DEAL CASE LAW UPDATE

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EFFECTS OF TERMINATION

TERMINATION OF MERGER AGREEMENT DEPRIVES INJURED PARTY OF REMEDIES

- Buyer agrees to acquire Seller
- Merger consideration = new class of preferred stock
  - Convertible at fixed price, establishing value floor for Seller's shareholders
- Buyer needed to register new stock, via S-4, as "promptly as practicable" and use its "reasonable best efforts" to have the SEC declare the registration effective
- Seller terminated agreement and then sued for damages alleging, among other things, breach for Buyer's failure to register new stock

TERMINATION OF MERGER AGREEMENT DEPRIVES INJURED PARTY OF REMEDIES

Exercise caution when terminating

- Under merger agreement, however, parties agreed that termination extinguished all parties' obligations to each others – including remedies

Yatra Online, Inc. v. Ebix, Inc., (Del. Ch. Aug. 30, 2021), *aff'd*, (Del. Apr. 11, 2022)

- Seller could have sued for damages (and not terminated)
- Seller could have tried to obtain specific performance as to registration
- But Seller could not have terminated and then sued for damages

"AND"

AND SO WHAT IS THE MEANING OF THE WORD "AND"? CONJUNCTION / DISJUNCTION MALFUNCTION

- *Weinberg v. Waystar, Inc.*, 2022 WL 2452141 (Del. Ch. July 6, 2022)
- The Situation:
  - Plaintiff is an executive who is hired by the Defendant. She receives various equity compensation incentives.
  - About three years later, her employment is terminated. The equity awards held by Defendant …. *"shall be subject to the right of repurchase … exercisable by [Defendant] … as determined by [Defendant] in its sole discretion, during the six month period following (x) the (i) Termination of [Plaintiff's] employment with [Defendant] for any reason …* ***and*** *(y) a Restrictive Covenant Breach."*
  - Both sides agree that no Restrictive Covenant Breach has occurred. Defendant seeks to repurchase the equity awards held by Plaintiff. Can it?

INTERPRETATIONS OF CONTRACTS

- The parties sought a judgment on the pleadings. This can only be granted when "the contract provisions at issue are unambiguous."
  - Contracts are not unambiguous simply because the parties disagree about what the contract means – rather, the provisions must be "reasonably or fairly susceptible of different interpretations."
- The court find that in this case "and" is meant in the "several" (disjunctive) sense, rather than the "joint" (conjunctive) sense
  - Court finds that in general, when "and" is used in a **permissive** sentence, it is usually meant to be used in a several / disjunctive sense – "'You can take a doughnut, a Danish and a bagel' invites, but does not mandate, gluttony"
  - (As an aside – in this particular case, the executive's proposed interpretation would also render another provision in the agreement superfluous)

THREE EQUIVALENT SENTENCES

- 1: "He may contribute to charitable or educational institutions."
- 2: "He may contribute to charitable institutions and educational institutions." [Here, "and" is several, and not joint.]
- 3: "He may contribute to charitable institutions or educational institutions." [Here, "or" is inclusive, not exclusive.]

ADDRESSING THIS ISSUE IN AGREEMENTS

- "[Consequence] shall apply *[if all of] / [if any of]* the following circumstances are present
- May attempt to address in the interpretation section, but some danger in doing this
  - *Unless the context otherwise requires, when the word "and" is used in a permissive sentence, it shall be interpreted to mean in a several (and/or) manner rather than joint manner*
- Interpretation sections more frequently address the interpretation of "or": *the word "or" shall be disjunctive and not be exclusive*

IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

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- Does a company that leased a dock at a port to unload fuel have the right, under the implied covenant, to allow its customers to cross the port's land to collect that fuel?
  - When negotiating lease, the companies did not address whether there was a contractual right to use the disputed roads to access tanks
  - Lease agreement was silent
    - Did not explicitly grant the company or customers the right to use the roads to access tanks
    - Did not speak to the issue in any other way

IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

- Court: Yes, right to access the tanks under the **implied covenant and fair dealing**
  - "The reality of [the company's] access was so fundamental that it did not warrant consideration," as there was no other way to get to the leased tanks
  - The company had conducted the same business at the port and had been using the roads in question to access its tanks for almost 50 years
  - Without being able to access the tanks, the dock was useless, and vice versa
- **Takeaway** = Delaware courts will still invoke the implied covenant when they believe the facts warrant it, but only when the strict criteria for doing so are met

