Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions

*By the Annual Survey Working Group of the M&A Jurisprudence Subcommittee, Mergers and Acquisitions Committee, ABA Section of Business Law**

The primary charge of the Annual Survey Working Group is to monitor and summarize annually judicial decisions that we believe are of the greatest significance to M&A practitioners.[1]

The decisions selected for this year's Annual Survey are

Effect of Non-Use and Non-Disclosure Provisions in Confidentiality Agreements

1. *Martin Marietta Materials, Inc. v. Vulcan Materials Co.* (enjoining unsolicited public offer for violating non-use and non-disclosure provisions in an NDA)
2. *Goodrich Capital, LLC v. Vector Capital Corp.* (declining to dismiss claim for breach of non-use provision where defendant allegedly used information provided by plaintiff to evaluate a target in the same industry)

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1. To be included in the Survey, cases must meet two criteria:

    1. The decision must address a transaction involving a change of control, including by means of a merger, sale of equity interest, or recapitalization, or a sale of all or substantially all of a company's assets or of a subsidiary or division.
    2. The court must (i) interpret or apply the provisions of an acquisition agreement or an agreement preceding an acquisition agreement (e.g., letter of intent, confidentiality agreement, or standstill agreement); (ii) interpret or apply a state statute that governs one of the constituent entities; (iii) rule on a successor liability issue; or (iv) decide a breach of fiduciary duty claim (although the survey may not include all fiduciary duty cases if they appear to have received sufficient publicity in other publications during the year). Excluded are cases dealing exclusively with federal law, securities law, tax law, or antitrust law.

Successor Liability—De Facto Merger Doctrine

3. *Flavors & Fragrances, Inc. v. St. Paul Protective Insurance Co.* (continuity of ownership requirement)
4. *Fizzano Bros. Concrete Products, Inc. v. XLN, Inc.* (continuity of ownership requirement)

Reliance Clauses

5. *RAA Management, LLC v. Savage Sports Holdings, Inc.* (preclusion of liability for fraud by non-reliance provision)
6. *Barr v. Dyke* (upholding non-reliance clause against claims of fraud and unjust enrichment)

Assignments of Agreements

7. *DBA Distribution Services, Inc. v. All Source Freight Solutions, Inc.* (reverse triangular merger violates prohibition on assignment by operation of law)
8. *Coughlan v. NXP B.V.* (two-step asset transfer treated under the step transaction doctrine as single transaction violating assignment prohibition)

Agreements to Negotiate

9. *EQT Infrastructure Ltd. v. Smith* (finding a "plausible" agreement to negotiate in good faith without additional conditions)
10. *PharmAthene, Inc. v. SIGA Technologies, Inc.* (enforcement of agreement to negotiate and imposition of equitable license)

Controlling Shareholders

11. *In re Synthes, Inc. Shareholder Litigation* (equal consideration for all shareholders as safe harbor to get to business judgment rule in sale of controlled company)
12. *Frank v. Elgamel* (merger of controlled corporation with unaffiliated company subject to entire fairness review when controllers roll over)
13. *Americas Mining Corp. v. Theriault* (special committee process not effective and over $2 billion awarded for controlling stockholder's breach of fiduciary duty)

Exclusivity Agreements

14. *Vector Capital Corp. v. Ness Technologies, Inc.* (dismissing claim of breach of exclusivity agreement)

Fiduciary Duties in the LLC Context

15. *Auriga Capital Corp. v. Gatz Properties, LLC* (LLC manager held liable for orchestrating sale to himself)

Board of Directors' Bad Faith

16. *In re Answers Corp. Shareholders Litigation* (target directors' potential bad faith and buyer's potential aiding and abetting)

Use of Written Consents to Approve Agreements

17. *In re OPENLANE, Inc. Shareholders Litigation* (declining to enjoin merger notwithstanding quick stockholder approval by written consent)

Effect of Non-Use and Non-Disclosure Provisions in Confidentiality Agreements

1. *Martin Marietta Materials, Inc. v. Vulcan Materials Co.* (Enjoining Unsolicited Public Offer for Violating Non-Use and Non-Disclosure Provisions in an NDA)

The Delaware Court of Chancery enjoined for four months an unsolicited public exchange offer by Martin Marietta for all of Vulcan's shares after finding that Martin Marietta had used confidential information provided by Vulcan under confidentiality agreements.

Background

In 2010, Martin Marietta and Vulcan began discussing a merger.[2] They signed two confidentiality agreements, each governed by Delaware law:

- A general non-disclosure agreement (the "NDA"), requiring each party to use the other's confidential information (defined in more detail as "Evaluation Material") "solely for the purpose of evaluating a Transaction," with "Transaction" defined as "a possible business combination transaction . . . between" the two companies,[3] and prohibiting disclosure of the other party's Evaluation Material and of the parties' negotiations except as provided in the NDA. The NDA had a term of two years.[4]
- A joint defense and confidentiality agreement, intended to facilitate antitrust review (the "JDA" and, together with the NDA, the "Confidentiality Agreements"), requiring each party to use the other's confidential information (defined in more detail as "Confidential Materials") "solely for the purposes of pursuing and completing the Transaction," with "Transaction" defined as "a potential transaction being discussed by" the parties, and restricting disclosure of Confidential Materials.[5]

Neither agreement contained an express standstill provision.

2. Martin Marietta Materials, Inc. v. Vulcan Materials Co., No. 7102-CS, 2012 Del. Ch. LEXIS 93, at *7 (May 4, 2012) [hereinafter *Martin Marietta I*].
3. *Id.* at *24.
4. *Id.* at *23.
5. *Id.* at *24.

When the merger discussions fell through, Martin Marietta commenced an exchange offer for all outstanding Vulcan shares. Martin Marietta made various filings with the SEC and other public disclosures, which included the fact that Martin Marietta and Vulcan had discussed the possibility of a merger as well as details from Vulcan's confidential information.[6] Martin Marietta went to court seeking a declaratory judgment that its actions did not violate the Confidentiality Agreements, and Vulcan counterclaimed for the opposite.

Use of Confidential Information in Connection with the Hostile Bid Violated the Confidentiality Agreements

The court found that, despite some efforts by Martin Marietta, Martin Marietta had used information it had obtained under the Confidentiality Agreements in connection with its hostile offer.[7]

The court examined whether such use violated both Confidentiality Agreements. The court found that the meaning of "business combination transaction," as used in the NDA's definition of Transaction, could range from narrow (as used in Delaware's anti-takeover statute) to broad (as under the SEC's regulatory rules).[8] The court reviewed the NDA text as well as similar provisions in treatises and model agreements (including the ABA M&A Committee's Model Confidentiality Agreement and a working draft of the ABA M&A Committee's M&A Dictionary) and determined that there was no clear interpretation of "business combination transaction" based on the plain language of the NDA.[9]

The court then considered whether the word "between" limited the phrase "business combination transaction."[10] The court noted, among other things, that the Ontario Superior Court of Justice, in its 2009 *Certicom* decision, had determined that a confidentiality agreement's requirement to use information only in connection with a transaction "between" the parties to the agreement acted to restrict use of that information to only a transaction to which the target had consented.[11] The court also noted, though, that the *Certicom* confidentiality agreement contained additional language not found in the Confidentiality Agreements[12] and further noted that the parties could have used the word "negotiated" rather than "between" if they intended that meaning, as was discussed in treatises and model agreements even after the *Certicom* decision.[13] The court thus found the NDA provision to be ambiguous.[14]

6. *Id.* at *74–76.
7. *Id.* at *64–69.
8. *Id.* at *95–98.
9. *Id.* at *109 n.156, *117.
10. *Id.* at *118.
11. *Id.* at *119–20.
12. *Id.* at *120 (noting that the agreement in *Certicom* stated that its "[p]urpose" was to assess "a business or contractual relationship between the Parties which may include . . . some form of business combination between the Parties").
13. *Id.* at *128–29.
14. *Id.* at *118–19.

The court next looked to extrinsic evidence. The court reviewed the drafting history of the NDA, and noted, among other things, that Martin Marietta took measures to strengthen the NDA's protections of confidential information.[15] In addition, the court found that Martin Marietta's conduct indicated that it believed the use of Evaluation Material in connection with an unsolicited bid might violate the Confidentiality Agreements: for example, its legal and financial advisors "expressed concern" about using confidential information in the process of forming the hostile bid.[16] The court also noted the "gloss" provided by the definition of Transaction in the JDA, including the references in the JDA to "the" Transaction rather than to "a" Transaction.[17] The court thus found that a "business combination transaction between" the parties was meant to refer only to a negotiated transaction "agreed upon . . . by the sitting boards of both companies."[18]

The court did not find any ambiguity in the JDA's definition of "the Transaction," noting that Martin Marietta's unsolicited bid "was not 'the' transaction that was 'being discussed'" when the parties negotiated the JDA.[19]

Therefore, the court found that Martin Marietta's use of Vulcan's confidential information in connection with its unsolicited bid breached both Confidentiality Agreements.[20]

The Delaware Supreme Court confirmed this analysis with respect to the JDA.[21] The Supreme Court did not address the chancery court's conclusions as to Martin Marietta's violation of the NDA's use restrictions.[22]

Disclosure of Confidential Information and Transaction Information Violated the Confidentiality Agreements

According to Vulcan, the NDA allowed the parties to disclose information when "legally required" to do so, where "required" was defined in paragraph four ("Required Disclosure") to mean only when in response to an external demand.[23] The preceding paragraph that provided for the non-disclosure of that information (paragraph three, "Non-Disclosure of Discussions; Communications") referred to paragraph four but did not itself define "legally required."[24] While the court found reasonable Vulcan's argument that both paragraphs should be read together to harmonize the agreement,[25] it also considered

15. *Id.* at *132–33.
16. *Id.* at *135.
17. *Id.* at *139–40.
18. *Id.* at *141.
19. *Id.* at *143.
20. *Id.* at *141.
21. Martin Marietta Materials, Inc. v. Vulcan Materials Co., No. 254, 2012, 2012 Del. LEXIS 342, at *32–34 (July 10, 2012) [*Martin Marietta II*].
22. *Id.* at *21 n.42.
23. *Martin Marietta I*, 2012 Del. Ch. LEXIS 93, at *148–51.
24. *Id.*
25. *Id.* at *151–57.

plausible Martin Marietta's position that "legally required" had a broader meaning, including all legal requirements regardless of their source, with paragraph four's "external demand" requirements only applicable to the conditions therein.[26]

The court thus again turned to extrinsic evidence and found that Vulcan's interpretation was correct.[27] Among other things, the drafting history showed that Martin Marietta added to paragraph three the language "[s]ubject to paragraph (4)" to link the two paragraphs where they were not previously expressly connected.[28] The court also reviewed treatises and model agreements, including the ABA M&A Committee's Model Confidentiality Agreement.[29]

The court also found that, even if otherwise "legally required," Martin Marietta violated the NDA by not complying with the requirement to notify Vulcan prior to disclosing the information. Similarly, failure to obtain Vulcan's advance consent also violated the JDA.[30]

The court also noted that, given its findings, it did not need to address the question of whether Martin Marietta, by agreeing not to disclose confidential information, had effectively also agreed not to "embark on [a] discretionary course of action if it knew that the course of action would trip a legal obligation to make public disclosure," as advanced by Vulcan.[31]

Without reaching the issue of interpreting an ambiguous contract, the Delaware Supreme Court affirmed the Chancery Court's holding on this point by finding that the NDA did not allow disclosure of Evaluation Material unless triggered by an external demand and that the JDA required advance consent in all events.[32]

Conclusion

Buyers and sellers should note the drafting pitfalls that created ambiguity in the Confidentiality Agreements. In deciding how, and whether, to resolve such ambiguities, a party should consider the other party's likely reaction and the potential impact of negotiating history on later interpretation of the contract.

While a confidentiality agreement may expressly restrict only use and disclosure of confidential information, it also can act as a "backdoor standstill" against other actions. However, a party that wants to prohibit unsolicited bids and related steps also should consider negotiating an express standstill, especially to cover related steps.

