negotiations with Delek, even agreeing to certain terms. After the standstill

[3] No. CV 2017-0591-MTZ (Del. Ch. July 31, 2019)

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period expired, the special committee made several offers to Delek, each more favorable than the preceding one, until Delek ultimately agreed to a price significantly less than it paid two years prior.

Plaintiff sued on behalf of itself and a class of Alon's common stockholders alleging breaches of fiduciary duty and, interestingly, a claim against Delek for breach of the stockholder agreement. Delek moved to dismiss arguing that plaintiff was not a third-party beneficiary under the agreement and therefore lacked standing to enforce it.

Analysis

In order to have standing to bring the claim of breach of the stockholders agreement, plaintiff must demonstrate that "the contracting parties intended to confer a benefit directly to [plaintiffs]; they conveyed the benefit as a gift or in satisfaction of a pre-existing obligation; and conveying the benefit was a material part of the purpose for entering into the agreement."

The court held that, because the stockholder agreement replicates aspects of Section 203, which provide a direct benefit to stockholders in the form of anti-takeover protections, each of these three elements were adequately alleged in the complaint. The court further held that plaintiffs' direct claims under Section 203 also survived defendant's motion to dismiss because the stockholder vote that vitiated Section 203's protections was not fully informed. Notably, plaintiffs alleged that defendants failed to accurately describe material aspects of the stockholder agreement, failed to adequately disclose facts relating to the special committee's formation, and did not mention that the special committee's financial advisor increased its holdings in the acquirer. The court similarly held that plaintiffs' claims for breach of fiduciary duty, unfair process and unfair price also survived the motion to dismiss.

Takeaways

This decision is noteworthy because in addition to involving typical fiduciary duty claims, it involved claims by target stockholders for the acquiror's pre-deal breach of a contract with the target company. The working assumption by acquirors is often that when the target company becomes a wholly owned subsidiary at closing, any exposure the acquiror has for pre-deal breach of contract with the target will disappear. *Alon USA Energy* suggests that former stockholders may be able to bring claims based on the agreement even post-closing.

While *Alon USA Energy* involved breach of standstill obligations by a controlling stockholder, the implications also extend to other situations, such as the following:

- What if a stockholder is a party to a stockholders agreement that contains drag-along and/or support obligations in connection with an M&A transaction? If the stockholder refuses to sign an onerous support agreement in connection with a sale transaction, would it be subject to liability to other stockholders not party to the stockholders agreement because of the loss of the deal and associated lost merger premium?
- What about disputes with parties that are not stockholders? Consider the situation where a third party has a contractual dispute with a target company, and then acquires the target company to resolve the dispute. Would the target company's stockholders be third-party beneficiaries with standing to bring a post-closing claims relating to the contractual dispute? In most situations, stockholders would presumably not be able to establish third-party beneficiary rights under the test described in *Alon USA Energy*. But acquirors in such a situation should at least analyze the possibility, and perhaps take the simple precaution (at least in a non-hostile deal) of resolving the dispute as a condition to completing the acquisition.
- Merger Agreements—the rights of stockholders to bring third party beneficiary claims under merger agreements is discussed in connection with the following summary and takeaways for the *Dolan v. Altice* decision.

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Dolan v. Altice USA, Inc., No. CV 2018-0651-JRS (Del. Ch. June 27, 2019)

Stockholders may have third-party beneficiary rights to enforce post-closing covenants of acquiror under merger agreements, notwithstanding general exclusion of third-party beneficiary rights.

Background

In connection with the sale of Cablevision Systems Corp., the Dolan family, who founded the company and were holders of about 30% of the outstanding shares, negotiated for a merger agreement covenant that obligated the acquiror, an affiliate of Altice USA, Inc. (Altice), to operate the News12 division of the company through at least the end of 2020 in accordance with a specified business plan. After closing, the Dolan family learned that Altice was laying off employees in violation of the covenant. When Altice refused to rescind the terminations, the Dolan family and two employees brought suit to enforce the operating covenant and enjoin future terminations. Altice moved to dismiss.

