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The Delaware Court of Chancery Enforces Clear and Unambiguous Terms of Merger Agreement in Finding Termination Fee Provision Did Not Afford Exclusive Remedy for Termination

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The Delaware Court of Chancery's recent decision, *Genuine Parts Company v. Essendant Inc.*,[1] provides a helpful reminder that Delaware courts will enforce the clear and unambiguous terms of a merger agreement, and will consider contractual interpretation issues on a motion to dismiss when it finds the contractual terms to be clear and unambiguous. In *Essendant*, the Court denied the defendant's motion to dismiss and found that: (i) Genuine Parts Company ("GPC") adequately pled that the termination fee in the merger agreement was not the exclusive remedy for termination; (ii) GPC did not waive its breach of contract claim by accepting the termination fee; and (iii) GPC pled sufficient facts to support a reasonably conceivable claim that the exclusivity provision in the merger agreement between the parties was a material term. This decision once again reinforces the need for parties to be mindful when negotiating and drafting a contract that contractual provisions reflect their understanding of the agreements they have made. [2]In particular, *Essendant* cautions that contracting parties who want to limit recovery to the terms of the termination fee provision should carefully craft broad termination fee provisions that clearly and unambiguously state the parties' intentions. *Essendant* also serves as a further reminder that a contractual party's acceptance of a termination fee will not preclude that party from pursuing a breach of contract claim.

Background

This action arises from a merger agreement between GPC and Essendant Inc. ("Essendant"), two companies involved in the wholesale distribution of office supplies. In September of 2017, GPC and Essendant began discussing a merger. Three days before the parties signed a merger agreement,

Sycamore Partners ("Sycamore"), a private-equity firm, expressed an interest in purchasing Essendant. The Essendant board of directors (the "Board") decided not to pursue a deal with Sycamore at that time, and signed the merger agreement with GPC on April 12, 2018 (the "Merger Agreement"). Pursuant to the terms of the Merger Agreement, GPC shareholders would receive approximately 40.2 million shares of Essendant common stock, representing approximately 51% of Essendant's outstanding shares. Essendant's existing shareholders would hold the remaining 49% of the outstanding shares. The Merger Agreement contained a non-solicitation provision that required Essendant to abandon all pending merger negotiations and prohibited Essendant from pursuing a competing transaction unless the competing transaction constituted a Superior Proposal, defined as a proposal that the Board "determines, in its good faith judgment, after consulting with a financial advisor of internationally recognized reputation and external legal counsel . . . to be (a) more favorable from a financial point of view, to the stockholders of [Essendant] than the Merger and (b) reasonably expected to be consummated." If Essendant determined to pursue a Superior Proposal, it could terminate the Agreement by paying GPC a termination fee.

On April 17, 2018, Sycamore officially offered to purchase all of Essendant's outstanding stock at a price of $11.50 per share. The Board rejected this proposal on April 24, 2018 and informed GPC of the offer three days later. On April 29, Sycamore issued a second offer, promising the same stock price but indicating that it might increase the price per share after conducting due diligence. Essendant thereafter determined that Sycamore's renewed offer constituted a Superior Proposal under the terms of the Merger Agreement and informed GPC of the offer on May 4, 2018.

GPC disagreed that Sycamore's offer constituted a Superior Proposal based on a preliminary cash flow analysis that revealed the implied share price for Essendant was much lower than the implied share price resulting from the GPC merger. GPC informed Essendant that any further negotiations with Sycamore would breach the Merger Agreement. GPC also offered additional consideration in the form of a contingent value right, through which GPC would pay Essendant stockholders an additional $4 per share at the end of 2019. Essendant's Board rejected GPC's contingent value right offer on June 1, 2018 and continued negotiating with Sycamore. Essendant publicly announced a merger with Sycamore on September 10, 2018, paid GPC the contractual termination fee of $12 million and terminated the Merger Agreement on September 14, 2018. Essendant explained that it believed Sycamore's proposal was superior to GPC's proposal after Essendant discovered documents that showed GPC believed Essendant was a competitor, which created antitrust risks.