26. *Id.* at *157–59.
27. *Id.* at *163.
28. *Id.* at *165.
29. *Id.* at *180 n.232.
30. *Id.* at *195.
31. *Id.* at *186 n.241.
32. *Martin Marietta II*, 2012 LEXIS 342, at *29, *46–47.

2. *Goodrich Capital, LLC v. Vector Capital Corp.* (Declining to Dismiss Claim for Breach of Non-Use Provision for Allegedly Using Information Provided by Plaintiff to Evaluate a Target in the Same Industry)

In *Goodrich Capital, LLC v. Vector Capital Corp.*,[33] the U.S. District Court for the Southern District of New York declined to dismiss the plaintiffs' claim that the defendant had breached non-use and non-circumvention provisions of a non-disclosure agreement (the "NDA") by using the plaintiffs' confidential information for a purpose other than that stated in the NDA and by depriving the plaintiffs of the fees they would have otherwise earned.

Background

Goodrich Capital, LLC ("Goodrich") and Windsor Sheffield & Co., Inc. ("Windsor") alleged that Vector Capital Corp. ("Vector") used confidential information and advice of Goodrich to acquire Tidel, a smart safe manufacturer.[34] The three parties had previously been engaged to help Treasurer—a cash management business—attempt to acquire another smart safe manufacturer.[35] As part of this engagement, Goodrich, Treasurer, and Vector entered into the NDA, which provided that: "Recipient shall not use any portion of the Confidential Information of Discloser except to the extent reasonably necessary to explore the Contemplated Business Arrangement."[36] The NDA also contained a non-circumvention provision stating that neither party would "seek, in violation of any agreement between the parties entered into after the date hereof with respect to the Contemplated Business Arrangement, to circumvent, avoid, bypass or obviate the other party . . . to avoid payment of fees or other compensation."[37] The court applied New York law in its consideration of both claims.[38]

After failing to acquire Treasurer, Goodrich and Treasurer turned their focus to Tidel.[39] Vector also began preparing to acquire Tidel without the other parties, and it eventually succeeded.[40] Goodrich and Windsor sued Vector, claiming, *inter alia*, that Vector had breached the non-use and non-circumvention provisions of the NDA by basing its proposal to Tidel on proprietary strategies and analysis contained in a presentation deck provided to Vector by Goodrich,[41] and by consummating a transaction for which it relied on Goodrich's insights and strategies without paying any compensation to Goodrich.[42]

33. No. 11 Civ. 9247 (JSC), 2012 U.S. Dist. LEXIS 92242 (S.D.N.Y. June 25, 2012).
34. *Id.* at *7.
35. *Id.* at *2–4.
36. *Id.* at *2. The term "Contemplated Business Arrangement" was defined as a business arrangement or relationship with regard to a new business opportunity related to cash handling services. *Id.* at *2–3.
37. *Id.* at *3.
38. *Id.* at *11.
39. *Id.* at *3–4.
40. *Id.* at *4.
41. *Id.* at *7.
42. *Id.* at *10–11.

Analysis

Goodrich alleged that Vector used the confidential presentation deck from Goodrich and Windsor for a purpose other than pursuing a business arrangement involving Goodrich and Treasurer.[43] By so doing, Goodrich claimed, Vector damaged Goodrich and Windsor by depriving them of the fee they otherwise would have earned for their provision of strategic advice.[44] The court accepted these allegations as sufficiently pleading a claim for breach of contract.[45]

Vector argued that the NDA did not cover the transaction with Tidel that ultimately occurred because it only applied to transactions between Goodrich, Treasurer, and Vector.[46] The court found that the language of the NDA prohibiting use of the information for any purpose other than the contemplated business arrangement was enough to cover the Tidel transaction.[47] Although Vector argued that such a broad reading amounted to a prohibition not to enter the cash management industry, the court found this unpersuasive, interpreting the NDA instead as providing a "definite obligation" not to use the information for purposes other than the specific purposes outlined in the NDA.[48]

Goodrich further alleged that Vector had breached the non-circumvention provision of the NDA.[49] After initially failing to acquire Tidel, Vector expressed interest in another deal structure involving Goodrich and Treasurer, and it prepared a presentation deck providing for $3.5 million in fees to Goodrich, which were never paid.[50] The court accepted these allegations as plausibly suggesting that Vector had restructured its transaction to avoid payment of such fees to Goodrich.[51]

Vector argued that the plaintiffs had not pointed to any applicable "agreement between the parties entered into after" the NDA.[52] The court quickly dismissed this argument, however, citing the implied covenant of good faith and fair dealing under New York law.[53] By allegedly promising payment to Goodrich in the presentation deck for its deal with Tidel, making use of Goodrich's expertise and then not making good on its promise, Vector had breached its duty to deal with Goodrich in good faith.[54]

Conclusion

Although a non-use provision in a non-disclosure agreement may be broad, unless it is so indefinite as to make it unclear whether there has been a breach,

43. *Id.* at *7–8.
44. *Id.* at *8.
45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.* at *9.
49. *Id.* at *11.
50. *Id.*
51. *Id.*
52. *Id.* at *11.
53. *Id.* at *12.
54. *Id.*

the provision will support a breach of contract claim and not be disregarded as too indefinite to enforce.

Successor Liability—De Facto Merger Doctrine

3. *International Flavors & Fragrances, Inc. v. St. Paul Protective Insurance Co.* (Continuity of Ownership Requirement)

In *International Flavors & Fragrances, Inc. v. St. Paul Protective Insurance Co.*,[55] the Appellate Division of the New York Supreme Court held that, under Illinois law, strict continuity of shareholder interest, in the form of receipt by the seller's shareholders of the buyer's stock, must exist for successor liability to be imposed under the de facto merger doctrine.[56]

Background

International Flavors and Fragrances, Inc. ("International Flavors") is the parent company of Bush Boake Allen, Inc. ("BBA").[57] In 1990, BBA purchased all of the stock of Food Materials Corporation ("FMC").[58] One year later, BBA dissolved FMC and used its assets to continue operations until it closed the FMC facilities in 2002.[59]

In 2004 and 2006, BBA was named defendant in an action alleging personal injury resulting from exposure to butter flavoring products that had been supplied by FMC.[60] International Flavors demanded insurance coverage from the insurers that had covered FMC at the time of the exposure, claiming that, under the de facto merger doctrine, BBA bore successor liability for such claims and was thus entitled to insurance coverage from the defendant insurers.[61] The trial court denied the defendant insurance companies' motions for summary judgment dismissing the claim.[62]

Analysis

The Appellate Division found that the trial court erred because the trial court did not apply Illinois law, which has a limited and "rigorous" de facto merger exception to the general rule that there is no successor liability in a sale of assets

55. 950 N.Y.S.2d 521 (App. Div. 2012).
56. *Id.* at 523.
57. *Id.*
58. *Id.* at 522.
59. *Id.*
60. *Id.* at 522–23.
61. *Id.* at 522.
62. *Id.* The Appellate Division does not provide additional facts regarding FMC's dissolution or how its assets (including presumably FMC's insurance coverage) and liabilities were handled at that time. Accordingly, it is unclear why this situation must be analyzed under the de facto merger framework.

transaction.[63] The Appellate Division noted that Illinois courts apply the de facto merger exception only when all four of the following factors are met:

> (1) the seller ceased its ordinary business operations and disso[l]ved; (2) the buyer assumed the seller's liabilities and obligations necessary for uninterrupted continuation of business; (3) there is a continuity of shareholders; and (4) there is a continuity of the business enterprise, including management, employees, location, general business operations, and assets.[64]

In contrast, New York and other out-of-state laws relied on by the trial court provided more "flexible" approaches.[65]

The Appellate Division cited Illinois case law providing that the third factor in the de facto merger exception, continuity of shareholders, requires "the seller's shareholders [to] receive shares of the buyer's stock as payment for the seller's assets,"[66] and the court found that such facts were absent in this case.[67]

Conclusion

A company's exposure to successor liability can vary depending upon the law being applied. Under Illinois law, this court narrowly interpreted the continuity of shareholders factor as requiring the shareholders of the seller of an asset to receive shares of the buyer's stock.

4. *Fizzano Bros. Concrete Products, Inc. v. XLN, Inc.* (De Facto Merger Doctrine—Continuity of Ownership Requirement)

In *Fizzano Bros. Concrete Products v. XLN, Inc.*,[68] the Pennsylvania Supreme Court held that, in cases arising out of breach of contract and express warranty actions, "some sort" of proof of continuity of ownership or shareholder interest is required in order for the de facto merger doctrine to apply under Pennsylvania law.[69]

Background

Fizzano Brothers Concrete Products, Inc. ("Fizzano Brothers") purchased a license to use software from System Development Group, Inc. ("SDG").[70] Subsequently, XLN, Inc. bought SDG from its shareholders, primarily through issuance of promissory notes.[71] The notes were secured by the code for the software, which was placed in escrow, with ownership remaining with SDG's former

63. *Id.* at 523.
64. *Id.*
65. *Id.*
66. *Id.*
67. *Id.*
68. 42 A.3d 951 (Pa. 2012).
69. *Id.* at 969.
70. *Id.* at 953.
71. *Id.* at 955.

shareholders until the promissory notes were paid in full.[72] The two SDG shareholders who had developed the software received the bulk of the consideration and also entered into employment contracts with XLN.[73] No equity was issued to any of the SDG shareholders in connection with the acquisition.[74] The primary asset of value XLN acquired was the right to license the software.[75]

In August 2003, XLNT, Inc. purchased all of XLN's assets except for two work stations and servers and an undeveloped derivative of the software.[76] The asset purchase agreement was contingent on two agreements with SDG's former shareholders: (1) an agreement that SDG's former shareholders would transfer their ownership of the software to XLNT when the promissory notes from the transaction with XLN were satisfied; and (2) employment contracts between XLNT and the two former SDG shareholders who had developed the software.[77]

Fizzano Brothers brought breach of contract claims against XLN and, subsequently, XLNT based on a failed implementation of the software.[78] Fizzano Brothers obtained a judgment against XLN.[79] The trial court then found that XLNT was liable for this judgment under the de facto merger doctrine, but the appellate court reversed, holding that there was no de facto merger because there was no continuity of ownership between XLN and XLNT.[80]

Analysis

The Pennsylvania Supreme Court addressed whether the de facto merger doctrine requires proof of continuity of ownership.[81] It noted that it could render a broad holding, finding that in all cases arising out of contract or commercial law, strict continuity of ownership is required, but that in other cases where a public policy goal might be furthered by relaxation of the rule, such as in cases involving products liability or fraud, the continuity of ownership factor may be viewed more flexibly.[82]

The court noted two issues that would arise without a more tailored, narrow holding. First, the court observed that under Pennsylvania's Business Corporation Law, it is possible in a de jure merger for the target's stock to be converted not just into the buyer's equity but also into obligations, cash, property, or

72. *Id.*
73. *Id.* Each of these primary shareholders was entitled to 42.333 percent of the promissory notes. *Id.*
74. *Id.*
75. *Id.* Although not explicitly stated, this was presumably an exclusive right, because XLN had "control over the [s]oftware" and the "right to license the [s]oftware." *Id.* at 954, 955.
76. *Id.*
77. *Id.* at 955–56.
78. *Id.* at 954.
79. *Id.* at 953.
80. *Id.* at 958.
81. *Id.* at 953.
82. *Id.* at 966.

rights.[83] The court found that it would be inconsistent to require a de facto merger to meet stricter requirements than a de jure merger.[84] Second, a de facto merger is an equitable doctrine, and as such, is not well-suited to a mechanical rule.[85]

The court held that breach of contract and express warranty cases require "some sort of" proof of continuity of ownership or stockholder interest.[86] However, such proof is not limited to "mere evidence of an exchange of assets from one corporation for shares in a successor corporation."[87] The court found that "the elements of the de facto merger are not a mechanically[] applied check list, but a map to guide a reviewing court to a determination that, under the facts established, for all intents and purposes, a merger has or has not occurred between two or more corporations, although not accomplished under the statutory procedure."[88]

The court declined to rule on whether a de facto merger was present in this case.[89] The court did, however, find that the lower court erred in focusing too narrowly on the formalities of the asset sale agreement between XLN and XLNT instead of considering the broader "transactional reality."[90] The court specifically noted that XLNT had assumed XLN's debt obligations to the former SDG shareholders; that the former SDG shareholders continued to own the software, XLNT's principal asset of value, at all times relevant to the case; and that the two principal former SDG shareholders held "positions of importance" first with XLN and then with XLNT.[91]

Conclusion

Fizzano demonstrates that the de facto merger doctrine, as an equitable doctrine, is not necessarily a mechanical test. Even in cases arising out of contract or commercial law disputes, which have widely been subject to stricter application of the de facto merger elements, Pennsylvania courts must look at the entire transactional reality and not limit their focus to specific formalities. Nevertheless, in contract and commercial law cases, the continuity of ownership factor cannot be entirely absent: "some sort of" proof of continuity of ownership or stockholder interest is required.

