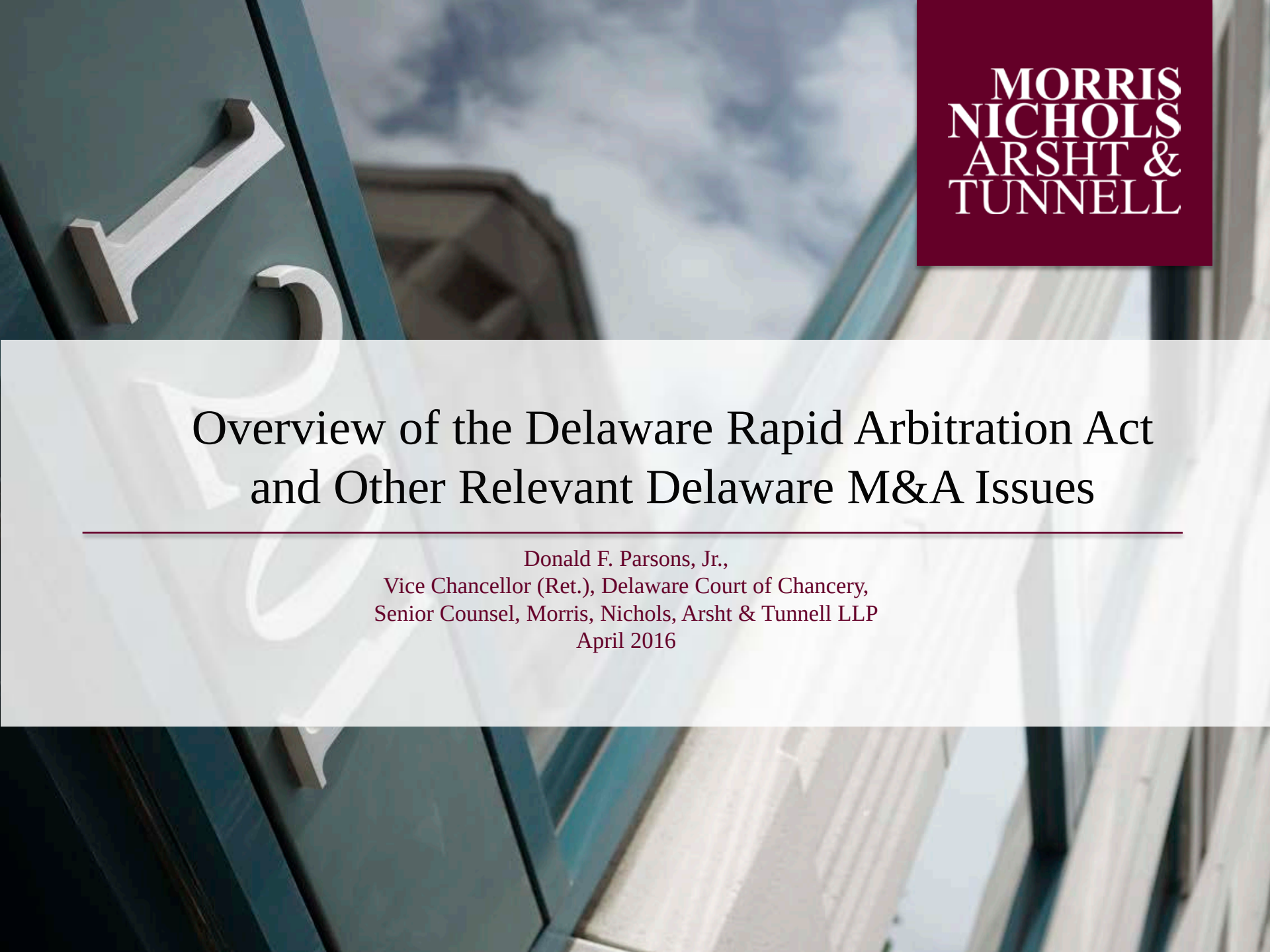

MORRIS NICHOLS ARSHT & TUNNELL

Overview of the Delaware Rapid Arbitration Act and Other Relevant Delaware M&A Issues

Donald F. Parsons, Jr.,
Vice Chancellor (Ret.), Delaware Court of Chancery,
Senior Counsel, Morris, Nichols, Arsht & Tunnell LLP
April 2016