GPC filed a complaint on October 10, 2018, claiming, among other things, that Essendant's negotiations with Sycamore and its termination of the Merger Agreement in favor of an inferior proposal breached the Merger Agreement, and that the termination fee was neither an exclusive nor adequate remedy for the breach. Essendant moved to dismiss, arguing that the termination fee was the exclusive remedy, regardless of whether or not it was adequate.

The Court denied Essendant's motion to dismiss because, in the Court's view, under the clear and unambiguous terms of the Merger Agreement, the termination fee was not the exclusive remedy if the termination was not the result of a Superior Proposal or if it resulted from a breach of the non-solicitation provision. The Court further found that, though "GPC's acceptance of the Termination Fee may present factual and legal issues for its damages claim," it has "adequately pled facts that allow a reasonable inference that GPC's acceptance of the Termination Fee does not prevent it from pursuing damages caused by" termination after an alleged breach of contract.

Takeaways

- **Contracting parties must clearly and unambiguously state their intention for a termination fee to be the exclusive remedy for a breach of a merger agreement**. The Merger Agreement's termination provision stated in Section 9.03(e):

notwithstanding anything in this Agreement to the contrary (including Section 9.02), ***in the event that the Termination Fee is paid in accordance with this Section 9.03***, the payment of the Termination Fee shall be the sole and exclusive remedy of GPC . . . and in no event will GPC or any other such Person seek to recover any other money damages or seek any other remedy based on a claim in law or equity . . . .

The Court found that because Essendant terminated the Merger Agreement under Section 9.01(g), Essendant's obligations were governed by and depended on whether it acted "in accordance with" Section 9.03(a)(ii), which contemplated termination "pursuant to" Section 9.01(g). Section 9.01(g) allowed Essendant to terminate if it entered into a Superior Proposal pursuant to Section 7.03(d)(ii). Section 7.03(d)(ii), in turn, permitted termination under Section 9.01(g) provided that Essendant received a proposal in connection with a "Competing [Essendant] Transaction" that did not arise from a material breach and which the Essendant Board determined was a Superior Proposal. According to GPC (and for reasons explained below), Essendant's termination under Section 7.03(d)(ii) arose from (1) receipt of a proposal arising from a material breach of the non-solicitation provision, and (2) an inappropriate determination by the Board that the proposal constituted a Superior Proposal. Because the Court found these allegations plausible, it concluded that GPC had adequately alleged that the termination fee was not paid "in accordance with . . . Section 9.03." In that case, the termination provision did not provide the exclusive remedy.

The Court distinguished its ruling from *Cirrus Holding Co. v. Cirrus Industries, Inc.* [3] which involved a similar exclusive remedy provision. However, in *Cirrus*, the merger agreement provided that the termination fee was the exclusive remedy just so long as Cirrus "consummate[d] an Alternative Transaction." The *Cirrus* provision, therefore, was much broader than the one contained in the Merger Agreement between GPC and Essendant. Indeed, the fact that the termination provision in *Cirrus* was unconditional and merely applied once a qualifying alternative transaction was consummated was "important to Vice Chancellor Lamb's decision."

- **Delaware courts respect and enforce protective covenants, such as non-solicitation clauses, in merger agreements**. In the Merger Agreement, the non-solicitation provision expressly required Essendant to "immediately cease and cause to be terminated all existing discussions or negotiations with any [p]ersons . . . with respect to a Competing . . . transaction." Here, Sycamore expressed an interest in purchasing Essendant three days before Essendant signed the GPC agreement, but Essendant never disclosed that fact to GPC. Then, after it entered the Merger Agreement with GPC, Essendant received an official offer from Sycamore and, after declining that offer, allegedly told Sycamore it would entertain a revised offer, which "support[ed] a pleading stage inference of breach of" the non-solicitation provision. Essendant then declared a revised offer from Sycamore to be superior even though it was at the same price as the prior offer, but accompanied only by Sycamore's representation that it might offer more depending on the results of due diligence. Sycamore did submit a higher bid, suggesting that Essendant had provided Sycamore with material non-public information on terms that were less restrictive than those in the confidentiality agreement between Essendant and GPC, in violation of the Merger Agreement. These allegations permitted a reasonable inference that the Board "'directly' or 'indirectly' shared its preferences or inclinations with Sycamore, thereby encouraging it to resubmit its offer with

a slight alteration so the board could 'properly' begin competing negotiations.'" Therefore, GPC adequately pled that the provision of non-public information to Sycamore violated the non-solicitation agreement.