83. *Id.* (citing 15 Pa. Cons. Stat. §§ 1921(a), 1922(a)(3)).
84. *Id.* at 968.
85. *Id.*
86. *Id.* at 969.
87. *Id.*
88. *Id.*
89. *Id.* at 970.
90. *Id.*
91. *Id.* at 969–70.

Reliance Clauses

5. *RAA Management, LLC v. Savage Sports Holdings, Inc.* (Preclusion of Liability for Fraud by Non-Reliance Provision)

In *RAA Management, LLC v. Savage Sports Holdings, Inc.*,[92] the Delaware Supreme Court determined that the non-reliance provision contained in a non-disclosure agreement (the "NDA") signed by the parties at the beginning of diligence review was "broad enough to preclude claims for fraud."[93] Although the court assumed that New York law applied to its review and interpretation of the NDA, the court determined that its ruling would be the same under Delaware law.[94]

Background

RAA Management, LLC ("RAA") entered into the NDA with Savage Sports Holdings, Inc. ("Savage") as part of a bidding process in which RAA was one of the potential bidders.[95] At the beginning of its diligence review, Savage represented to RAA that there were no "'significant unrecorded liabilities or claims against Savage.'"[96] During the course of RAA's diligence, however, RAA discovered three large liabilities that resulted in RAA terminating its negotiations for the acquisition of Savage.[97]

RAA brought suit against Savage to recover the $1.2 million it spent pursuing the acquisition, claiming that if RAA had known about the large liabilities at the outset it would not have pursued the transaction.[98] The Delaware Superior Court dismissed RAA's complaint because it found that the NDA contained an effective non-reliance provision, which "'unambiguous[ly]' bar[red] liability for fraudulent misrepresentations."[99]

Discussion

In affirming the dismissal, the Delaware Supreme Court focused on two key provisions in the NDA. First was the reliance disclaimer, which provided:

> You [RAA] understand and acknowledge that neither the Company [Savage] nor any Company Representative is making **any** representation or warranty, express or implied, as to the accuracy or completeness of the Evaluation Material or of **any** other information concerning the Company provided or prepared by or for the Company, and none of the Company nor the Company Representatives[] will have **any** liability to you or any other person resulting from your use of the Evaluation Material or any

92. 45 A.3d 107 (Del. 2012).
93. *Id.* at 119.
94. *Id.* at 112.
95. *Id.* at 109.
96. *Id.*
97. *Id.* at 111–12.
98. *Id.* at 109.
99. *Id.* at 112.

> such other information. **Only** those representations or warranties that are made to a purchaser in the Sale Agreement when, as and if it is executed, and subject to such limitations and restrictions as may be specified [in] such a Sale Agreement, shall have any legal effect.[100]

Second, the NDA included an agreement between the parties that, until a definitive sales agreement was entered into, there was no agreement between the parties regarding the sale.[101]

RAA argued that the non-reliance provision applied only to mistakes or inadvertent misrepresentations and not to intentional or willful misrepresentations.[102] The court disagreed, stating that the non-reliance provision did not explicitly differentiate as to the cause of the misrepresentation and accordingly served to disclaim any reliance RAA may have had on the information disclosed, even if the information contained an intentional and fraudulent misrepresentation.[103] The court affirmed the superior court's determination that the non-reliance provision was unambiguous.[104]

The court also rejected RAA's final two arguments, stating that New York law's "peculiar-knowledge" rule did not apply to the facts[105] and that public policy did not prevent the court from enforcing the non-reliance provision.[106]

With respect to the public policy exception, the court determined that RAA's fraud claims were based on information provided outside of the NDA as opposed to with respect to representations made within the NDA. Accordingly, consistent with prior New York and Delaware case law, the court determined that RAA could not "reasonably rely upon representations outside of the contract, where the contract . . . contains a provision explicitly disclaiming reliance upon such outside representations."[107]

6. *Barr v. Dyke* (Upholding Non-Reliance Clause Against Claims of Fraud)

In *Barr v. Dyke*,[108] the Supreme Judicial Court of Maine determined that a reliance disclaimer in a stock purchase agreement barred the plaintiffs' claim for rescission because it prevented plaintiffs from proving one of the essential elements of a fraud claim, namely that they relied upon the fraudulent information when entering into the agreement.[109] As partial support for its reasoning, the

100. *Id.* at 110.
101. *Id.* at 110–11.
102. *Id.* at 112.
103. *Id.* at 113.
104. *Id.* at 113–15.
105. According to the Delaware Supreme Court, under New York law, non-reliance provisions may not bar claims of fraudulent inducement in the context of sales contracts if the facts at issue were "'peculiarly within the misrepresenting party's knowledge.'" *Id.* at 115 (quoting Warner Theatre Assocs. Ltd. P'ship v. Metro Life Ins. Co., 149 F.3d 134, 136 (2d Cir. 1998)).
106. *Id.*
107. *Id.* at 117.
108. 49 A.3d 1280 (Me. 2012).
109. *Id.* at 1286.

court cited *RAA Management, LLC v. Savage Sports Holdings, Inc.* (discussed above).[110]

Background

Two minority shareholders of Bushmaster, Inc. brought suit against Bushmaster's directors alleging breach of fiduciary duties in 2002.[111] In 2004, the parties entered into a settlement whereby Bushmaster agreed to purchase the stock held by the plaintiffs in exchange for their release of all claims.[112] The sale was based on an approximate valuation of Bushmaster of $27.5 million.[113] The stock purchase agreement contained a representation that the plaintiffs did not rely on Bushmaster or any of its directors or other agents in determining the value of the shares being sold.[114] Two years later, Bushmaster was sold for $76 million.[115]

The plaintiffs sued the former Bushmaster directors, claiming breach of fiduciary duties caused by the fraudulent misrepresentations and omissions made by the directors in negotiating the settlement and seeking rescission of the stock purchase agreement.[116] The plaintiffs claimed that the defendants had concealed certain financial information, including a report that indicated Bushmaster's value to be approximately $35 million at the time of the sale.[117] The lower court granted the defendants' motion for summary judgment because it concluded that the non-reliance provision and the general release prevented the plaintiffs from recovering damages against the defendants or setting aside the stock purchase agreement.[118]

Analysis

The Supreme Judicial Court of Maine first reviewed plaintiffs' claim that the stock purchase agreement should be rescinded based on defendants' fraud. The court determined that the reliance disclaimer was "specific and unambiguous" and thus should be enforced under Maine law.[119]

The court then analyzed whether the agreement should be set aside based on fraud in the inducement. The court determined that plaintiffs could not meet the required element in a fraud claim of justifiable reliance on the fraudulent representation based on the reliance disclaimer in the agreement.[120]

110. *Id.* at 1288, 1289.
111. *Id.* at 1283.
112. *Id.*
113. *Id.* at 1285.
114. *Id.* at 1284.
115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.* at 1285.
119. *Id.* at 1286.
120. *Id.* at 1286–87.

The court then turned to the issue of whether judicial policy required the court to set aside the agreement. In its analysis, the court considered specifically whether the presence of a fiduciary relationship between the directors at the time of settlement imposed stricter standards on the parties, thus requiring the court to set aside the agreement.[121] However, in this instance, the court reasoned that at the time of the settlement the plaintiffs and the fiduciaries were adversaries and thus the plaintiffs likely no longer regarded the fiduciaries with the same amount of trust as they would have absent the dispute.[122] "Courts will therefore enforce disclaimer-of-reliance clauses even between fiduciaries when, as during litigation, fiduciaries are no long justified in relying on one another."[123]

Conclusion

In the eyes of the respective courts, both *RAA Management* and *Barr* provide contracting parties predictability and assurance that their negotiated agreements will be enforced to the extent they are unambiguous.[124] Accordingly, parties should expect that non-reliance language can bar claims of fraud or misrepresentation with respect to information provided outside of the four corners of the contract.

Assignments of Agreements

7. *DBA Distribution Services, Inc. v. All Source Freight Solutions, Inc.* (Reverse Triangular Merger Violates Prohibition on Assignment by Operation of Law)

In *DBA Distribution Services, Inc. v. All Source Freight Solutions, Inc.*,[125] the U.S. District Court for the District of New Jersey found a provision in an exclusive sales agreement ("ESA") that prohibited assignment or transfer by operation of law was breached by the acquisition of one of the parties through a reverse triangular merger.

Background

The ESA, between DBA Distribution Services, Inc. ("DBA") and All Source Freight Solutions, Inc. ("ASFS"), provided that ASFS would be DBA's exclusive agent for the sale and operation of freight. The ESA provided that it "shall not be assigned by either party without first obtaining the written consent of the other party and shall not be assignable or transferable by operation of law."[126]

121. *Id.* at 1287.
122. *Id.* at 1289.
123. *Id.*
124. *RAA Mgmt.*, 45 A.3d at 119; *Barr*, 49 A.3d at 1289.
125. No. 11-3901 (JAP), 2012 WL 845929 (D.N.J. Mar. 13, 2012).
126. *Id.* at *1–2.

Radiant Logistics, Inc. ("Radiant") acquired DBA's shares through a reverse triangular merger in which a newly formed subsidiary of Radiant merged into DBA.[127] DBA alleged that ASFS breached the ESA when it notified DBA of ASFS's intent to terminate the ESA so that it could perform freight services for another company.[128]

Analysis

The court noted that, under New Jersey law, upon a merger "[a]ll real and personal property, tangible and intangible, of every kind and description, belonging to each of the corporations so merged . . . , shall be vested in the surviving or new corporation."[129]

The court noted that several courts had criticized the notion that no assignment occurs upon a merger based on a theory of "corporate continuity,"[130] and it held that in this instance there was a transfer by operation of law.[131]

The court then noted that it was important to distinguish between generic no-assignment clauses and those that expressly prohibit assignment or transfer by operation of law.[132] The court noted a prior case in which it had decided that a merger did not violate a no-assignment clause where the no-assignment clause did not expressly prohibit assignments by operation of law.[133] The court concluded that, since the ESA provided that it was not assignable or transferable by operation of law, DBA could not plead the performance of DBA's contractual obligations, which was a necessary element of its breach of contract claim.[134]

Conclusion

DBA emphasizes the need to review applicable law with respect to the effect of a merger on contracts, even where the acquisition is structured as a reverse triangular merger, which is the structure usually thought to have the least impact on the target.

It also illustrates the significance of addressing explicitly assignments "by operation of law" even if assignments more generally already are addressed.

127. *Id.* at *2.
128. *Id.* at *2, *5.
129. *Id.* at *4 (quoting N.J. Stat. Ann. 14A:10-6(d)).
130. *Id.* (citing SQL Solutions, Inc. v. Oracle Corp., No. C-91-1079, 1991 U.S. Dist. LEXIS 210987, at *8–11 (N.D. Cal. Dec. 18, 1991) (finding a transfer of rights under a license agreement as a result of a merger violated a no-assignment clause)).
131. *Id.*
132. *Id.*
133. *Id.* (citing Prof'l Buyer's Guild, LLC v. ACE Fire Underwriters Ins. Co., No. 06-2127, 2007 U.S. Dist. LEXIS 80143 (D.N.J. Oct. 30, 2007)).
134. *Id.* at *5.