The Attorney-Client Privilege in M&A

- *Great Hill Equity Partners v. SIG Growth Equity Fund*, 80 A.2d 155 (Del. Ch. 2013).
  - Court holds that <u>all</u> sell-side privilege passes to the buyer under Section 259 of the DGCL.
  - <u>Deal Structure</u>:
    - Target: Plimus, Inc., VC-backed payments processing company.
    - Reverse triangular merger.
    - California target survived, but merger agreement provided that the merger would have effects under California and Delaware law.
  - <u>Post-Closing Dispute</u>:
    - A full year after closing, the buyer sued the sellers, stockholders' representative and others, claiming fraud in connection with representations about the health of the business.
    - The buyer had taken possession of pre-closing, merger-related communications between sellers and sell-side deal counsel.
    - The buyer promptly notified the sellers; parties disputed privilege.

The Attorney-Client Privilege in M&A

- *Great Hill Equity Partners v. SIG Growth Equity Fund*, 80 A.2d 155 (Del. Ch. 2013).
  - Statutory Interpretation:
    - DGCL Section 259 provides that in a merger, "**all** property, rights, **privileges**, powers and franchises, and all and every other interest" of the constituent corporations "**shall be thereafter as effectually the property of the surviving or resulting corporation**."
    - Then-Chancellor Strine held that this language unambiguously included the constituent corporations' attorney-client privilege and that, as a result, control of the privilege passes as a matter of law in a merger.
  - Contract Out:
    - Then-Chancellor Strine expressly acknowledged that parties could have "negotiated special contractual agreements to protect themselves and prevent certain aspects of the privilege from transferring to the surviving corporation in the merger."
  - Takeaways:
    - For example, a seller may negotiate for a provision opting out of Section 259 to maintain for itself the privilege and any privileged information relating to the sale transaction.

The Attorney-Client Privilege in M&A

- *Sample Privilege Provision* (taken from recent publicly filed acquisition agreement, with formatting added)
  - (x) all communications prior to the Effective Time among any member of the Seller Group, the Company and its Subsidiaries, any of their respective Affiliates, directors, officers, employees or Advisors, and Company Counsel that relate to the negotiation, preparation, execution, delivery and closing under, or any dispute arising in connection with, this Agreement, or otherwise relating to any potential sale of the Company or the Transactions (the "Specified Communications"), will be deemed to be privileged and confidential communications and
  - (y) all rights to such Specified Communications, the expectation of client confidentiality, and the control of the confidentiality and privilege applicable thereto, belong to and will be retained by the Seller Group.
- The Specified Communications may be used by the Seller Group and/or any of their respective Affiliates in connection with any dispute that relates in any way to this Agreement or the Transactions.
- In the event that a dispute arises between the Surviving Corporation and its Affiliates, on the one hand, and a third party other than the Seller Group (solely in their capacity as equityholders of the Company or the Representative), on the other hand, the Surviving Corporation and its affiliates may assert the attorney-client privilege with respect to Specified Communications to prevent disclosure of confidential communications to such third party.

Choice of Law

- The Restatement (Second) of Conflicts of Laws
  - Delaware follows the Restatement (Second) of Conflicts of Laws, pursuant to which the parties' choice of law will generally control an agreement.
  - In relevant part, the Restatement (§ 187(2)) provides that:
    - (2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either
      - (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
      - (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

Choice of Law

- The Delaware Statute on Choice of Law
  - Delaware courts are bound to respect contract parties' chosen law as long as the chosen law has a material relationship to the transaction.
  - A Delaware statute (*6 Del. C. § 2708*), however, provides, in relevant part:
    - (a) The parties to any contract, agreement or other undertaking, contingent or otherwise, may agree in writing that the contract, agreement or other undertaking shall be governed by or construed under the laws of this State, without regard to principles of conflict of laws, or that the laws of this State shall govern, in whole or in part, any or all of their rights, remedies, liabilities, powers and duties if the parties, either as provided by law or in the manner specified in such writing are: (1) Subject to the jurisdiction of the courts of, or arbitration in, Delaware; and (2) May be served with legal process. ***The foregoing shall conclusively be presumed to be a significant, material and reasonable relationship with this State and shall be enforced whether or not there are other relationships with this State.*** (b) Any person may maintain an action in a court of competent jurisdiction in this State where the action or proceeding arises out of or relates to any contract, agreement or other undertaking for which a choice of Delaware law has been made in whole or in part and which contains the provision permitted by subsection (a) of this section. (emphasis added).

Choice of Forum

- The Delaware Statute:
  - Section 115 of the Delaware General Corporation Law, covering forum selection provisions, states: "The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State, and no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State. 'Internal corporate claims' means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery."