- **Courts will review the allegations supporting a breach of contract claim as a whole, and will draw all reasonable inferences in plaintiff's favor**. In denying Essendant's motion to dismiss, the Court noted that "none of GPC's allegations, standing alone, would support a claim that Essendant breached the Non-Solicitation Provision." However, the Court, "taking a cue" from the Court of Chancery's decision in *NACCO Industries, Inc. v. Applica, Inc.*,[4] determined that the allegations as a whole sufficiently stated a breach of the Merger Agreement. For example, with respect to GPC's breach of Section 7.03(a) claim, the Court considered the fact that (1) Sycamore was not a pop-up bidder, (2) Essendant knew about Sycamore's interest in a transaction prior to entering into the Merger Agreement, (3) the non-solicitation provision required Essendant to terminate its discussions with potential competing bidders, and (4) Essendant told Sycamore it would consider a higher offer after it entered the agreement with GPC. Though none of these facts alone may support GPC's breach allegations, collectively they stated a claim for breach of the non-solicitation provision, particularly at the pleading stage, where the Court must draw all inferences in GPC's favor. When viewing the allegations as a whole, and drawing all inferences in GPC's favor, the Court found GPC had sufficiently stated a "pleading stage inference" of breach of the Merger Agreement.

- **Accepting payment of a termination fee does not waive other remedies for breach of a merger agreement**. The Court determined, as a matter of law, that there was "no basis to conclude that [GPC's] acceptance of the Termination Fee precludes it from pursuing breach of contract claims." Rather, according to the Court, the exclusive remedy provision clearly would not apply if the termination fee was not paid "in accordance with Section 9.03." Because the Court found that GPC had sufficiently pled allegations that Essendant breached the non-solicitation and Superior Proposal provisions in the Merger Agreement, its acceptance of the termination fee did not impede GPC's ability to pursue additional damages. In its ruling, the Court relied on *NACCO,*[5] where Vice Chancellor J. Travis Laster similarly found that acceptance of a termination fee did not preclude a breach of contract claim, although Vice Chancellor Laster also acknowledged that such acceptance could serve as a limitation on damages. The Court here found Vice Chancellor Laster's findings "instructive" and determined that, although GPC's acceptance of the fee may impact GPC's damages claim, it did not preclude GPC from pursuing that claim.

- **The right to secure the exclusive ability to close a transaction is a material term**. Under Delaware law, a material breach is the "failure to do something that is so fundamental to a contract that the failure to perform that obligation defeats the essential purpose of the contract or makes it impossible for the other party to perform under the contract." The Court determined it was reasonable to infer from the pleadings that securing the exclusive ability to merge with Essendant was a fundamental purpose of the Merger Agreement and, therefore, a material term to GPC. Factors evidencing the materiality of the non-solicitation provision included the fact that GPC alleged that it was only pursuing a merger with Essendant, and the broad nature of the non-solicitation provision. The Court, therefore, found it was "reasonable to infer that a fundamental purpose of the Agreement, from GPC's perspective, was lawfully

to secure GPC's exclusive ability to merge with Essendant." This outcome reinforces the legality and enforceability of no-shop provisions, and serves as a reminder that Delaware courts will enforce such provisions so long as they are not overly restrictive.

Please click here for the full *Essendant* opinion.

1 2019 WL 4257160 (Del. Ch. Sept. 9, 2019).

2 *See also* J. Halper, *et al.,* Delaware Court of Chancery Strictly Interprets Merger Agreement in Finding That Rent-A-Center, Inc. Properly Terminated Its Proposed Merger with Vintage Rodeo, Cadwalader, Wickersham & Taft LLP (Apr. 4, 2019),.

3 794 A.2d 1191 (Del. Ch. 2001).

4 997 A.2d 1, 17 (Del. Ch. 2009). In *NACCO*, the Court stated "I recognize that each of the allegations in the Complaint, when viewed separately and in isolation, can be minimized . . . . My task at the pleadings stage, however, is not to weigh competing inferences but rather to draw reasonable inferences in favor of the plaintiff."

5 997 A.2d 1.

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