8. *Coughlan v. NXP B.V.* (Two-Step Asset Transfer Treated Under the Step Transaction Doctrine as Single Transaction Violating Assignment Prohibition)

In *Coughlan v. NXP B.V.*,[135] the Delaware Court of Chancery applied the "step transaction doctrine" to a two-step transfer of assets, and found that the two steps, taken together, triggered a contingent payment acceleration provision in the agreement by which the transferor had acquired the assets.[136]

Background

In late 2007, NXP B.V. and GloNav, Inc. merged.[137] GloNav became NXP's wholly owned subsidiary and GloNav's shareholders received cash plus rights to additional payments contingent on the future performance of GloNav's intellectual property assets.[138] The merger agreement provided for acceleration of the contingent payments if NXP transferred, other than to a subsidiary of NXP, (i) a majority of GloNav stock, (ii) all or substantially all of GloNav's assets, (iii) a majority of NXP stock, or (iv) all or substantially all of NXP's assets.[139]

In 2008, NXP and another company formed a joint venture (the "JV") into which NXP contributed its wireless business, including GloNav's intellectual property assets, in exchange for a 20 percent interest.[140] NXP effected its contribution in two steps[141]:

1. Transfer GloNav's assets to a newly created subsidiary; and
2. Transfer all shares of the new subsidiary to the JV.

NXP contended that neither step triggered acceleration, since the first step was to a subsidiary of NXP, and the second step did not involve a transfer of GloNav stock or assets or significant NXP stock or assets.[142]

Analysis

The court explained that the step transaction doctrine "treats the 'steps' in a series of formally separate but related transactions involving the transfer of property as a single transaction[] if all the steps are substantially linked."[143] The court noted that the step transaction doctrine would apply if any one of three different tests were satisfied:

135. No. 5110-VCG, 2011 Del. Ch. LEXIS 166 (Nov. 4, 2011).
136. *Id.* at *20.
137. *Id.* at *2.
138. *Id.*
139. *Id.* at *3–4.
140. *Id.* at *8.
141. *Id.*
142. *Id.* at *18–19.
143. *Id.* at *20 (quoting Gatz v. Ponsoldt, 925 A.2d 1265, 1281 (Del. 2007)) (modification in original).

(1) End result test—if the "separate transactions were prearranged parts of what was a single transaction, cast from the outset to achieve the ultimate result."[144]

(2) Interdependence test—if "the steps are not independently significant and '[have] meaning only as part of the larger transaction.'"[145]

(3) Binding commitment test—if "at the time the first step is entered into, there was a binding commitment to undertake the later steps."[146]

The court found that NXP's two-step transfer satisfied each of the tests.[147] The court thus held that it triggered the acceleration provision for a transfer of all or substantially all of GloNav's assets.[148]

Whether the Step Transaction Doctrine Applies Is a Question of the Parties' Intent

The court further affirmed that "the controlling principle in applying the step transaction doctrine . . . is the effectuation of the parties' intentions as expressed in, or reasonably inferred from, their agreement."[149]

The court determined that the intent of NXP and GloNav in adopting the acceleration provision "was to ensure that the [s]tockholders would continue to receive their bargained-for [c]ontingent [p]ayments in the event that NXP sold GloNav," and that application of the step transaction doctrine to such a sale was therefore appropriate.[150]

The court considered an earlier draft of the acceleration provision, rejected by NXP, that would have provided for acceleration in any situation where NXP ceased to be the owner of the GloNav assets, either directly or through a wholly owned subsidiary, which would more clearly have covered transactions such as NXP's two-step transfer.[151] The court rejected NXP's argument that the narrower provision in the final agreement should be construed literally in light of the drafting history, finding that "nothing in the . . . drafting history . . . suggests that the acceleration was not meant to occur upon a series of interdependent transactions that, when analyzed substantively rather than hyper-technically, clearly fits within the transactions enumerated in [the acceleration provision]" and that NXP's suggested construction would "render those provisions meaningless."[152]

144. *Id.* at *21 (quoting Noddings Inv. Grp., Inc. v. Capstar Commc'ns, Inc., No. 16538, 1999 WL 182568, at *6 (Del. Ch. Mar. 24, 1999)).

145. *Id.* at *22 (quoting *Noddings*, 1999 WL 182568, at *6).

146. *Id.* at *23 (quoting *Noddings*, 1999 WL 182568, at *6). The court held that the binding commitment test was satisfied because the joint venture agreement between NXP and ST obligated NXP to transfer the GloNav business to the ST Joint Venture in two steps. *Id.*

147. *Id.* at *28–29.

148. *Id.* at *30.

149. *Id.* at *27.

150. *Id.* at *24.

151. *Id.* at *23–24.

152. *Id.* at *24–25.

Application of Equity

The court also stated that, even without the step transaction doctrine, it would treat the transactions together "as a matter of equity," since "equity regards substance rather than form."[153]

Conclusion

NXP shows the limits on the extent to which a party can rely on technical structuring distinctions to avoid triggering undesirable contract provisions, particularly where a court might find that the parties' intent was otherwise.[154] On the other hand, parties also cannot always rely on courts to ignore literal interpretations of contracts.

A party with obligations triggered by a specified type of transaction, and that wants flexibility to structure transactions that may be close, in form or effect, to the triggering type of transaction without triggering the obligations, thus may want to consider including an interpretation provision stating that the step transaction doctrine shall not apply, helping to ensure that only a transaction of exactly the type specified will trigger the obligations.

Agreements to Negotiate

9. *EQT Infrastructure Ltd. v. Smith* (Finding a "Plausible" Agreement to Negotiate in Good Faith Without Additional Conditions)

In *EQT Infrastructure Ltd. v. Smith*,[155] the U.S. District Court for the Southern District of New York denied Smith's motion to dismiss by finding that EQT Infrastructure Limited ("EQT") had plausibly stated a claim for breach of contract arising from Smith's failure to negotiate with EQT in good faith pursuant to a letter of intent (the "LOI") between the parties.

Background

Smith owned various stevedoring and bulk storage businesses (the "Businesses") and a marine services business (the "Marine Business").[156] EQT made an initial offer to purchase the Businesses in November 2009. Both parties were aware that, because EQT was a foreign entity, it would be unable to own or operate the Marine Business.[157] EQT and Smith negotiated until August 2010, when they entered into the LOI.[158]

153. *Id.* at *29.

154. Another recent case, *Meso Scale Diagnostics, Inc. v. Roche Diagnostics GmbH*, also suggests that creative transaction structuring might not always work, holding that the acquisition of a company in a reverse triangular merger in certain circumstances may constitute an assignment of an agreement. No. 5589-VCP, 2011 Del. Ch. LEXIS 61 (Apr. 8, 2011).

155. 861 F. Supp. 2d 220 (S.D.N.Y. Mar. 19, 2012).

156. *Id.* at 223.

157. *Id.*

158. *Id.* at 223–24.

The LOI described the transaction as EQT's purchase of the Businesses, "excluding the Marine Services operations," for $110 million.[159] The LOI included an exclusivity provision, under which Smith would "work with [EQT] in good faith and on an exclusive basis" until the earlier of September 8, 2010, or the notification by EQT that it was terminating negotiations.[160] This provision was made binding by its exception from the paragraph in the LOI entitled "Non-Binding Effect."[161] The LOI also contained an acknowledgement that EQT would "expend considerable time, effort, and expense in connection with" the potential purchase.[162] The LOI did not contain any statement that the sale of the Businesses would be conditioned upon Smith's separate sale of the Marine Business.[163] The LOI was stated to be governed by New York law.[164]

Following expiration of the exclusivity period, Smith informed EQT that the Businesses would not be sold for $110 million because Smith had been unable to find a separate purchaser for the Marine Business, and it requested an increase in purchase price to $125 million.[165] EQT filed suit, claiming that the defendants had breached a binding obligation to negotiate in good faith under the LOI by negotiating with EQT when they knew that they would not sell the Businesses for $110 million unless the Marine Business were also sold.[166]

Analysis

Under the Second Circuit's interpretation of New York law, a preliminary agreement can create binding obligations if it is a "Type I" or "Type II" agreement.[167]

- A Type I agreement is complete on its face with regard to all material matters and binds the parties whether or not a more formal agreement is reached.[168]
- A Type II agreement is binding to some degree and reflects agreement on particular terms while leaving others open for negotiation.[169]

Additionally, a Type II agreement obligates the parties to negotiate open issues in good faith to reach the parties' objectives within an agreed-upon framework.[170] The creation of conditions not existing in the LOI, such as the sale

159. *Id.* at 224.
160. *Id.*
161. *Id.* at 224–25.
162. *Id.* at 224.
163. *Id.* at 225.
164. *Id.* at 226.
165. *Id.* at 225.
166. *Id.* at 226.
167. *Id.*
168. *Id.* at 226–27.
169. *Id.*
170. *Id.* at 227.

of the Marine Business, would be a breach of this obligation.[171] The court found it "plausible that a Type II agreement was intended."[172]

The court concluded that the LOI evinced a binding agreement to negotiate in good faith during the exclusivity period, due to the express agreement to "work with [EQT] in good faith."[173] Whether the obligation extended beyond such period was a much closer question. Several factors weighed in the defendants' favor. The court found that the LOI did not clearly imply an intent by the parties to be bound by the terms of the LOI, though the court also declined to infer from the express sunset of the exclusivity provision that the parties intended to allow bad faith negotiations after that.[174] The LOI also contained more open terms than a typical Type II agreement.[175]

Despite this, the court found that several factors weighed in favor of a finding that the obligation to negotiate in good faith could have continued to bind Smith beyond the exclusivity period.

- The context of the negotiations, following roughly nine months of preliminary discussions and negotiations, supported a conclusion that the parties intended to negotiate beyond the LOI, and thus to do so in good faith.[176]
- EQT, whom the parties acknowledged in the LOI would "expend significant time, effort and expense in connection with the Possible Transaction," spent $1.5 million on attorneys, accountants, and consultants.[177] This supported the existence of a Type II agreement, as partial performance weighs in favor of finding such an agreement existed.[178]

The court found the final factor—the necessity of putting the agreement in final form—to be neutral, as Type II agreements, by definition, require future negotiations and contracts, and therefore such necessity cannot preclude a finding of a Type II agreement.[179]

The defendants argued that because the exclusive period had expired by the time of the October 19 letter, they were free to walk away from the sale of the Businesses, and that the mere fact that Smith was looking for a buyer for the Marine Business did not mean that such sale was a secret condition.[180] The court found that the October 19 letter plausibly suggested that, as of that date, Smith was conditioning the sale of the Businesses for $110 million on the sep-

171. *Id.* at 228.
172. *Id.* at 230.
173. *Id.* at 231.
174. *Id.* at 229.
175. *Id.* at 230. Although the court noted that open terms are found in Type II agreements by definition, the LOI contained no terms of a final agreement other than a purchase price, rendering it less of a "framework" than other agreements that had been found to be Type II.
176. *Id.* at 229.
177. *Id.* at 230.
178. *Id.*
179. *Id.*
180. *Id.* at 231.

arate sale of the Marine Business.[181] As it was plausible to the court that the LOI was a Type II agreement and therefore contained an obligation to negotiate in good faith toward the consummation of the possible transaction, such a condition could be a breach of the LOI.[182]

The court further found that, even if the obligation to negotiate in good faith had expired on September 8 along with the exclusivity period, EQT had plausibly alleged that there had been such a secret condition all along. Accepting that factual allegation as true, the defendants had breached the obligation to negotiate in good faith, regardless of whether such obligation expired in September.[183]

Conclusion

Lawyers should bear in mind, when drafting letters of intent, that obligations such as the obligation to negotiate in good faith may be construed by courts to extend beyond exclusivity periods laid out in the letter itself, and they may be implied even when the letter of intent does not contain any express obligation to negotiate in good faith, if the letter has sufficient binding terms and is prepared in the context to make it a Type II contract.