Buckeye Partners, LP v. GT USA Wilmington LLC, 2020 WL 2551916 (Del. Ch. Mar. 29, 2022)

FRAUD AND EXTRACONTRACTUAL REMEDIES

THAT PERENNIAL SOURCE OF CASE LAW: FRAUD CLAIMS AND CONTRACTUAL EFFORTS TO PREVENT THEM

- *Online Health Now, Inc. v. CIP OCL Investments, LLC*, 2021 WL 3557857 (Del. Ch. Aug. 12, 2021)
- The Situation:
  - Online HealthNow purchases an online education company from a PE firm
  - The agreement includes the following limitations:
    - Reps don't survive closing
    - Buyer reps that it did not rely on any reps from any person other than those set forth in the SPA
    - Non-recourse provision – SPA may only be enforced by parties to the agreement
  - After the closing, Buyer alleges that there were breaches of reps and sues not only the seller, but other affiliates of Seller

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THE WALKING DEAD: NON-SURVIVAL AND NON-RECOURSE DEFEATED

- The defense moved to dismiss on the ground that the reps did not survive closing
  - **The court disagreed**: the seller "cannot invoke a clause in a contract allegedly procured by fraud to eviscerate a claim that the contract itself is an instrument of fraud"
  - The court also casts doubt on a prior case (*Sterling*) that suggested that such a cut-off would be allowed if there was a "reasonable" diligence and claim period
- The defense also argued that the claims against non-parties should be dismissed, per the non-recourse provision
  - **The court disagreed**: "Commentators and courts have generally understood Delaware law to disregard non-recourse clauses where the parties purportedly insulated by those clauses were complicit in contractual fraud."

SELLER EFFORTS TO LIMIT EXPOSURE TO FRAUD CLAIMS: "WHAT," "WHEN," "WHO" AND "HOW MUCH"

- "**What**" information the may the buyer rely upon
  - *ABRY: The parties may contractually disclaim reliance on extra-contractual statements, but a seller may not contractually limit its liability for making knowingly false statements in the contract itself*
- "**When**" the buyer may bring a claim
  - *Online Health: A non-survival provision will not stop a fraud claim made after closing*
- "**Who**" among the sellers may be held liable
  - *Online Health: A non-recourse claim will not stop a claim against a non-party that was complicit in a fraudulent statement made within the purchase agreement*
- "**How much**" the buyer may recover if it proves its claim
  - *ABRY: Contractual caps for indemnification claims will not cap the recovery for contractual fraud*

THE WORLD BEYOND DELAWARE: THERE BE MONSTERS (AND FLORIDA)

- *NM Residential, LLC v. Prospect Park Dev., LLC*, 336 So. 3d 807 (Fla. Dist. Ct. App. 2022)
- Plaintiff bought a property development from the defendant seller. Plaintiff asked the developer to fix certain defects and developer told plaintiff that it had done so. After closing, the plaintiff found the property still had some of the defects and sued.
- The contract had the following protections for the seller:
  - An "as-is" clause that includes a disclaimer by seller of any extracontractual or implied representations
  - An acknowledgment by buyer of the foregoing and a disclaimer by buyer of any reliance on extracontractual representations
  - An integration clause

WINGARDIUM LEVIOSA: APPROPRIATE MAGIC LANGUAGE MAY SOMETIMES BE NEEDED

- What the contract did not have, however, was an express affirmation that fraud may have been committed, which was required under FL Supreme Court precedent (*Oceanic Villas)*
- Applying *Oceanic Villas*, the court found that the plaintiff's claims were not barred:
  - "It may seem intuitive that a combination of provisions such as an as-is clause, a disclaimer affirming that there were no representations of the seller on which the purchaser is relying, an averment that the purchaser would rely instead on its own investigation, a general release, and an integration clause would eliminate the seller's liability for fraudulent misrepresentations on which the purchaser might later claim to have relied. … However, until such time as … [*Oceanic Villas* is revisited] … something more is needed -- a contractual "[recognition] that fraud may have been committed and a stipulation that such fraud, if found to be committed, should not vitiate the contract."