Bonanno v. VTB Holdings, Inc.

- *Bonanno v. VTB Holdings, Inc.*, 2016 WL 614412 (Del. Ch. Feb. 8, 2016).
  - The Court held that the enforcement of a forum selection provision specifying New York as the forum in a right of first refusal agreement would not contravene Delaware public policy, finding that Section 115 of the DGCL does not preclude placing forum selection provisions in stockholders agreements and other contracts.

  - Facts:
    - Plaintiff contended that his preferred stock redemption right had been triggered by a prior merger.
    - In connection with a stock purchase agreement, plaintiff was bound by a forum selection provision, selecting New York as the applicable forum.
    - In a subsequent reclassification, plaintiff entered into a right of first refusal agreement containing the same forum selection clause as contained in the stock purchase agreement.
    - Defendant moved to dismiss plaintiff's complaint on the grounds that the forum selection provision, appearing in multiple documents, required the plaintiff to litigate his claim in New York.
    - Plaintiff argued that dismissing the action by enforcing the forum selection provision would offend Delaware public policy.

Bonanno v. VTB Holdings, Inc.

- *Bonanno v. VTB Holdings, Inc.*, 2016 WL 614412 (Del. Ch. Feb. 8, 2016).
  - Analysis:
    - The Court noted that Delaware's "strong public policy [ ] of providing a Delaware forum to stockholders of a Delaware corporation" was embodied in Section 115 of the DGCL.
    - The Court found that the legislative synopsis indicated the legislature's unwillingness to regulate exclusive forum selection provisions in contracts signed by, and later enforced against particular stockholders.
      - The Court also found that shareholder agreements had been listed in Section 202(b) and Section 273(a) of the DGCL, noting the absence of such a "similarly inclusive list" in Section 115.
    - The Court held that the enforcement of the forum selection provision in the right of first refusal agreement would not contravene Delaware public policy.

Overview of the DRAA

- In response to common concerns with traditional arbitration, the Delaware Rapid Arbitration Act (the "DRAA" or, "the Act") is designed to give Delaware business entities greater capacity to resolve business disputes in a rapid and efficient manner through voluntary arbitration, conducted by expert arbitrators under strict timelines.
- The Act is an enabling statute. Consistent with Delaware's "contractarian" approach, the Act is designed "to give maximum effect to the principle of freedom of contract and the enforceability of agreements."
- The animating themes of the Act are speed, efficiency, and the confidential resolution of complex business issues.
- Parties forego comprehensive and often time-consuming pre-hearing evidence gathering in exchange for a prompt resolution of their dispute.
- The Act provides for the resolution of disputes in as little as 120 days.
- Types of disputes ideal for DRAA include: Post-merger working capital adjustments and earn-out disputes; advancement and indemnification requests by employees, officers or directors; investor information rights; and valuation disputes.

Pre-Arbitration Mechanics

- The DRAA is limited to business disputes.
  - To invoke the Act, the parties must have a written agreement, signed by the parties to the arbitration, governed by Delaware law, that expressly refers to the DRAA by name.
  - The deal documents need not be governed by Delaware law.
  - At least one of the parties to the arbitration agreement must either have its principal place of business in Delaware or be a Delaware-organized entity.
  - The Act is not applicable to any dispute with a "consumer."
  - The DRAA does not contain monetary thresholds. The parties may use the Act to seek non-monetary relief.

Pre-Arbitration Mechanics

- The parties may designate a person in the arbitration agreement to serve as the arbitrator.
  - An arbitrator who is not legally trained may retain counsel to resolve legal issues that arise during the arbitration proceeding.
    - This may be ideal if the disputes concern escrow determinations or working capital adjustment and designation of a financial expert is more apt than a law trained individual.
  - If the arbitrator is not expressly named, the parties may also designate a method in the agreement under which an arbitrator may be selected.
- If the parties did not select an arbitrator and cannot agree on one, the Court of Chancery must appoint an arbitrator within 30 days of the service of a petition.
  - The Court's decision is *not* appealable to the Delaware Supreme Court.

The DRAA Arbitration

- The arbitrator has discretion to select a time and place for the hearing, which may take place outside Delaware.

- The DRAA does not address the scope of permissible discovery.

  - The parties may contract for a desired scope.
  - If the parties cannot agree to a scope, discretion is given to the arbitrator.

- By statutory default, arbitrators have the authority to compel attendance of witnesses and the production of documents.