Drafters should consider including any conditions to the consummation of a transaction in such letters of intent, to avoid the possibility that the later imposition of such a condition will be seen as a breach of such obligations.

10. *PharmAthene, Inc. v. SIGA Technologies, Inc.* (Enforcement of Agreement to Negotiate and Imposition of Equitable License)

In *PharmAthene, Inc. v. SIGA Technologies, Inc.*,[184] PharmAthene sought to enforce a non-binding term sheet for a license agreement.[185] The court determined that, although SIGA Technologies, Inc. ("SIGA") had failed to negotiate in good faith, as required by their merger agreement, specific performance of the term sheet was not an appropriate remedy, and instead awarded PharmAthene an equitable payment stream based on economic terms that the court determined would likely have resulted had the parties negotiated in good faith.

Background

In 2004, SIGA acquired ownership of a drug called ST-246.[186] Approximately one year later, SIGA entered into negotiations with PharmAthene to license the product and help fund further research and development.[187] A term sheet was

181. *Id.* at 232.
182. *Id.* at 231.
183. *Id.*
184. No. 2627-VCP, 2011 WL 4390726 (Del. Ch. Sept. 22, 2011).
185. *Id.* at *11.
186. *Id.* at *2.
187. *Id.* at *3.

drafted and circulated through several rounds of negotiations. The term sheet generally provided for a license by SIGA to PharmAthene for the future development and exploitation of ST-246 and contemplated that PharmAthene, in addition to funding research and development, would pay SIGA (1) an upfront license fee of $6 million, (2) aggregate milestone payments of $10 million, and (3) royalty payments based on a percentage of sales.[188]

The parties then turned their attention to a possible merger between the companies. As a condition to proceeding with the merger negotiations, SIGA required PharmAthene to provide a bridge loan of $3 million to cover the costs of developing ST-246 during the negotiations.[189] The parties entered into a merger agreement, which included a provision that if the merger were terminated the parties would negotiate in good faith a license agreement in accordance with the term sheet.[190] The bridge loan agreement contained a similar requirement as well as a ninety-day exclusivity period for the parties to negotiate the license agreement.[191]

Following the signing of the merger agreement, the parties collaborated in the development of ST-246.[192] Subsequently, however, SIGA elected to terminate the merger.[193]

Pursuant to the merger agreement, the parties proceeded with the drafting of a definitive license agreement.[194] Based on SIGA's assessment of the development costs and potential market for ST-246, they suggested that the parties revisit the economic terms of the license and initially proposed an upfront payment of approximately $40 to $45 million and a 50/50 profit split.[195] However, in its initial draft of the license agreement, SIGA built in (1) an upfront payment of $100 million, (2) milestone payments of $235 million, (3) royalties ranging from 18 percent to 28 percent depending on the volume of sales, and (4) a 50/50 profit split. The draft license also contained certain non-economic terms that were very favorable to SIGA.[196]

PharmAthene filed suit seeking specific performance and expectation damages based on SIGA's failure to negotiate the license agreement in good faith.[197]

Analysis

Breach of Duty to Negotiate in Good Faith

The court first addressed whether the two-page term sheet amounted to a binding agreement.[198] The court determined that the parties did not intend to

188. *Id.* at *5.
189. *Id.* at *6.
190. *Id.* at *8.
191. *Id.* at *7.
192. *Id.* at *8.
193. *Id.* at *9.
194. *Id.*
195. *Id.* at *10.
196. *Id.*
197. *Id.* at *12.
198. *Id.* at *13.

be bound by its terms,[199] noting that both the merger agreement and the bridge loan agreement merely obligated the parties to negotiate the terms of a license agreement in the event the merger was terminated.[200] The court also noted that the term sheet did not "contain all of the essential terms of a license agreement for a product like ST-246" because it lacked terms regarding diligence, indemnification, confidentiality, ownership, and commercialization, among others.[201]

The court determined that both the merger agreement and the bridge loan agreement explicitly obligated the parties to negotiate a license agreement in good faith if the merger terminated.[202] The court also determined that SIGA acted in bad faith during negotiations of the license agreement.[203] Under Delaware law, "bad faith constitutes '. . . the conscious doing of a wrong because of dishonest purpose or moral obliquity.'"[204] Furthermore, "an attempt to condition future agreement on a previously 'contested and compromised' point is 'an unambiguous act of bad faith' where the other party performed in reliance on that compromise."[205] In this case that court determined that based on the amount of time spent in the negotiation of the economic terms and the specificity of those terms in the term sheet, the economic terms were contested and compromised by the parties; therefore, SIGA's attempt to negotiate the license agreement based on drastically different economic terms constituted bad faith.[206]

Remedies

The court stated that it had broad authority in crafting an equitable remedy in order to address SIGA's breach appropriately.[207] Because neither specific performance nor expectation damages were appropriate, the court determined that an equitable award in the form of future payment streams after certain marginal expenses were recovered would be the most appropriate remedy.[208]

In crafting its remedy, the court determined that, had the parties negotiated in good faith, PharmAthene likely would have agreed to SIGA's first post-termination proposal of increasing the upfront payment to $40 million and sharing in

199. *Id.* at *13–14.
200. *Id.* at *14–16.
201. *Id.* at *16–17.
202. *Id.* at *19.
203. *Id.* at *22.
204. *Id.* (quoting CNL-AB LLC v. E. Prop. Fund I SPE (MS Ref) LLC, No. 6137-VCP, 2011 WL 353529, at *9 (Del. Ch. Jan. 28, 2011)).
205. *Id.* (quoting RGC Int'l Investors, LDC v. Greka Energy Corp., No. 17674, 2001 WL 984689, at *13 (Del. Ch. Aug. 22, 2001)).
206. *Id.* at *22–24. The court also determined that PharmAthene made a successful claim for relief based on promissory estoppel, *id.* at *27, and may have also supported its claim of unjust enrichment, *id.* at *28. However, the court ultimately concluded that any claim for unjust enrichment was adequately covered by PharmAthene's breach of contract claim and thus it was not required to analyze the cause of action further. *Id.* at *29.
207. *Id.* at *34.
208. *Id.* at *38.

50 percent of the profits.[209] Additionally, based on the record, the court concluded that a ten-year term was consistent with the parties' intentions.[210] Specifically, once SIGA realized $40 million in net profits from the sales of ST-246, then PharmAthene was entitled to an equitable payment stream of 50 percent of all additional net profits for ten years after the first commercial sale of ST-246.[211] The court also awarded PharmAthene one-third of its reasonable attorney's fees and expert witness fees.[212]

Conclusion

By awarding an equitable payment stream to PharmAthene based on terms it determined would have most likely resulted from good-faith negotiations between the parties, the court demonstrated its ability to craft relief for parties even where damages are speculative.

This case also cautions parties against negotiating in bad faith. Even if SIGA had negotiated in good faith, it is possible that the parties would not have entered into a license agreement. However, because of SIGA's blatant attempts to skew the transaction in its favor, SIGA ended up with court-imposed economic terms and obligations.

CONTROLLING STOCKHOLDERS

11. *IN RE SYNTHES, INC. SHAREHOLDER LITIGATION* (Equal Consideration for All Shareholders as Safe Harbor to Get to Business Judgment Rule in Sale of Controlled Company)

In *In re Synthes, Inc. Shareholder Litigation*,[213] the Delaware Court of Chancery dismissed a stockholder challenge to the acquisition of Synthes, a publicly traded company with a controlling stockholder for $21.3 billion, payable in a mix of 65 percent stock and 35 percent cash.[214] The court held that there was "no basis to conclude that the controlling stockholder had any conflict with the minority that justifie[d] the application of the entire fairness challenge"[215] because the controlling stockholder accepted pro rata treatment with the minority in the merger, which "remains a form of safe harbor" under Delaware law.[216] Moreover, the court held the *Revlon* doctrine inapplicable to this mixed-consideration merger.[217]

209. *Id.* at *40.
210. *Id.* at *41.
211. *Id.* at *42.
212. *Id.* at *44–45.
213. 50 A.3d 1022 (Del. Ch. 2012).
214. *Id.* at 1030.
215. *Id.* at 1024.
216. *Id.*
217. *Id.*

Background

Synthes was a publicly traded Delaware corporation and a global medical device company based in Switzerland.[218] Synthes was founded and allegedly controlled by its Chairman of the Board, Hansjoerg Wyss, who held effective control of approximately 52 percent of the company's shares.[219] The plaintiffs alleged that Wyss wanted to liquidate his investment in Synthes to satisfy his personal estate planning objectives.[220]

Beginning in September 2010, the company contacted nine potential strategic buyers, including Johnson & Johnson.[221] As talks continued with Johnson & Johnson, the board reached out to six potential financial buyers.[222] Three of them submitted non-binding proposals, but they indicated that none could independently finance the acquisition.[223] As a result, the board authorized the three interested financial buyers to form a consortium and submit a collective bid.[224] Dual-track negotiations moved forward, culminating in an offer by Johnson & Johnson for CHF 159 (Swiss Francs) per share, payable in stock and cash and subject to due diligence,[225] and an offer by the financial buyers' consortium for CHF 151 per share, contingent upon Wyss rolling over "a substantial portion of this equity investment in Synthes into an equity investment in the post-merger company."[226]

Controlling Stockholder Has No Conflicts of Interest If It Accepts Pro Rata Treatment

The court rejected the plaintiffs' argument that Wyss had a conflict of interest with the minority stockholders, and it instead adopted a pro rata safe harbor for controlling stockholders in a merger.[227] The court held that there were no pled facts to support the counterintuitive argument that, absent any immediate liquidity needs, Wyss was an "impatient capitalist" who needed to exit from his sizable Synthes investment at a suboptimal price.[228] The court also rejected the claim that Wyss wronged the minority shareholders by preferring the total-company bid from Johnson & Johnson over the partial-company bid from the private equity consortium that would have required Wyss to roll over a substantial portion of his equity.[229] The court held that he had every right to do so.[230] Delaware

218. *Id.* at 1025.
219. *Id.*
220. *Id.*
221. *Id.* at 1026–27.
222. *Id.* at 1027.
223. *Id.*
224. *Id.*
225. *Id.* at 1027–29.
226. *Id.* at 1028.
227. *Id.* at 1024.
228. *Id.* at 1035.
229. *Id.* at 1037–38.
230. *Id.*

law does not require self-sacrifice of controlling stockholders, and, with very limited exceptions, pro rata treatment offers a form of safe harbor for a controlling stockholder.[231]

Enhanced Scrutiny Is Inapplicable to a Deal Involving 35 Percent Cash and 65 Percent Widely Held, Publicly Traded Stock

The court held that the business judgment rule, and not *Revlon* enhanced scrutiny, applied to this case. The court first noted that this was an odd case in which to find that a sale or change in control had occurred, given that Synthes was a company with a controlling stockholder and the post-merger entity was a large, publicly traded company with no controller.[232] The court then held that under the "binding precedent" of *In re Santa Fe Pacific Corp. Shareholder Litigation*,[233] a merger transaction in which the deal consideration consists of 35 percent cash and 65 percent stock in a widely held, publicly traded company does not constitute a sale or change in control that would trigger *Revlon* enhanced scrutiny.[234]

Court Gives More Leeway to Deal Protections After a Robust and Public Pre-Signing Process

The court also rejected challenges to the deal protections in the merger agreement,[235] including a 3.05 percent termination fee, a no-shop with a fiduciary out, matching rights, a force-the-vote provision, and a voting agreement that locked up 37 percent of the outstanding shares in favor of the merger (or 33 percent in the case of a change in recommendation).[236] As the court observed, these deal protections were agreed to after an open solicitation process, and no showing was made as to their preclusiveness.[237] The court stated that a company that has undertaken a robust and open pre-signing process will have a more informed view of the likelihood of potential topping bids, and its decision to employ deal protections will be owed more deference by the court.[238]

12. *Frank v. Elgamel* (Merger of Controlled Corporation with Unaffiliated Company Subject to Entire Fairness Review When Controllers Roll Over)

In *Frank v. Elgamal*,[239] the Delaware Court of Chancery held that any transaction in which the minority stockholders are cashed out while the controlling

231. *Id.* at 1040–41.
232. *Id.* at 1047 n.114.
233. 669 A.2d 59, 71 (Del. 1995).
234. *Synthes*, 50 A.3d at 1048.
235. *Id.*
236. *Id.* at 1048 n.118.
237. *Id.* at 1048–49.
238. *Id.* at 1049.
239. No. 6120-VCN, 2012 WL 1096090 (Del. Ch. Mar. 30, 2012).

stockholders retain an equity interest in the surviving entity triggers entire fairness review unless the deal is conditioned upon "robust procedural protections."[240] The court also provided guidance as to when separate stockholders will be deemed to constitute a control group under Delaware law.