The acquiror's covenant to operate the company in accordance with the business plan was set forth in Section 6.4(f) of the merger agreement. Section 9.8 of the merger agreement included a general disclaimer of third-party beneficiaries. Section 9.1 of the merger agreement provided that except for specified provisions (which did not include Section 6.4(f)), the representations, warranties, covenants and agreements did not survive closing. Section 6.8(e) of the merger agreement provided that nothing in the agreement would prevent the acquiror or any of its affiliates from terminating any employees after closing, or would create any third-party beneficiary rights in any employee.

Analysis

In considering whether the Dolan family and the two employees had standing to enforce the contract as third-party beneficiaries, the court set forth the same test as in the Alon USA Energy case, described above, i.e.:

> (i) the contracting parties must have intended that the third-party beneficiary benefit from the contract, (ii) the benefit must have been intended as a gift or in satisfaction of a pre-existing obligation to that person, and (iii) the intent to benefit the third party must be a material part of the parties' purpose in entering into the contract.

The court found that the Dolan family had adequately pled the first two elements, given that the Dolan family alleged that they would not have voted for a merger that included the News12 division in the transaction without the operating covenant, and the operating covenant was intended to meet the pre-existing commitment the acquirors made to the Dolan family regarding the operation of News 12. The court found, on the other hand, that the second element was not satisfied with respect to the two employees, noting that Section 6.8(e) of the merger agreement evidenced the lack of any pre-existing obligation towards the two employees. The court found that it was reasonably conceivable that the intent to benefit the Dolan family under the covenant was a material part of the parties' purpose in entering into the merger agreement, in satisfaction of the third element.

The court held that the language in the contract disclaiming third-party beneficiaries could not be harmonized with the language requiring Altice to operate the News12 division, rendering the contract ambiguous on this point. Moreover, the court stated that for plaintiffs' claims to survive the motion to dismiss, it must be reasonably conceivable that the non-survival language in Section 9.1 did not apply to Section 6.4(f). The Dolan family reasoned that it would not make sense to include the heavily negotiated language in section 6.4(f) if it was intended to survive closing. The defendants, on the other hand, portrayed Section 6.4(f) as merely a non-binding "goodwill gesture." The court found the language ambiguous. Given the ambiguity in the third-party beneficiary and non-survival language, the court denied the defendants' motion to

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dismiss the applicable claims of the Dolan family, and held that it was appropriate to receive parol evidence in an effort to discern the parties' intent

Takeaways

Merger agreements often contain post-closing covenants of the acquiror, and, as was the case in *Altice*, disclaim third-party beneficiary rights. As alluded to by the Altice defendants, the provisions are often thought of as "goodwill gestures" as opposed to binding obligations. They set forth what the parties contemplate, but have more moral, than legal, force and give the selling stockholders or management something to point to in order to show that they acted appropriately in the sale process. *Altice* is a warning to acquirors that these provisions may be more enforceable than previously assumed.

The *Altice* decision, and the *Alon USA Energy* decision summarized above, also have broader implications for merger agreements. Merger agreements expressly provide for the consideration that stockholders are entitled to receive if the deal closes. Whether or not stockholders are expressly made third-party beneficiaries to deal consideration provisions, it is generally assumed that stockholder may be able to sue to enforce such provisions after closing. A separate question presents itself when a deal does not close: What rights do the stockholders have to bring a claim against an acquiror for lost merger premium, as expectancy damages, as a result of the acquiror having breached the merger agreement and refused to close? Alternatively, what right does the target company have to bring an action against the acquiror for damages equal to the aggregate lost merger premium? In the Second Circuit, this issue was addressed in the 2005 *Consolidated Edison, Inc. v. Northeast Utilities* decision.[4] There, reversing a District Court decision, the Second Circuit held that stockholders were not third-party beneficiaries under the merger agreement and thus not entitled to bring a claim for lost merger premium against an acquiror that refused to close. Although there is no similar decision under Delaware law,[5] the *Alon USA Energy* and *Altice* decisions may prove useful fodder for target stockholders in arguing for Delaware courts to reach the opposite conclusion. Perhaps more importantly, they provide a reminder to deal parties of the possibility that stockholders may have third-party beneficiary rights, and thus of the advisability of addressing such rights with specificity in merger agreements.