  - Subpoena power may be conferred by the arbitration agreement.

The DRAA Arbitration (cont'd)

- Parties who submit to arbitration under the DRAA are treated as having consented to submit all issues of arbitrability exclusively to the arbitrator.
  - This provision cannot be altered by contract.
  - The parties can modify the arbitrator's powers by agreement, but the statutory default gives the arbitrator the power to make rulings of law or to impose sanctions as the arbitrator deems proper to resolve the dispute.
  - The arbitrator's interim rulings *cannot be appealed or challenged*.
  - Courts may not enjoin an arbitration under the Act.
  - However, the Court of Chancery may issue an injunction "in aid of arbitration" only if it is done *before* the arbitrator accepts appointment.
  - Such an injunction may not divest the arbitrator of his or her authority.

The DRAA Arbitration (cont'd)

- Absent an agreement to the contrary, all matters must be finally determined within 120 days of the arbitrator's acceptance of appointment.
  - This deadline can be extended by 60 days with the unanimous consent of all parties.
  - The arbitrator's fee is reduced on a percentage basis if the arbitrator does not decide the matter within the deadline.
  - If the arbitrator's decision is more than 60 days late, then the arbitrator forfeits his or her fee entirely.

MORRIS NICHOLS ARSHT & TUNNELL

The Arbitrator's Final Award

- The final award can be legal or equitable unless the parties' agreement provides otherwise.
- The Act eliminates the confirmation process for an arbitrator's award.
  - The final award is "deemed confirmed" by the court 5 days after the challenge period expires (15 days from the issuance of the final award).
- The prevailing party must have final judgment on the award entered in a Delaware court.
  - The Delaware Superior Court enters final judgment if the award is solely for monetary damages.
  - The Delaware Court of Chancery enters final judgment for all other awards.

Appellate Review

- Parties to an arbitration under the DRAA are deemed to have waived their right to challenge an interim ruling or order of an arbitrator.
- Challenges to a final award are made directly to the Delaware Supreme Court.
  - But, an appeal to the Delaware Supreme Court is presumptively public.
  - A challenge to the Delaware Supreme Court must be made within 15 days of the issuance of the final award.
  - The Delaware Supreme Court may only "vacate, modify or correct the final award in conformity with the Federal Arbitration Act."
  - The statute does not allow for plenary review by the Court.
- The parties can waive their right to appeal the arbitrator's final award by agreement.
- The parties may contract for a private appeal to one or more appellate arbitrators.
  - This approach preserves the feature of privacy inherent in the DRAA's contemplated proceedings.
  - Parties may contract for an applicable appellate standard of review in a private appeal.

Issues To Consider In Drafting

- The type and scope of dispute that will be subject to arbitration.
- The identity of the arbitrator and whether to require an arbitrator with particular non-legal expertise.
- The procedure for selecting the arbitrator if one is not named in the agreement.
- The fee arrangement and how fees will be allocated among the parties.
- The scope of the arbitrator's power, including with respect to the ability to compel discovery from third-parties.
- The nature and scope of the evidence to be presented at the hearing.
- The location for the arbitration.
- The nature and scope of appellate review, if any.

Enforcement of Foreign Court Judgments

- In dealing with the enforcement of foreign court judgments, most states in the United States have enacted either the 1962 Uniform Foreign Money-Judgments Recognition Act ("1962 Recognition Act") or the 2005 Uniform Foreign-Country Money Judgments Recognition Act ("2005 Recognition Act").
- According to *Recognition and Enforcement of Foreign Judgments*, by Ronald A. Brand *("Brand"):*
  - ***The 1962 Recognition Act***
    - The rules contained in the 1962 Act largely mirror those in the Restatement. While the Act provides the law applicable to recognition of inbound judgments, its drafters sought to make the law clear so that countries that require reciprocity of treatment in order to enforce a judgment from a U.S. court would consider such judgments more favorably. Some states have added a reciprocity requirement to the uniform rules of the Act.
  - ***The 2005 Recognition Act***
    - The 2005 Act is largely a revision of the 1962 Recognition Act. Although most major elements remain the same, the 2005 Act adds rules dealing with burden of proof, procedure, and statutes of limitations. Delaware is among the jurisdictions that have adopted the 2005 Recognition Act.
  - ***The Restatement (Third) of Foreign Relations Law***
    - Other states continue to deal with the recognition of foreign judgments through common law principles reflected in the Restatement (Third) of Foreign Relations Law (1987).