Contemporaneous Entry into Voting, Exchange, and Employment Agreements Sufficient to Demonstrate the Existence of a Control Group

The court denied the defendants' motion to dismiss a stockholder challenge to the merger of American Surgical Holdings, Inc. into an affiliate of Great Point Partners I, LP.[241] The court found that the actions taken by four of American Surgical's insiders "were connected in a legally significant way," such that they constituted a control group.[242] In particular, the four members of the control group contemporaneously entered into: (1) voting agreements in support of the merger; (2) exchange agreements granting them an equity stake in the post-merger entity; and (3) employment agreements governing their post-merger employment.[243]

Absent Robust Procedural Protections, Entire Fairness Applies to Any Deal in Which the Controlling Stockholder Retains Equity While the Minority Are Cashed Out

The court held that under *In re John Q. Hammons Hotels Inc. Shareholder Litigation*,[244] and *In re LNR Property Corp. Shareholders Litigation*,[245] entire fairness applies to any such transaction unless it is (1) conditioned upon a non-waivable majority-of-the-minority vote, and (2) recommended by an independent and disinterested special committee of the board.[246] In this case, there were no such "robust procedural protections" and, in denying the motion to dismiss, the court held that entire fairness would apply to the challenged transaction.[247]

Conclusion

Together, *Synthes* and *Frank* reaffirm the importance that the Delaware courts place on the transaction structures and procedural protections employed by controlling stockholders.

240. *Id.* at *8.
241. *Id.* at *1.
242. *Id.* at *8.
243. *Id.*
244. No. 758-CC, 2009 WL 3165613, at *10 (Del. Ch. Oct. 2, 2009).
245. 896 A.2d 169 (Del. Ch. 2005).
246. *Frank*, 2012 WL 1096090, at *9–10.
247. *Id.* at *10 (noting, *inter alia*, that the fact that a majority of the minority stockholders ultimately voted in favor of the deal is no substitute for making a non-waivable majority-of-the-minority vote a necessary precondition to a transaction).

13. *Americas Mining Corp. v. Theriault* (Special Committee Process Not Effective and Over $2 Billion Awarded for Controlling Stockholder's Breach of Fiduciary Duty)

In *Americas Mining Corp. v. Theriault*,[248] the Delaware Supreme Court affirmed the Delaware Court of Chancery's ruling in *In re Southern Peru Copper Corp. Shareholder Derivative Litigation*,[249] in which the Court of Chancery held that a controlling stockholder and affiliated directors breached their fiduciary duty of loyalty where a special committee process was not effective.

Background

In 2004, Grupo México, S.A.B. de C.V. ("Grupo México"), the controlling stockholder of Southern Peru, a publicly traded Delaware corporation, offered to sell to Southern Peru its 99.15 percent interest in a non-public Mexican mining company, Minera México, S.A. de C.V. ("Minera"), in exchange for stock of Southern Peru.[250] The proposed deal valued Minera at nearly $3.05 billion.[251]

Southern Peru's board of directors formed a special committee of independent directors (the "Special Committee") to evaluate Grupo México's proposal.[252] The Special Committee and Grupo México negotiated for eight months.[253] Early in the process, the Special Committee's financial advisor provided the Special Committee with an "Illustrative Give/Get Analysis," which demonstrated a "stark disparity" between the value of Southern Peru stock to be issued in the proposed merger, based on current market prices ($3.1 billion), and the financial advisor's valuation of Minera ($1.7 billion).[254] Thereafter, the Special Committee's focus shifted to valuations of Southern Peru and Minera on a relative basis.[255] The Special Committee's financial advisor ultimately provided a "Relative Discounted Cash Flow Analysis," which valued Southern Peru at approximately $1.1 billion below its actual market price at the time.[256]

On October 21, 2004, the Special Committee approved Southern Peru's acquisition of Minera in exchange for 67.2 million shares of Southern Peru stock.[257] Although the transaction was conditioned on a two-thirds stockholder vote, it was not subject to a "majority-of-the-minority" voting condition.[258] The two-thirds voting condition would be satisfied if Grupo México and one of two other large stockholders voted in favor of the transaction. One of those other holders, Cerro Trading Company, Inc. ("Cerro"), entered into a voting agreement

248. Ams. Mining Corp. v. Theriault, 51 A.3d 1213 (Del. 2012).
249. *In re* S. Peru Copper Corp. S'holder Derivative Litig., 30 A.3d 60, 64 (Del. Ch. 2011).
250. *Id.* at 1221.
251. *Id.*
252. *Id.* at 1221–22.
253. *Id.* at 1219–20, 1223–32.
254. *Id.* at 1224.
255. *Id.*
256. *Id.* at 1220, 1245–46.
257. *Id.* at 1219.
258. *Id.* at 1234.

that required it to vote in favor of the merger if the Special Committee maintained its favorable recommendation.[259] When the merger closed, the value of 67.2 million shares of Southern Peru had grown from $3.1 billion (value at signing) to $3.75 billion.[260]

Analysis

Whether Use of a Special Committee Results in Burden Shifting Under the Entire Fairness Standard Must Be Determined Before Trial

In its post-trial opinion, the Delaware Court of Chancery applied the entire fairness standard of judicial review and held that Grupo México and the Southern Peru directors who were affiliated with Grupo México each breached their fiduciary duty of loyalty by "'extract[ing] a deal that was far better than market' . . . due to the ineffective operation of [the] [S]pecial [C]ommittee."[261] On appeal, the Delaware Supreme Court confirmed that when a controlling stockholder stands on both sides of a transaction, the entire fairness standard of judicial review applies *ab initio*, and defendants ordinarily have the burden of persuasion to prove that the challenged transaction is entirely fair.[262] The burden of persuasion may shift to plaintiffs, however, if defendants can show that a well-functioning committee of disinterested and independent directors approved the challenged transaction, or if the corporation conditioned the challenged transaction on a fully informed vote of a majority of its disinterested stockholders.[263]

To obtain burden shifting on the issue of entire fairness, defendants must prove that a special committee "function[ed] in a manner which indicates that the controlling shareholder did not dictate the terms of the transaction and that the committee exercised real bargaining power at an arms'-length."[264] The Delaware Supreme Court explained that a determination of which party bears the burden of proof must occur, if possible, before trial.[265] The Delaware Supreme Court further held that, in future cases, "if the record does not permit a pretrial determination that the defendants are entitled to a burden shift, the burden of persuasion will remain with the defendants throughout the trial to demonstrate the entire fairness of the interested transaction."[266] The court

259. *Id.* at 1228–30.

260. *Id.*

261. *In re* S. Peru Copper Corp. S'holder Derivative Litig., 30 A.3d 60, 64 (Del. Ch. 2011). The court dismissed plaintiff's claims against the Special Committee members "because the plaintiff had failed to present evidence supporting a non-exculpated breach of their fiduciary duty of loyalty." *Id.* at 85.

262. *Ams. Mining Corp.*, 51 A.3d at 1240.

263. *Id.* at 1240–41. Although holders of a majority of the stock held by disinterested stockholders ultimately approved the merger, the Court of Chancery held that such vote did not shift the burden of persuasion under the entire fairness standard because the disinterested stockholders were not fully informed of flaws in the Special Committee's process and the merger was not conditioned up-front upon obtaining a majority-of-the-minority vote. *S. Peru Copper Corp.*, 30 A.3d at 93–94.

264. *Ams. Mining Corp.*, 51 A.3d at 1240 (quoting Kahn v. Tremont Corp., 694 A.2d 422, 429 (Del. 1997)) (internal quotation marks omitted).

265. *Id.* at 1242–43.

266. *Id.*

explained that such a rule would not discourage the use of special committees because "the use of a properly functioning special committee of independent directors" is an "integral part[] of the best practices that are used to establish a fair dealing process" and "[a] fair process usually results in a fair price."[267]

An Ineffective Special Committee Process Resulted in a Transaction that Was Not Entirely Fair

The Delaware Supreme Court also held that the record supported the Court of Chancery's finding of "unfair dealing . . . that resulted in the payment of an unfair price."[268] In its opinion, the Court of Chancery detailed a number of questionable aspects of the special committee process that led the trial court to conclude that the special committee operated with a "controlled mindset."[269] First, the Special Committee's mandate failed to clarify the Special Committee's role in negotiations.[270]

The Court of Chancery also concluded that the Special Committee's financial advisor focused on "analyses that obscured the actual value of what Southern Peru was getting and that was inclined toward pushing up, rather than down, the value in the negotiations of what Grupo México was seeking to sell."[271] The trial court determined that these analyses evidenced the Special Committee's attempt to "rationalize" Grupo México's asking price, effectively ignoring the actual cash value of Southern Peru shares.[272]

The Court of Chancery also questioned the Special Committee's failure to capitalize on its belief that Southern Peru was trading at a premium over its fundamental value, noting that the Special Committee did not explore potential options to sell at the top of the market, declare a special dividend, or propose that Grupo México make a premium-to-market offer for Southern Peru.[273]

The Court of Chancery also criticized the Special Committee's failure to obtain an updated fairness opinion based on the substantial increase in Southern Peru's stock price between signing and closing in light of the fact that the merger involved a fixed exchange ratio with no collar or walk-away right.[274] The court likewise questioned the Special Committee's failure to examine seriously whether it should change its recommendation in view of "important emerging evidence that the transaction's terms were skewed in favor of Grupo México."[275] Although the Special Committee could not terminate the merger agreement or avoid a vote on the merger through a change of recommendation, a change in

267. *Id.* at 1244.
268. *Id.* at 1248.
269. *In re* S. Peru Copper Corp. S'holder Derivative Litig., 30 A.3d 60, 98, 100, 102, 104, 112, 114 (Del. Ch. 2011).
270. *Id.* at 98–99.
271. *Id.* at 104.
272. *Id.* at 103–04.
273. *Id.* at 73–74.
274. *Id.* at 83–85.
275. *Id.* at 84–85.

recommendation would have resulted in Cerro being obliged to vote against the merger.[276]

The Court of Chancery Properly Exercised Its "Broad Historic Discretionary Powers in Fashioning a Remedy"

In determining the appropriate remedy, the Court of Chancery awarded the difference between the value of the Southern Peru shares issued ($3.8 billion) and the amount the court determined the 99.15 percent interest in Minera was worth ($2.4 billion), resulting in a damages award equaling $1.3 billion, plus pre- and post-judgment interest, for a total amount of $2 billion.[277] The trial court also awarded plaintiff's attorney's fees and expenses in the amount of 15 percent of the total judgment, equaling more than $304 million.[278]

Conclusion

The Delaware Supreme Court's decision in *Americas Mining Corp. v. Theriault* confirmed that the entire fairness standard of review will apply *ab initio* and remain the standard of judicial review throughout the course of litigation if a controlling stockholder stands on both sides of a transaction. While defendants can obtain a shift of the burden of persuasion on the issue of entire fairness by showing that the transaction was negotiated and approved by a well-functioning committee of disinterested and independent directors, the burden shifting determination must be made before trial, if possible. The burden of persuasion will remain with defendants if a pre-trial burden shifting determination is not feasible.

The Delaware Supreme Court's decision, and the underlying decision of the Court of Chancery, further demonstrate that Delaware courts will carefully scrutinize all aspects of a special committee's process to determine if a transaction with a controlling stockholder was, in fact, entirely fair.