Manti Holdings, LLC v. Authentix Acquisition Co., Inc., No. CV 2017-0887-SG (Del. Ch. Aug. 14, 2019)

Clear and unambiguous contractual waivers of appraisal rights may bind stockholders of Delaware corporations where the stockholders are sophisticated and fully informed when signing the waiver.

Manti Holdings involved a motion for rehearing focused on the issue of whether holders of common stock can give contractual waivers of appraisal rights. The petitioners were rollover stockholders in a 2009 acquisition of Authentix, Inc. In connection with the acquisition, they signed a Stockholders Agreement that contained a waiver of appraisal rights. The petitioners sought statutory appraisal in connection with a 2017 transaction. In a 2018 decision, the Court of Chancery

[4] 426F.3d 524 (2nd Cir. 2005)

[5] In *Tooley v. Donaldson Lufkin, & Jenrette, Inc*., 845 A.2d 1031 (2004), the Delaware Supreme Court held that plaintiff stockholders, who brought a claim for damages caused by a 22-day delay in completing a tender offer and associated merger, had "no separate contractual right to the alleged lost time-value of money arising out of extensions in closing of a tender offer. These extensions were made in connection with a merger where the plaintiffs' right to any payment of the merger consideration had not ripened at the time the extensions were granted." While this could be interpreted as Delaware law being consistent with the holding in *Consolidated Edison*, a subsequent Chancery Court decision characterized *Tooley* as a decision more about ripeness to bring a claim than standing as a third-party beneficiary. (*See Amirsaleh*, where court characterized the appropriate analysis as being about the intent of the parties as opposed to a blanket rule, and concluded that a stockholder did have standing to bring a claim under the merger agreement in that case.)

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held that the appraisal waiver applied to the 2017 transaction, and that Authentix could enforce the waiver. The petitioners moved for reargument on the underlying legal issue as to whether appraisal rights could be so waived via contract.

The court noted that *Appraisal of Ford Holdings, Inc. Preferred Stock* held that modification of a statutory appraisal right is permissible where it is "express or at least very clearly implied."[6] While that decision involved appraisal rights of holders of preferred stock, the court in *Manti Holdings* held that the reasoning was also applicable to common stock. Accordingly, waiver of appraisal rights is "permitted under Delaware law, as long as the relevant contractual provisions are clear and unambiguous."

Manti Holdings noted that the petitioners were sophisticated investors who were fully informed and represented by counsel when they signed the Stockholders Agreement, and that the Stockholders Agreement clearly and unambiguously waived appraisal rights. In holding that the appraisal waiver should be enforced, the court noted that it was not addressing whether an appraisal waiver would be upheld where these elements were not present.

Takeaways

Practitioners should ensure that contractual appraisal waivers are clearly and unambiguously drafted, and that waiving parties are informed at the time of giving the waiver. Waivers are more likely to be enforceable where the waiving parties are sophisticated. These elements, particularly regarding sophistication, may not always be satisfied, such as where employees exercising options are required to sign up to stockholders agreements that contain appraisal waivers. It is unlikely that employers will go to a lot of trouble and expense to ensure that all of the elements are satisfied, given that enforceability of appraisal waivers will have no consequences until a sale transaction, and even then it is not the sort of issue that will be a deal-breaker. Accordingly, acquirors that want to rely on such waivers in an acquisition should consider the circumstances under which they were given by the target's stockholders, and the identity of those stockholders, in order to evaluate their enforceability.

In Re Altor Bioscience Corp., No. CV 2017-0466-JRS (Del. Ch. May 15, 2019)

To be enforceable, contractual waivers of appraisal claims must be clearly and affirmatively set forth in the applicable agreement; a general covenant not to sue is insufficient.

The Facts

Altor BioScience Corporation and NantCell, Incorporated entered into a definitive agreement and plan of merger in May of 2017, pursuant to which NantCell agreed to acquire Altor. After Altor disclosed the plan to its stockholders, Altor stockholders (and former Altor directors) Clayland Boyden Gray and Adam Waldman notified Altor of their intent to sue, alleging defects in the disclosure and problems with the transaction.