WATCH-OUTS

- Selection of governing law in contracts
- Another demonstration that form sometimes prevails over substance, particularly in areas where public policy is hostile to disclaimers
  - A court will not necessarily combine different provisions to find an implied waiver

THE FORTHRIGHT NEGOTIATOR PRINCIPLE

FORTHRIGHT NEGOTIATOR PRINCIPLE

- SPA purchase price included possibility of earnout payments
  - Three payments of up to $13.3 million if EBITDA targets (based on pre-acquisition financial projections) were satisfied
    - Each “Measurement Period” had its own EBITDA target
- Sellers negotiated limitations on Buyer’s operational freedom
  - Buyer required to acquire not less than 60 tractors during each Measurement Period
  - If Buyer violated any operating covenant, earnout payments would be accelerated and due within days of breach

FORTHRIGHT NEGOTIATOR PRINCIPLE

Acquire not less than 60 tractors every year for three years after the acquisition

- Buyer
  - Covenant required Buyer only to acquire at least 60 tractors per year
  - Buyer undisputedly did

- Sellers
  - Covenant required Buyer to grow fleet of tractors by at least 60 tractors per year
  - Buyer undisputedly did not do (because also sold/eliminated tractors)

FORTHRIGHT NEGOTIATOR PRINCIPLE

Contract language

- Operating covenant required Buyer to "acquire not less than 60 tractors"
- Buyer bought at least 60 tractors, but also sold 60+ tractors
- Breach? Ambiguous contract

Extrinsic evidence

- Forecasts, LOIs, SPA drafting history
- Supported reasonable interpretation that Buyer had to grow fleet
- But evidence did not lead to "obvious conclusion" regarding intent

Forthright Negotiator Principle

- Buyer: Reasons to know the sellers understood the covenant to require growing truck fleet
- Sellers: No reason to know Buyer understood covenant to require only buying 60 trucks per year

FORTHRIGHT NEGOTIATOR PRINCIPLE

- Under the **Forthright Negotiator Principle**, "only an objectively reasonable interpretation that is in fact held by one side of a negotiation and which the other side knew or had reason to know that the first party held can be enforced as a contractual duty."
  - If Party A knew or had reason to know of Party B's reasonable understanding during negotiations and did not contradict it, Party B's understanding can be enforced, but only where (1) contract language is ambiguous and (2) extrinsic evidence does not lead to an obvious conclusion about shared intent

Schneider Nat'l Carriers, Inc. v. Kuntz, 2022 WL 1222738 (Del. Super. Ct. Apr. 25, 2022)

SANDBAGGING IN DELAWARE

TOO MUCH KNOWLEDGE, TOO LITTLE KNOWLEDGE – SANDBAGGING AND JUSTIFIABLE RELIANCE

- *Arwood v. AW Site Servs., LLC*, 2022 WL 705841 (Del. Ch. Mar. 9, 2022)
- The Situation:
  - Plaintiff is an entrepreneur who starts a family of waste collection companies, including rentals of dumpsters and portable toilets
  - "[A]lthough he built a large waste business, [Plaintiff] was an alarmingly unsophisticated businessman" – kept no financial records and had very … *informal* … business and compliance practices
  - A private equity buyer became interested in the company; the buyer generated the financial statements of the target and had full access to all of the target's records for the diligence process
  - After the closing, a variety of problems emerged – the buyer alleged breaches of reps and fraud

HOW DOES DELAWARE FEEL ABOUT SANDBAGGING?

- The court considered whether the buyer could assert claims for rep breaches even if the buyer knew at signing that they were untrue (i.e., "sandbagging")
  - *"In the 19th century, ruffians roamed the streets armed with cotton socks. These ostensibly harmless socks were filled with sand and used as weapons… . Sandbaggers, as they came to be known, were reviled for their deceitful treachery: representing themselves as harmless, until they have you where they want you."*
- The agreement was silent as to whether knowledge of a breach forecloses the claim, and question had never been directly addressed in Delaware

HOW DOES DELAWARE FEEL ABOUT SANDBAGGING?