Enforcement of Foreign Court Judgments

- As adopted in Delaware, the 2005 Recognition Act, 10 *Del. C.* § § 4801-4812 provides, in pertinent part, that:
  - Except as otherwise provided in subsections (b) and (c) of Section 4803, a court of this State shall recognize a foreign-country judgment to which the Act applies. A party resisting recognition of a foreign-country judgment has the burden of establishing that a ground for nonrecognition stated in Section 4803 (b) or (c) exists. Those grounds are:
  - (b) A court of this State may not recognize a foreign-country judgment if: (1) The judgment was rendered under a judicial system that does not provide impartial tribunals or procedures compatible with the requirements of due process of law; (2) The foreign court did not have personal jurisdiction over the defendant; or (3) The foreign court did not have jurisdiction over the subject matter.
  - (c) A court of this State need not recognize a foreign-country judgment if: (1) The defendant in the proceeding in the foreign court did not receive notice of the proceeding in sufficient time to enable the defendant to defend; (2) The judgment was obtained by fraud that deprived the losing party of an adequate opportunity to present its case; (3) The judgment or the cause of action on which the judgment is based is repugnant to the public policy of this State or of the United States; (4) The judgment conflicts with another final and conclusive judgment; (5) The proceeding in the foreign court was contrary to an agreement between the parties under which the dispute in question was to be determined otherwise than by proceedings in that foreign court; (6) In the case of jurisdiction based only on personal service, the foreign court was a seriously inconvenient forum for the trial of the action; (7) The judgment was rendered in circumstances that raise substantial doubt about the integrity of the rendering court with respect to the judgment; or (8) The specific proceeding in the foreign court leading to the judgment was not compatible with the requirements of due process of law.

Enforcement of Foreign Court Judgments

- Certain countries have become party to the Hague Convention on Choice of Court Agreements (the "Hague Convention") which, as of October 2015, will govern the international enforcement and jurisdiction of judgments in civil and commercial matters in those contracting states.

- The United States has **not** yet ratified the Hague Convention.

- Some of the main provisions of the Hague Convention are:
  - The parties' chosen court arising from an exclusive choice of court agreement has jurisdiction. *See* Article 5.
  - If an exclusive choice of court agreement exists, a court not chosen by the parties does not have jurisdiction and must decline to hear the case. *See* Article 6.
  - A judgment arising from an exercise of jurisdiction in accordance with an exclusive choice of court agreement must be recognized and enforced in the courts of other contracting states. *See* Article 8.

Enforcement of U.S. Court Judgments

- According to the U.S. Department of Commerce, because the United States is not a party to any international convention governing the recognition and enforcement of foreign judgments, recognition and enforcement is determined in accordance with the recognizing country's domestic law. Per an information sheet prepared by the Office of the Chief Counsel for International Commerce, common requirements for recognition and enforcement include:
  - (a) proper notice;
  - (b) proper jurisdiction (personal and subject matter);
  - (c) final and binding judgment; and
  - (d) no violation of "recognizing" country's public policy.

Common Obstacles to Recognition and Enforcement of U.S. Judgments

- a) **Lack of jurisdiction**. Brazil, Switzerland, and France, for example, will refuse to enforce a judgment against their nationals unless there is a "clear indication" that the national intended to submit to the foreign court's jurisdiction.

- b) **Special notice procedures**. Some "recognizing" countries require that the foreign litigant serve the "local" party in accordance with procedures not commonly employed in the United States.

- c) **Treaty requirement**. Several states, including most of the Nordic countries, the Netherlands, and Saudi Arabia, will refuse to recognize a foreign judgment absent the existence of a judgments convention between the "rendering" and "recognizing" jurisdictions.

- d) **Confusion over the lack of uniformity of U.S. law**. Foreign courts often cannot discern a "U.S. policy" on recognition and enforcement, i.e., because 51 different approaches exist.

- e) **Public policy concerns**. Foreign courts view such features of U.S. law as unrestricted jury awards, punitive and treble damages actions, and the use of long-arm statutes as contrary to their own public policy.