To facilitate the merger in the midst of this dispute, Altor notified its stockholders that the company was planning on sending a supplemental information statement. Plaintiffs and Altor also signed a series of standstill letters that, among other terms, contained a release of all claims by Plaintiffs (Section 3) and a covenant not to sue on their behalf for a period of five years after closing of the merger (Section 7): "[Plaintiffs shall not] directly or indirectly commence, prosecute or cause to be commenced or prosecuted against any Company Releasee any action or other proceeding of any nature before any court, tribunal, Governmental Authority or other body, except for the Company's breach of this letter agreement."

[6] 698 A.2d 973 (Del. Ch. 1997).

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Plaintiffs ultimately sued, alleging (1) breaches of fiduciary duty against Altor's board of directors and against Patrick Soon-Shiong, who was Chair of Altor's board; indirect holder of 51.4% of Altor's stock; and the CEO, chair, and 85% stockholder of NantCell, and (2) aiding and abetting against NantCell. Plaintiffs also asserted claims for appraisal and quasi-appraisal. Defendants Altor and NantCell asserted that the standstill letter agreements operated to bar Plaintiffs' claims.

The Court's Decision

After holding that Section 3 did not purport to release future claims, and thus did not bar plaintiffs' action, the court considered the effect of Section 7 of the standstill agreement. The court held that, under Section 7, Plaintiffs were barred by their covenant not to sue from pursuing their breach of fiduciary duty and aiding and abetting claims. The court then held, however, that Plaintiffs' appraisal claims could proceed.

The court noted that it was settled law in Delaware that "there can be no waiver of a statutory right unless that waiver is clearly and affirmatively expressed in the relevant agreement." The court noted that since appraisal rights are statutory rights, a waiver of them must be clearly set forth in the applicable document. The court held that Section 7 of the letter agreements did not contain any clear and affirmative waiver.

The court noted that exercise of appraisal rights did not conflict with the letters' purpose in preventing Plaintiffs from scrutinizing the Board's actions with the looming threat of litigation. A company with a board acting in full compliance with its fiduciary duties when approving a merger could still face an appraisal action, because the sole focus of an appraisal action is the determination of the value of the appraisal petitioner's shares on the date of the merger. The standstill letter, intended to broker a "peace in the valley," thus did not seek to prevent an appraisal action.

Takeaways

Parties seeking waiver of appraisal claims should ensure that they are clearly and expressly set forth in the relevant agreement. A covenant not to sue, without more, will not waive appraisal claims.

Mehta v. Mobile Posse, Inc., No. CV 2018-0355-KSJM (Del. Ch. May 8, 2019)

Even where holders of common stock will not receive any proceeds in a merger, such holders should still be provided with timely statutory appraisal notices, and information provided to such stockholders still needs to be materially complete and accurate

The Facts

Mehta involved the denial of a motion to dismiss various claims brought by a holder of common stock of Mobile Posse, Inc., in connection with a merger in which all of the proceeds went to the holders of preferred stock, given the liquidation waterfall provisions under the company's charter. The company failed to deliver to the holders of common stock the notices and information the company was required to provide under Delaware law. While the merger was approved by the holders of preferred stock on April 2, 2018, no consent to the merger was sought from, or information statement provided to, the holders of common stock. Plaintiff only learned about the merger because plaintiff received solicitation materials from the company seeking consent pursuant to Section 280G of the Internal Revenue Code. The solicitation materials did not describe the merger.

On April 19, 2018, Plaintiff received a notice (Initial Notice), pursuant to Section 228(e) of the Delaware General Corporation Law (DGCL), that stockholder consent to the merger had been obtained. The notice attached the merger agreement, but not a payment schedule to the merger agreement on which the merger consideration was to be set forth.

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The notice referenced the right of stockholders to seek appraisal under DGCL §262, but did not describe the appraisal process or include a copy of the appraisal statute.

Plaintiff commenced litigation on May 18, 2018, alleging multiple failures to comply with the DGCL. The company circulated a supplemental notice on June 19, 2018 in an attempt to address the deficiencies, and on July 11, 2018, moved for judgment on the pleadings.

Vice Chancellor McCormick described plaintiff's complaint as "read[ing] like a law school exam designed to test a student's knowledge" of basic legal requirements under Delaware law, and found that plaintiff pled numerous violations of the DGCL sufficient to withstand a motion to dismiss.