- Court finds that Delaware is a pro-sandbagging state
  - *"When parties choose not to (or fail to) allocate the risk of sandbagging in their contract, the buyer may rest on its reasonable belief that it has acquired as part of the transaction the seller's implicit promise to be truthful in its representations. … Reliance, whether justified or unjustified, is not a* prima facie *element of breach of contract."*
- Caution should be exercised by would-be sandbaggers
  - "Forthright negotiator" concepts can come into play in some interpretations
  - MAE case law often focuses on "unanticipated" versus "anticipated" events (with greater protection given to buyers for "unanticipated" events)
  - The Delaware chancery court is a court of equity, and that ethos can seep into decisions

WHAT ABOUT BUYER'S FRAUD CLAIM?

- For the buyer, there is good news and bad news:
  - The good news: court finds that at least one of the Seller's reps in the purchase agreement has been breached
  - The bad news: the purchase agreement has one of those pesky caps on damages for general rep breaches (the buyer asserts ~$9.8MM of damages; the cap is $3.9MM)
- The buyer's solution: also assert a fraud claim (which would avoid the cap)
- The court ultimately rejects the fraud claim:
  - Buyer was unable to prove scienter by the Seller – the Seller provided complete access to the target's records and no indication of an intent (or ability) to deceive
  - Buyer was also unable to show justifiable reliance – the Buyer knew, or clearly should have known, about the issues prior to signing

BOOKS AND RECORDS

BOOKS AND RECORDS AND CURRENT TRENDS

Who	• Stockholders (beneficial and of record)
How	• Evidence of ownership for beneficial stockholders
What	• Books and records (and potentially of sub)
Why	• Proper purpose = reasonably related to interest as stockholder

- Statue allows stockholders to access corporate "books and records"
- Need "credible basis" to investigate potential mismanagement or other wrongdoing
  - Lowest possible burden of proof

BOOKS AND RECORDS AND CURRENT TRENDS

- Not just traditional, core board materials (minutes, board books, etc.)
- Stockholders seeking increasingly broad set of materials
  - **Text messages** and **emails**
  - From **personal** accounts
  - From **directors** and **officers** – and other employees, too

BOOKS AND RECORDS AND CURRENT TRENDS

- *Garner* exception to attorney-client privilege:
  - (i) necessity of the information and its availability from other sources
  - (ii) whether the plaintiff's claim is colorable; and
  - (iii) the extent to which the information is specifically identified
- Shareholder-plaintiff made a "credible basis" sufficient to invoke exception in Section 220 context
- Privileged materials required to be produced

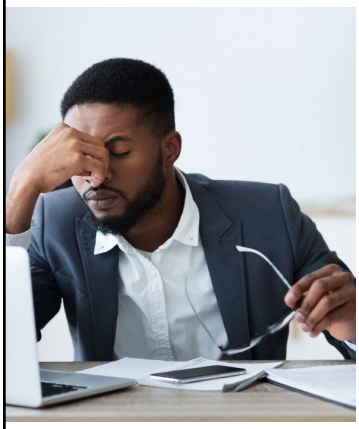
BOOKS AND RECORDS AND CURRENT TRENDS

- "[The company]—met with a facially valid Section 220 demand and allegations of wrongdoing—took the lessons of our case law to heart. It did not reject the demand out of hand, place unreasonable conditions on inspection, or raise a panoply of merits-based defenses."
- "Instead, [the company] attempted to avoid litigation by producing the core, formal board materials that generally satisfy a company's obligations under Section 220 …. [This] production ultimately proves fatal to the plaintiff's demand for a broader inspection."

- "Regrettably, [the company's] overly aggressive defense strategy epitomizes a trend."
- "Fee shifting may be appropriate here. [The company] exemplified the trend of overly aggressive litigation strategies … for no apparent purpose other than obstructing the exercise of Plaintiffs' statutory rights."
- "[The company's] pre-litigation failure to provide any Plaintiff with even a single document despite the ample evidence of a credible basis and the obvious responsiveness of certain categories of documents amplifies the court's concerns."

THE (ONGOING?) TWITTER SAGA
A TOUR DE FORCE OF LEGAL ISSUES

TWITTER/MUSK – SHAREHOLDER LITIGATION FALLOUT



- Twitter shareholders vs. Musk
  - – Market manipulation
  - – Breach of fiduciary duty (against Musk as “controlling” stockholder)
  - – Breach of contract (seeking specific performance)
    - Merger agreement had no third-party beneficiary clause
  - – Failure to file Schedule 13D on time

WHEN DO PUBLIC SHAREHOLDERS HAVE THIRD-PARTY BENEFICIARY STATUS?