Enforcement of Foreign Arbitration Awards

- The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") has been adopted in the United States. *See* 9 U.S.C. § § 201-208, which incorporates the New York Convention into the Federal Arbitration Act, *See* 9 U.S.C. § § 1-307.
- According to *Brand*, with limited exceptions, the New York Convention (and other Conventions and implementing statutes) requires United States courts to honor both an agreement of parties to arbitrate and any resulting award.
- United States courts will only enforce arbitral awards rendered in countries that have ratified the New York Convention.
  - Likewise, an arbitration award issued in any other contracting state can be enforced in another contracting state, subject to certain exceptions.
- As of March 2016, there are 156 contracting states to the New York Convention.
- According to one author, there is "almost universal agreement that recognition and enforcement under the New York Convention 'works.'" Yuliya Zeynalova, *The Law on Recognition and Enforcement of Foreign Judgments: Is It Broken and How Do We Fix It?*, Berkeley Journal of International Law (2013).
- Thus, unlike the uncertainty in the international community in connection with the recognition and enforcement of foreign court judgments, the New York Convention has promoted international uniformity with regard to the enforcement and recognition of foreign arbitration awards.

Enforcement of Foreign Judgments and Arbitration Awards Generally

- According to the Uniform Laws Commission, with regard to both arbitration awards and court judgments, the Uniform Foreign-Money Claims Act (UFMCA) reverses the rule that all money judgments must be valued in dollars and provides rules for fair conversions of foreign money judgments into dollar amounts. From the Uniform Laws Commission website, several key underlying principles of the UFMCA follow:
  - The UFMCA allows any claimant to assert a claim in foreign money.
  - The parties can establish the money that is appropriate.
  - The UFMCA alleviates the risk to claimants of currency fluctuation by establishing payment day (as opposed to judgment day or breach day) as the proper date for making a conversion of currency.
  - The UFMCA governs arbitrations as well as court judgments.
  - The UFMCA serves the goals of permitting claims in foreign currency and of establishing a fair conversion to dollars.
  - A judgment of a court in another jurisdiction that is expressed in terms of a foreign currency is enforceable, and may be converted into dollars under UFMCA at the judgment debtor's option, even though the jurisdiction in which the judgment is rendered does not provide for such a conversion.

Enforcement Comments (continued)

- The UFMCA has been adopted in Delaware in the form of 10 *Del. C.* § § 5201-5215. In part, it provides:
  - § 5206 Asserting and defending foreign-money claim.
    - (a) A person may assert a claim in a specified foreign money. If a foreign-money claim is not asserted, the claimant makes the claim in United States dollars.
    - (b) An opposing party may allege and prove that a claim, in whole or in part, is in a different money than that asserted by the claimant.
    - (c) A person may assert a defense, set-off, recoupment or counterclaim in any money without regard to the money of other claims.
    - (d) The determination of the proper money of the claim is a question of law.
  - § 5207 Judgments and awards on foreign-money claims; times of money conversion; form of judgment.
    - (a) Except as provided in subsection (c) of this section, a judgment or award on a foreign-money claim must be stated in an amount of the money of the claim. Such a judgment or award on a foreign-money claim shall be considered a judgment or claim for an ascertained amount.
    - (b) A judgment or award on a foreign-money claim is payable in that foreign money or, at the option of the debtor, in the amount of United States dollars which will purchase that foreign money on the conversion date at a bank-offered spot rate.
    - (c) Assessed costs must be entered in United States dollars . . . .

Enforcement Comments (continued)

- § 5208 Conversions of foreign money in distribution proceeding.
  - The rate of exchange prevailing at or near the close of business on the day the distribution proceeding is initiated governs all exchanges of foreign money in a distribution proceeding. A foreign-money claimant in a distribution proceeding shall assert its claim in the named foreign money and show the amount of United States dollars resulting from a conversion as of the date the proceeding was initiated.

- § 5210 Enforcement of foreign judgments.
  - (a) If an action is brought to enforce a judgment of another jurisdiction expressed in a foreign money and the judgment is recognized in this State as enforceable, the enforcing judgment must be entered as provided in § 5207 of this title, whether or not the foreign judgment confers an option to pay in an equivalent amount of United States dollars.
  - (b) A foreign judgment may be entered and indexed in accordance with any rule or statute of this State providing a procedure for its recognition and enforcement.
  - (c) A satisfaction or partial payment made upon the foreign judgment, on proof thereof, must be credited against the amount of foreign money specified in the judgment, notwithstanding the entry of judgment in this State.
  - (d) A judgment entered on a foreign-money claim only in United States dollars in another state must be enforced in this State in United States dollars only . . . .