Plaintiff Adequately Alleged that the Initial Notice Violated DGCL §262.

The court noted that DGCL §262(d)(2) requires that an appraisal notice, and a copy of DGCL §262, be sent to stockholders within 10 days after the merger. The court rejected the defendants' "replicated remedy" theory, finding the defendants failed to cite any authority to support their argument that the appraisal clock was reset when the supplemental notice was circulated. The court held that even if such a theory were valid, it could not be successfully invoked here because the supplemental notice inaccurately described the timing provisions and the appraisal process under DGCL §262.

Plaintiff Adequately Alleged that the 280G Solicitation Violated DGCL §228

The court declined to dismiss plaintiffs' claims that the 280G solicitation violated DGCL §228 by failing to disclose material facts to the stockholders. The court noted that the solicitation materials failed to provide any information relating to the merger, and this was the type of information that was important for stockholders.

Plaintiff Adequately Alleged that the Initial Notice Not Entitled to Protections Under DGCL §144

DGCL §144(a)(2) provides a safe harbor against officer and director interested party transactions being voided where the "material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders[.]" Plaintiff claimed that the Initial Notice failed to disclose "material facts in connection with the Board of Directors' relationships and interests in connection with the Merger, Merger Agreement and allocation of the . . . merger consideration." The court declined to dismiss plaintiffs' claims that the requirements of DGCL §144(a)(2) were not satisfied because of the deficiencies in the Initial Notice. The court held that "it is reasonable to conclude - given the complete dearth of information provided concerning the [m]erger and the alleged conflicts among the board members - that disinterested stockholder voting on the [m]erger lacked the material facts required to invoke the protections of Section 144."

Plaintiff Adequately Alleged that Section 228(e) Notice Not Promptly Given

The court also addressed plaintiff's claim that the DGCL §228(e) notice was not promptly given. The court noted that in a transaction like this where DGCL §262 applies, "the deadline in Section 262 should supply the outer bound of what constitutes "prompt" notice under Section 228." DGCL §228(e) notice was provided 17 days after the stockholder consent to the merger was obtained, and more than 10 days after the merger was completed. The court held that this made it reasonably conceivable that plaintiff would be able to show that the notice did not satisfy the "prompt" requirement under DGCL §228(e).

Plaintiff Adequately Alleged that the Merger Agreement Failed to Satisfy DGCL §251.

The court noted that DGCL §251(b) required the merger agreement to set forth the terms and conditions of the merger, and the manner of converting the shares of the constituent corporations in the merger. The merger agreement provided that the common stock would be cancelled for no consideration, and set forth the terms on which the preferred stock

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would be converted by reference to a payment schedule. The court noted that given that the payment schedule was not provided to the holders of common stock, it was reasonably conceivable that it had not been prepared when the merger agreement was executed, which meant the merger agreement lacked terms required under DGCL §251. Moreover, while the merger agreement provided that the holders of preferred stock would receive consideration consistent with the waterfall provisions in the company's charter, the charter was amended prior to closing to provide that the proceeds to the preferred would be "as set forth in the Merger Agreement". This created a circularity that meant that the merger agreement did not satisfy the requirements of DGCL §251.

The court also declined to dismiss plaintiff's claims relating to a breach of the fiduciary duty of disclosure, on the basis of plaintiff's pleading that the Section 262 notice was deficient, and plaintiff's claims under the entire fairness standard of review that each of the defendant directors was interested in the merger.

Takeaways

Deal practitioners should not assume that holders of common stock do not need timely and materially complete and accurate notice of mergers, whether pursuant to DGCL §228, DGCL §262 or otherwise, merely because they are not entitled to any proceeds in a merger. Practitioners should also be cognizant of the technical requirement of DGCL §251 when drafting merger agreements.

Practitioners should also not take a "no harm no foul" approach to the rights of holders of common stock where the common stock is underwater. While it may ultimately be found that the common stock has no value and that holders of common stock are therefore not entitled to any monetary damages for merger process failures, that finding is unlikely to be made at the motion to dismiss stage, and thus defendants may have to incur the burdens and expense of a trial in order to reach such a finding.

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