Exclusivity Agreements

14. *Vector Capital Corp. v. Ness Technologies, Inc.* (Dismissing Claim of Breach of Exclusivity Agreement)

In *Vector Capital Corp. v. Ness Technologies, Inc.*,[279] the United States District Court for the Southern District of New York dismissed a complaint for breach of an exclusivity agreement.

Background

Vector Capital Corp. ("Vector") began discussing a possible acquisition of Ness Technologies, Inc. ("Ness"), a Delaware corporation, in January 2011.

276. *Id.*
277. *Id.* at 120.
278. Ams. Mining Corp. v. Theriault, 51 A.3d 1213, 1252 (Del. 2012).
279. No. 11 Civ. 6259 (PKC), 2012 WL 913245 (S.D.N.Y. Mar. 19, 2012).

Vector was aware that Ness was also having discussions with other potential acquirors. Vector and Ness entered into an exclusivity agreement (the "Exclusivity Agreement") that required Ness to: (1) refrain from pursuing transactions with other potential acquirors, including participating in negotiations or discussions;[280] (2) inform Vector "promptly . . . of any inquiry, discussion, or proposal" from any person regarding an alternative transaction;[281] and (3) use all "reasonable best efforts to respond to all reasonable and customary data and information requests" from Vector.[282]

During the exclusivity period, Citi Venture Capital International ("CVCI") informed Ness of its interest in purchasing Ness. Ness disclosed this communication to Vector. According to Vector's complaint, Ness "actively discussed" the CVCI proposal several times.[283] Ness then received and reviewed, but did not disclose to Vector, a second communication from CVCI, which included prospective due diligence items.[284] The exclusivity period ended on May 20, 2011, and on June 10, 2011, Ness announced an agreement to be acquired by CVCI at a price higher than Vector had offered.[285]

Analysis

Vector alleged that Ness violated the Exclusivity Agreement by discussing internally CVCI's acquisition proposal, even though Vector did not allege that Ness had discussed the proposal with CVCI.[286] The court rejected this argument, noting that interpreting the Exclusivity Agreement to prohibit internal discussions of unsolicited proposals would obligate Ness by contract to violate governing law.[287] As directors of a Delaware corporation, the Ness directors had a fiduciary duty to obtain the highest value for the corporation's stockholders when the company was sold. If, as Vector alleged, Ness had agreed not to have internal discussions about unsolicited proposals, the directors would have been unable to fulfill their duty under Delaware law.[288]

Second, Vector alleged that Ness breached the Exclusivity Agreement by failing to inform Vector of CVCI's second letter addressing due diligence items. The court noted that the Exclusivity Agreement required Ness to disclose only an "inquiry, discussion, or proposal" regarding an alternative transaction and that set forth "material terms,"[289] and it determined that CVCI's second letter did not set forth "material terms," but rather only proposed topics that would need to be explored for diligence purposes.[290]

280. *Id.* at *1.
281. *Id.*
282. *Id.*
283. *Id.*
284. *Id.* at *2.
285. *Id.*
286. *Id.* at *4.
287. *Id.*
288. *Id.*
289. *Id.* at *5.
290. *Id.*

Finally, Vector's complaint alleged that Ness breached duties of good faith and fair dealing implied by the Exclusivity Agreement by "creat[ing] major and minor roadblocks to the completion of the negotiations."[291] Because breach of the implied covenant of good faith and fair dealing "'is merely a breach of the underlying contract,' and a plaintiff cannot invoke the covenant to impose obligations not actually created by the contract," the court rejected this allegation as well.[292] Ness was under no obligation to sell itself to Vector and, therefore, Vector "cannot invoke the covenant of good faith and fair dealing to impose those requirements on Ness."[293]

Conclusion

This case highlights the need for a board of directors of a target corporation to be able to discuss alternative proposals, at least internally, even if they are bound not to proceed with discussions with the party actually making the proposal.

The opinion also shows the limits of relying on the implied covenant of good faith in trying to hold a target company to facilitating a buyer's process.

Fiduciary Duties in a Limited Liability Company

15. *Auriga Capital Corp. v. Gatz Properties, LLC* (LLC Manager Held Liable for Orchestrating Sale to Himself)

In *Auriga Capital Corp. v. Gatz Properties, LLC*,[294] the Delaware Court of Chancery held that the manager of an LLC, who controlled a majority of the LLC's membership interests, had breached his fiduciary duties to the minority members by failing to cause the LLC to explore its strategic alternatives at an appropriate time, so that he could buy out the remaining interests at a "fire sale" price.[295] The Delaware Supreme Court upheld the Chancery decision, on the ground that the language of the LLC agreement, when "[v]iewed functionally," imposed fiduciary duties on the manager and made the transaction subject to entire fairness review.[296]

Background

In 1997, William Gatz and Auriga Capital Corp. formed a limited liability company (the "LLC") to build and operate a golf course on property owned by Gatz's family and leased by them to the LLC for a term of forty years (with options exercisable by the LLC to extend).[297] The LLC operating agreement des-

291. *Id.* at *6.
292. *Id.* (internal citation omitted).
293. *Id.*
294. 40 A.3d 839 (Del. Ch. 2012).
295. *Id.* at 873.
296. Gatz Props., LLC v. Auriga Capital Corp., No. 148, 2012, 2012 Del. LEXIS 577, at *15 (Nov. 7, 2012).
297. *Auriga Capital Corp.*, 40 A.3d at 845.

ignated Gatz's holding company as manager. By 2001, Gatz, with his family, held controlling shares of the LLC's interests.[298]

In March 1998, the LLC subleased the course to American Golf Corporation for a term of thirty-five years, with an option for American Golf to terminate after January 31, 2010.[299] American Golf, however, soon "evidenced a disinterest in the property."[300] By 2005, Gatz knew that American Golf was likely to terminate the sublease in 2010. However, Gatz "failed to take any steps at all to find a new strategic option for [the LLC]."[301] Among other things, Gatz failed to search for a buyer for the LLC.[302] When a potential buyer presented itself in 2007 ("RDC"), Gatz discouraged it by refusing to provide due diligence materials or negotiate in good faith and telling the potential buyer that its revenue projections for the LLC's golf course were too high.[303]

Starting in 2008, Gatz made several offers to buy out the minority, without disclosing to them RDC's willingness to consider a higher bid.[304] When the minority members refused, Gatz threatened to sue them under a provision of the operating agreement that allowed the holders of a majority of the LLC interests to vote out the minority so long as a fair price was paid.[305]

In 2009, Gatz conducted what the court characterized as a "sham" auction, using an inexperienced auctioneer from a firm that focused on bankruptcy work, limited publicity, and a due diligence package provided to buyers just one month before the auction (and without contacting RDC).[306] "Worst of all," according to the court, the auction materials indicated that Gatz, as a controlling interest holder, intended to bid and reserved the right to cancel the auction.[307] Ultimately, Gatz was the only bidder, offering to pay $50,000 and to assume the LLC's debts, on which Gatz was already the guarantor.[308]

The court concluded that the auction was "the culmination of Gatz's bad faith efforts to squeeze out" the LLC's minority members, and that "by failing for years to cause [the LLC] to explore its market alternatives, Gatz manufactured a situation of distress to allow himself to purchase [the LLC] at a fire sale price at a distress sale."[309]

The LLC Manager as a Fiduciary

The court acknowledged that the Delaware LLC Act "does not plainly state that the traditional fiduciary duties of loyalty and care apply by default as to

298. *Id.* at 845–46.
299. *Id.* at 847.
300. *Id.* at 842.
301. *Id.*
302. *Id.*
303. *Id.* at 863–64.
304. *Id.* at 868.
305. *Id.* at 869–70.
306. *Id.* at 870.
307. *Id.* at 842–43.
308. *Id.* at 843.
309. *Id.* at 873.

managers or members of a limited liability company."[310] But, observing that the LLC Act mandates that "the rules of law and equity . . . shall govern" LLCs,[311] and that LLC managers, who are "vested with discretionary authority to manage the business of the LLC," qualify as fiduciaries under "traditional principles of equity," the court concluded that LLC managers owe enforceable fiduciary duties.[312]

The court stated that these duties can be modified, or even eliminated, by an LLC's operating agreement.[313] However, the LLC's operating agreement did not include a provision limiting the manager's duties to those set forth in the operating agreement. Instead, it had a provision requiring arm's-length terms for self-dealing transactions, which the court noted was "akin to entire fairness review."[314] It also had a provision exculpating the manager and others for certain actions other than gross negligence, willful misconduct, and willful misrepresentation. The court pointed out that this provision is both "stronger and weaker" than that allowed for corporations, since it leaves the manager potentially liable for gross negligence, rather than exculpating all violations of the duty of care. Furthermore, it exculpates the manager from breaches of the duty of loyalty, to the extent not committed in bad faith or through willful misconduct.[315]

An Affirmative Duty to Manage

The court found that Gatz breached his duties in several ways, including[316]:

(1) failing to take any steps for five years to address in good faith the expected loss of American Golf as an operator;

(2) turning away a responsible bidder that could have paid a price beneficial to the LLC and its investors;

(3) using the leverage obtained by his own loyalty breaches to play "hardball" with the minority members by making unfair offers on the basis of misleading disclosures; and

(4) buying the LLC at an auction conducted on terms that were well-designed to deter any third-party buyer and to deliver the LLC to Gatz at a distress sale price.

In general, the court stated, an LLC manager's fiduciary duty includes the duty to "address in good faith known, material risks that threaten the viability of the business."[317] According to the court, "a responsible fiduciary" would have reviewed the LLC's strategic alternatives—including whether to find a replacement operator, whether the LLC could operate the course itself, and whether another

310. *Id.* at 849.
311. *Id.* (citing DEL. CODE ANN. tit. 6, § 18-1104).
312. *Id.* at 850–51.
313. *Id.* at 854 (citing DEL. CODE ANN. tit. 6, § 18-1101(c)).
314. *Id.* at 856.
315. *Id.* at 859.
316. *Id.*
317. *Id.* at 861.

company might acquire the LLC or its assets—"right away" when it became apparent that American Golf would not renew its lease and while the LLC was "still in a position of strength."[318]

The court acknowledged that Gatz, "of course, had no duty to sell his interests."[319] But the court also noted that "the fact that [Gatz] was not a seller does not mean that he had a free license to mismanage the LLC so as to deliver it to himself for an unfair price."[320]

Damages

The court found that, had Gatz dealt with RDC "with integrity" in 2007 when RDC was displaying its interest, it "seems probable" that the LLC could have been sold for a full return of the minority members' invested capital plus 10 percent.[321] Among other things, the court noted RDC's potential interest in discussing an acquisition at that price and Gatz's own unwillingness to sell his interests at that price.[322] The court accordingly awarded that amount as damages.[323]

The court noted that the ambiguities as to "what a fully negotiated third-party deal would have produced" were Gatz's "own fault" and accordingly should be construed against him.[324]

Delaware Supreme Court Affirmation

The Delaware Supreme Court affirmed the Chancery decision, based on the court's interpretation of the LLC agreement.[325] The court first found that, based on language in the LLC agreement, the manager owed fiduciary duties to the other members of the LLC.[326] The court focused on the provision of the LLC agreement, cited in the Chancery opinion, requiring that agreements between the manager and the LLC be "[no] less favorable to the Company than the terms and conditions of [a] similar agreement which could then be entered into with arms-length third parties . . . ," and found that such provision effectively imposed such fiduciary duties on the manager and subjected the transaction to entire fairness review.[327] Although the LLC agreement did not specifically refer to fiduciary duties, the court noted that "[t]o impose fiduciary standards of conduct as a contractual matter, there is no requirement in Delaware that an LLC agreement use magic words, such as 'entire fairness' or 'fiduciary duties.'"[328]

318. *Id.* at 860–62.
319. *Id.* at 878.
320. *Id.*
321. *Id.* at 877–78.
322. *Id.* at 878–79.
323. *Id.* at 879.
324. *Id.* at 875.
325. Gatz Props., LLC v. Auriga Capital Corp., No. 148, 2012, 2012 Del. LEXIS 577 (Nov. 7, 2012).
326. *Id.* at *16–19.
327. *Id.* at *15.
328. *Id.*

The court refrained, however, from addressing whether fiduciary duties would be owed by an LLC manager absent the kind of contractual language included in the LLC agreement.[329]

Conclusion

Gatz illustrates the potential for a fiduciary of a company to violate its duties if it fails to take steps to manage the company properly, particularly if seen as part of a plan to acquire the remainder of the company. It also contributes to, but does not resolve, the debate over whether an LLC manager owes fiduciary duties to other members absent language in the LLC operating agreement.