- Merger agreement included a "no third party beneficiaries" provision
  - No general exception made for shareholders
  - Limited exceptions made for other customary circumstances (like D&O exculpation) – presence of these limited exceptions made case for otherwise broad enforcement of "no third party beneficiaries" principle stronger
  - Merger agreement had "anti-Con Ed" provision: *"no termination shall relieve any party hereto of any liability or damages … [which] would include the benefits of the transactions contemplated by this Agreement lost by [Twitter's] stockholders … including lost stockholder premium … in which case the aggrieved party shall be entitled to all rights and remedies at law or in equity."*
    - Court notes that this passage is open to interpretation and allowed for further briefing

WAS ELON MUSK A FIDUCIARY TO TWITTER? (AND THEREFORE OWES FIDUCIARY DUTIES?)

- Court rejects idea that Musk was an affiliate of Twitter – rejected that any of the following, alone or together, was sufficient to infer controlling status
  - Ownership position (~9%), even if combined with ownership positions of potential co-investors (would have brought him to ~26%)
  - The fact that the merger agreement was signed following his agitation
  - Contractual rights granted in the interim operating covenant
  - Relationship with Jack Dorsey (founder of Twitter and 1 of 11 directors)

Crispo v. Musk, 2022 WL 6693660 (Del. Ch. Oct. 11, 2022)

FLAGRANT FOUL: FAILURES TO COMPLY WITH SECTION 13(D) OF THE EXCHANGE ACT

- Required filings for large shareholders under Section 13(d) of the Exchange Act:
  - Schedule 13D – due within 10 calendar days of acquiring >5% of class
  - Schedule 13G – due within 10 calendar days of acquiring >5% of class (for passive investors; different timing applies for certain qualified institutional investors)
- Timeline:
  - *January 31, 2022*: Musk begins to acquire Twitter stock
  - *March 14, 2022*: Musk crosses 5% threshold
  - *March 24, 2022*: Schedule 13D/13G would be due (at this point Musk owns ~7.5%)
  - *April 4, 2022*: Musk files 13G, disclosing 9.2% position; Twitter stock price increases ~27%
  - *April 5, 2022*: Musk joins Twitter board
  - *April 6, 2022*: Musk files 13D

WHAT IS THE PENALTY FOR WRONGDOING?

- SEC investigation launched – but how much investigation is really needed?
  - Sanction: Fines? Something else?
- Private shareholder lawsuit
  - Federal class action shareholder lawsuit filed by Twitter shareholders who sold between March 24 and April
  - Lawsuit alleges violations of Section 10(b) of the Exchange Act and Rule 10b-5

102(B)(7)

102(B)(7) AMENDMENT – OFFICER EXCULPATION

- Until August 2022, DGCL Section 102(b)(7) permitted a company's charter to eliminate or limit only a director's personal liability to the corporation or its stockholders for monetary damages stemming from breaches of the duty of care
- The gap between treatment of directors and officers allows plaintiffs, under certain circumstances, to pursue claims against officers in M&A litigation even after courts have dismissed similar claims against directors
  - Ex: Disclosure violations where plaintiffs need to plead only that a breach of care is "reasonably conceivable"
- In August 2022, Section 102(b)(7) was amended to allow for exculpation of certain officers for certain claims

102(B)(7) AMENDMENT – OFFICER EXCULPATION

- Protections available to directors and officers under Section 102(b)(7) are not identical
  - Derivative vs. direct (class) claims
- Officers include a company's president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer, as well as other individuals identified in public filings as the company's most highly compensated officers
- Companies that amend their charters (shareholder vote required) to include an officer exculpation provision will close the gap between directors and officers

OFFICER EXCULPATION: DELAWARE VS. OHIO

Ohio § 1701.641 (since 2016)

- An officer shall be liable in damages for a violation of the officer's [fiduciary] duties … only if it is proved by **clear and convincing evidence** … that the officer's action or failure to act involved an act or omission undertaken with **deliberate intent to cause injury** to the corporation or undertaken with **reckless disregard for the best interests** of the corporation.
- Ohio does not distinguish between derivative vs. direct (class) claims

QUESTIONS?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