MORRIS NICHOLS ARSHT & TUNNELL

Other Relevant Delaware M&A Issues

Jurisdiction Over Post-Closing Disputes

- Court of Chancery
  - Generally a court of equity only, but has statutory jurisdiction to hear certain disputes involving monetary damages.
    - Section 111 of the DGCL grants statutory jurisdiction to the Court of Chancery over post-closing disputes in the context of a merger agreement, but not in the context of stock purchase agreements (when stock is not being purchased from the issuer) or asset purchase agreements.
  - Because most post-closing disputes concern indemnification claims or post-closing adjustments for which money damages would afford complete relief, those kinds of disputes alone might not trigger Chancery jurisdiction if arising under an APA or SPA.
    - In *East Balt LLC v. East Balt US, LLC*, 2015 WL 3473384 (Del. Ch. May 28, 2015), Vice Chancellor Noble held that the Court of Chancery has jurisdiction over claims for specific performance compelling an escrow agent to release an escrow.
    - Vice Chancellor Laster reached a similar result in *NASDI Holdings, LLC v. N. Am. Leasing, Inc.*, tr. at 61 (Del Ch. Oct. 23, 2015).
  - Only bench trials in the Court of Chancery; punitive damages not available.

Jurisdiction Over Post-Closing Disputes

- In 2010, the Delaware Superior Court established a complex commercial litigation division (CCLD) to provide sophisticated parties a meaningful alternative for commercial disputes not otherwise litigable in Chancery.
  - "Any case that includes a claim asserted by any party (direct or declaratory judgment) with an amount in controversy of $1 Million or more (designated in the pleadings for either jury or non-jury trials), ***or involves an exclusive choice of court agreement*** or a judgment resulting from an exclusive choice of court agreement, or is so designated by the President Judge, qualifies for assignment to the CCLD."
    - Forum selection provision should contemplate CCLD as default option as alternative in the event Chancery does not have subject matter jurisdiction.
- Advantages are:
  - Judges with significant commercial background who are experts in Delaware law.
  - Case priority status so disputes can progress toward decision promptly.
  - Flexible procedures.
  - Case remains with the same judge throughout the litigation.
- Be sure to consider whether it would be appropriate to waive the right to a jury trial and the right to recover punitive damages, and if so, include clear language to effectuate the waivers.

Binding Stockholders To Decisions of Stockholders' Representative

- For signatories, include an "irrevocable designation" of the stockholders representative as "agent" in connection with the agreement.

- Nonsignatories generally will be bound by the decisions of the stockholders representative as a matter of corporate law.

  - Delaware law permits provisions of a merger agreement to be made dependent on "facts ascertainable," including a determination or action by any person or body.
  - Best practice, as in *Aveta Inc. v. Cavallieri*, 23 A.3d 157 (Del. Ch. 2010), is to draft the Total Merger Consideration as comprised of multiple parts – e.g., (i) Closing Consideration plus (ii) consideration, if any, distributed by the Escrow Agent pursuant to the terms of the Escrow Agreement and this Agreement plus (iii) consideration, if any, distributed pursuant to the Working Capital Adjustment.

    - This is opposed to stating that the Total Merger Consideration equals the top-line consideration, but that certain of that consideration will be held back.

Binding Stockholders To Clawbacks

- To obtain indemnity protection in excess of an escrow, buyers may try to bind stockholders to a clawback, either by simply stating so in the merger agreement or requiring stockholders to sign an LT, thus agreeing to the clawback, as a condition to receiving merger consideration.

- *Cigna Health & Life Insurance v. Audax Health Solutions*, 2014 WL 6784491 (Del. Ch. 2014), called that practice into question.
  - *Audax* involved the types of merger agreement and LT provisions discussed above. A significant stockholder, Cigna, refused to sign the LT and asked the Court of Chancery for a declaration that it was not bound by the indemnity provisions in the merger agreement.
  - The indemnification covered reps that would survive "indefinitely."
  - The buyer could seek indemnification up to a stockholder's pro rata share of the merger consideration.

Binding Stockholders To Clawbacks

- *Audax* suggests limits on binding stockholders.
  - Letter of transmittal.
    - The Court invalidated a release in the LT because there was no additional consideration for the release.
  - Clawback.
    - The clawback "literally" complied with "facts ascertainable" concept under Section 251.
    - But the clawback violated implicit requirement of DGCL 251 that merger consideration be "determinable" with "reasonable degree of precision."
    - The Court held that to the extent the clawback was "uncapped" and applied for "indefinite duration," it was not permissible.
- Court implicitly upheld:
  - escrow (*i.e.*, holdback instead of clawback).
  - clawback for post-closing price adjustment.
  - clawback for post-closing indemnification if limited to 36 months or less (no ruling).