Board of Directors' Bad Faith

16. *In re Answers Corp. Shareholders Litigation* (Target Directors' Potential Bad Faith and Buyer's Potential Aiding and Abetting)

In *In re Answers Corp. Shareholders Litigation*,[330] the Delaware Court of Chancery denied the target company's directors' motion to dismiss claims of breaches of fiduciary duty after finding that plaintiffs adequately pled that all the directors breached their duty of loyalty because they either were interested in the merger (due to employment or liquidity concerns) or acted in bad faith by agreeing to expedite the sales process in order to enter quickly into the merger agreement before public stockholders appreciated the company's improving prospects.

Background

Answers Corp., a Delaware corporation, had a seven-member board of directors consisting of its CEO (Rosenschein), two directors affiliated with Answers' largest (30 percent) stockholder—Redpoint—and four outside directors. The plaintiffs alleged that, by early 2010, Redpoint wanted to exit its investment in Answers, which it could likely do only through a sale of the entire company because Answers' common stock was thinly traded.[331] In March 2010, AFCV Holdings, LLC ("AFCV"), a portfolio company of a private equity firm (collectively, the "Buyout Group"), contacted Redpoint to discuss a sale of Answers to AFCV.[332]

AFCV and Rosenschein discussed a transaction until June 2010, when Redpoint informed the Answers board that, if the company were not sold in the near future, its entire management team (including Rosenschein) would be replaced.[333] In July 2010, Answers and AFCV entered into a confidentiality

329. *Id.* at *29.
330. No. 6170-VCN, 2012 WL 1253072 (Del. Ch. Apr. 11, 2012).
331. *Id.* at *1.
332. *Id.*
333. *Id.* at *2.

agreement.[334] In fall 2010, Answers and AFCV signed a series of non-binding letters of intent with increasing purchase prices as Answers' stock price rose over this time.[335] AFCV sought exclusivity but Answers rejected that request.

After failing to secure exclusivity, AFCV pushed for a quick market check.[336] Facts alleged by plaintiffs suggested that this was to permit signing up the deal before a Form 10-Q would need to be released that would have shown a "blowout" quarter, making AFCV's purchase price look less attractive.[337] Answers' financial advisor informed the board that the proposed two-week market check was not a "real" market check and that conducting the market check over the December holidays could negatively affect potential buyers' interest.[338] The board decided to proceed with the two-week market check over the holidays. None of the ten companies contacted expressed interest.[339]

The board approved AFCV's revised offer, but the board did not perform any analysis regarding alternatives to the merger, including the likely value that Answers' stock might achieve if the company remained independent.[340] After the court had denied plaintiffs' motion for a preliminary injunction,[341] a majority of the Answers stockholders approved the merger.[342]

Analysis

Plaintiffs' Claims Against the Board

The court found that the plaintiffs' complaint adequately alleged that all of the members of the Answers board breached their duty of loyalty.

Rosenschein allegedly knew that he would lose his job if he did not sell Answers. The court acknowledged that, in the past, the court had "questioned the theory that the managers of a target company should be considered 'interested' in a change of control transaction simply because those managers will, post-transaction, manage the acquiring company."[343] Here, however, the complaint alleged that Redpoint threatened to replace Rosenschein unless he successfully completed a change of control transaction.[344]

The complaint also adequately alleged that the Redpoint directors were interested in the transaction in order to achieve liquidity for Redpoint.[345]

The court also found that the plaintiffs adequately alleged that the rest of the board members acted in bad faith because they allegedly knew that Rosenschein and the Redpoint directors wanted to end the sales process quickly so that the

334. *Id.*
335. *Id.*
336. *Id.*
337. *Id.* at *2–3, *8 n.49.
338. *Id.* at *2.
339. *Id.* at *3.
340. *Id.*
341. *Id.* at *10.
342. *Id.* at *3.
343. *Id.*
344. *Id.*
345. *Id.*

board could enter into the merger agreement with AFCV before the market price for Answers' stock rose above the offer price.[346] They nevertheless agreed to expedite the sales process and did not consider that the highest value reasonably available to stockholders may have been achieved by remaining as an independent corporation.[347]

Plaintiffs' Claims Against the Buyout Group

The aiding and abetting claim against the Buyout Group also survived the motion to dismiss because the plaintiffs adequately alleged "knowing participation" by AFCV where, after receiving non-public information that Answers' financial performance was improving, AFCV pushed the board to conduct a flawed market check in breach of the board's fiduciary duties.[348]

Use of Written Consents to Approve Agreements

17. *In re OPENLANE, Inc. Shareholders Litigation* (Declining to Enjoin Merger Notwithstanding Quick Stockholder Approval by Written Consent)

In *In re OPENLANE, Inc. Shareholders Litigation*,[349] the Delaware Court of Chancery denied a motion to enjoin preliminarily the merger of OPENLANE, Inc. with a subsidiary of KAR Auction Services, Inc. ("KAR"). The plaintiff challenged the decision of the OPENLANE board of directors (the "Board") not to conduct an auction or negotiate for a "go-shop" provision[350] under circumstances in which the merger agreement's no-solicitation provision did not include a fiduciary out[351] and stockholder approval was obtained by written consent.[352]

Background

On August 15, 2010, OPENLANE and KAR entered into a merger agreement that required OPENLANE to obtain stockholder approval (through written consents) within twenty-four hours after execution of the agreement,[353] failing which either OPENLANE or KAR could terminate the agreement without paying a termination fee.[354] The merger agreement also contained a condition to closing, waivable by KAR, that holders of at least 75 percent of OPENLANE's outstanding stock deliver written consents approving the merger agreement.[355] The merger agreement included a "stringent" no-solicitation provision with no

346. *Id.*
347. *Id.*
348. *Id.* at *9.
349. No. 6849-VCN, 2011 WL 4599662 (Del. Ch. Sept. 30, 2011).
350. *Id.* at *5–6.
351. *Id.* at *10.
352. *Id.* at *9–10.
353. *Id.* at *3.
354. *Id.*
355. *Id.*

fiduciary out.[356] The OPENLANE board received "some financial information" from an investment bank, but it did not request or obtain a fairness opinion before it approved the merger.[357]

Shortly after execution of the merger agreement, OPENLANE received written consents from the holders of approximately 68 percent of its shares.[358] An OPENLANE stockholder sought a preliminary injunction asserting, among other things, that the OPENLANE directors breached their fiduciary duties under both *Revlon*[359] and *Omnicare*[360] by failing to engage in an adequate process to sell the company and by agreeing to "improper deal protection devices."[361]

Analysis

A Board's "Impeccable Knowledge" of Company's Business Can Make Limited Application of Traditional Value Maximization Tools Reasonable Under Revlon

In support of his claim that the Board breached its fiduciary duties under *Revlon* to secure the best value reasonably attainable, the plaintiff alleged that the Board "only contacted three potential buyers, failed to perform an adequate market check, failed to receive a fairness opinion . . . and relied on scant financial information in approving the [m]erger."[362] The court determined that, "although the Board's decision-making process was not a model to be followed," it was a reasonable one, in large part because of the Board's "impeccable knowledge" of OPENLANE's business and prospects.[363]

The court explained that the Board performed a targeted market check over a one-year period and pursued transactions with two legitimate strategic buyers,[364] and that, even though the Board never received a fairness opinion, it did receive "some financial information" from an investment bank.[365] The court also found that OPENLANE was "one of those seemingly few corporations that is actually 'managed by' as opposed to 'under the direction of' its board of directors,"[366] and this fact made the Board's actions appear more "understandable in light of the Board's impeccable knowledge" of the company's business.[367] In addition, the court noted that while a company's small size does not alter the Board's core fiduciary duties, "[w]here . . . a small company is managed by a board with impeccable knowledge of the company's business, the court may consider the size of the company in determining what is reasonable and

356. *Id.*
357. *Id.* at *6.
358. *Id.* at *3.
359. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).
360. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003).
361. *OPENLANE*, 2011 WL 4599662, at *4.
362. *Id.*
363. *Id.* at *7–8.
364. *Id.* at *6.
365. *Id.*
366. *Id.* (quoting DEL. CODE ANN. tit. 8, § 141(a)).
367. *Id.*

appropriate."[368] The court also considered that the company's directors and officers held over 68 percent of the outstanding stock, which supported a conclusion that the directors were motivated to get the best price reasonably available.[369] Accordingly, the court concluded that the Board's actions were reasonable under the circumstances.[370]

Stockholder Approval Through Written Consent Immediately Following Execution of Merger Agreement Does Not Violate Omnicare

The plaintiff also claimed that the OPENLANE directors breached their fiduciary duties under *Omnicare* by allegedly locking up the stockholder vote and approving a no-solicitation provision without a fiduciary out. The court found that, unlike in *Omnicare*, the OPENLANE merger was not a fait accompli before stockholder approval was obtained.[371] The court rejected plaintiff's assertion that the combined voting power of OPENLANE's directors and officers in their capacities as stockholders constituted a defensive device that, in view of the approval by written consent, impermissibly locked up the stockholder approval.[372] Rather, the court found that, regardless of the fact that the combined voting power of the directors and executive officers was sufficient to approve the merger, the record showed that there was no stockholder voting agreement (as there was in *Omnicare*), and the record merely suggested that the Board approved the merger and the holders of a majority of shares quickly consented.[373] The court explained that nothing in the DGCL prevents stockholders from submitting their consent to a merger soon after approval by the directors.[374] Accordingly, the court characterized the transaction as "a matter of majority rule by shareholders who were under no obligation to act in a particular way."[375]

The court then found that the merger agreement's no-solicitation provision, even though it did not include a fiduciary out, appeared reasonable, because "the Board could terminate the entire Merger Agreement" without paying a termination fee if OPENLANE's stockholders did not consent to the merger within twenty-four hours after the merger agreement was signed.[376] Thus, the sole defensive device employed by the Board, the no-solicitation provision, was of little import because the Board could back out of the deal if the required consents were not obtained.[377]

368. *Id.*
369. *Id.*
370. *Id.*
371. *Id.* In *Omnicare*, holders of a majority of the voting power entered into an agreement to vote in favor of the merger, and the merger agreement (1) required the company to hold a stockholders meeting, even if the board changed its recommendation, and (2) lacked a fiduciary out permitting the board to terminate the merger agreement for a superior proposal. *See* 818 A.2d at 936.
372. *OPENLANE*, 2011 WL 4599662, at *9–10.
373. *Id.* at *9.
374. *Id.* at *10.
375. *Id.*
376. *Id.*
377. *Id.*

Conclusion

OPENLANE demonstrates that, in some circumstances, directors can satisfy their obligations under *Revlon* even if they stray from the "norms" of conducting a pre-signing market check and obtaining a fairness opinion, at least where the members of the board possess a significant equity interest and exhibit "impeccable knowledge" of the company's business. While the court noted that the sale process in *OPENLANE* was not a "model" typically to be followed, the decision illustrates the fact-intensive nature of the *Revlon* analysis, and reaffirms that "[t]here is no single path that a board must follow in order to maximize stockholder value, but directors must follow a path of reasonableness which leads toward that end."[378]

Further, the decision confirms that obtaining stockholder approval by written consent shortly after the execution of a merger agreement does not constitute an impermissible "lock up" in violation of *Omnicare*.

378. *Id.* at *5 (quoting *In re* Smurfit-Stone Container Corp. S'holder Litig., No. 6164-VCP, 2011 WL 2028076, at *16 (Del. Ch. rev. May 24, 2011)).