Binding Stockholders To Clawbacks

- Structuring the indemnity after *Audax:*
  - Contractual approach:
    - Pre-closing joinder or support agreement (*e.g.*, as condition to closing).
    - True contract with pre-closing consideration.
    - Should work for release as well.
  - Statutory approach:
    - Holdback in escrow.
    - Clawback for formulaic purchase price adjustment.
    - Clawback limited to 36 months or less?
  - Hybrid statutory/contractual approach:
    - In merger agreement, provide that __% of merger consideration held back in escrow for ___ years, but will be released early to any holder who contractually agrees to a clawback.
  - If consideration is securities rather than cash: embed the adjustment terms in the security (*e.g.*, deduct indemnification losses from liquidation preference).

Drag Along

- One answer to *Audax*, as well as to *Trados*, may be to exercise a drag-along. But, need careful conformity with drag-along provisions.
- *Halpin v. Riverstone Nat'l, Inc.* (Del. Ch. Feb. 26, 2015).
  - Facts: Minority common holders sought to exercise appraisal rights, despite being party to a stockholders agreement that required them to vote for (or tender into) a deal approved by the majority. Under its terms, the obligation was not triggered unless the company gave the minority notice before the vote, which it did not; nor did the agreement give the majority a proxy to vote the minority's shares.
  - Holding: Minority not bound to vote yes, appraisal rights not lost.
  - Open question: Can common holders waive appraisal.
  - Takeaway: Not enough to just have a drag, must use it; get a proxy if possible (and vote upfront).

Time Period for Bringing Claims: Statute

- Can contractually shorten a statute of limitations period, so long as the shortened period is reasonable. *ENI Holdings, LLC v. KBR Grp. Holdings, LLC*, 2013 WL 6186326 (Del. Ch. Nov. 27, 2013).

- Prior caselaw suggested the statute of limitations period could not be lengthened unless a contract was under seal. In response, Delaware adopted 10 *Del. C.* 8106(c), effective August 1, 2014.
  - So long as contract involves at least $100,000, can have a survival period up to 20 years, even if contract not under seal.
    - Synopsis: "Examples of a 'period' that may be specified in a written contract, agreement or undertaking would include, without limitation, (i) a specific period of time, (ii) a period of time defined by reference to the occurrence of some other event or action, another document or agreement or another statutory period and (iii) an indefinite period of time."
  - In *Bear Stearns Mortgage Funding Trust 2006-SLI v. EMC Mortgage LLC*, 2015 WL 139731 (Del. Ch. 2015), the Court of Chancery held that Section 8106(c) applies retroactively to agreements entered into before August of 2014.

Time Period for Bringing Claims: Choice of Forum

- Even assuming the parties choose Delaware law to govern their contract, if another forum is chosen to hear disputes, the parties should consider whether that forum will apply its local rules on statutes of limitation or the contract-chosen law of Delaware.

- In *Pivotal Payments Direct Corp. v. Planet Payment, Inc.*, 2015 WL 9595285 (Del. Super. Dec. 29, 2015), the Delaware Superior Court applied the Delaware statute of limitations period to claims under a contract with a New York choice of law because:
  - The choice of law provision did not expressly reference the New York statute of limitations.
  - The parties did not demonstrate that New York substantive law is "inseparably interwoven" with its statute of limitations.

Time Periods for Bringing Claims: Interaction of Notice Provisions & Survival Periods

- In indemnity provisions, parties may expressly provide for notice periods during which one party must notify the other of potential indemnification claims.

- The parties need to be clear about whether the notice provision is meant to extend the limitations period. A notice period will not necessarily be read as extending a survival period which, under Delaware law, is treated as a claims limitation period. *GRT, Inc. v. Marathon GTF Tech., Ltd.*, 2011 WL 2682898 (Del. Ch. 2011).

  - In *ENI Holdings, LLC v. KBR Group Holdings, LLC*, 2013 WL 6186326 (Del. Ch. 2013), a buyer made an indemnity claim by providing seller notice of the claim within the contractual period for notice, but the buyer did not bring a lawsuit until after the survival period for the underlying rep.

    - The court held that the notice of claims period did not extend the limitations period. Rather, a lawsuit had to be brought within the survival period of the underlying representation because the parties did not expressly provide otherwise.

Time Periods for Bringing Claims: Interaction of Notice Provisions & Survival Periods

- Drafting tip: If intent is to allow a party to file a lawsuit on a noticed claim after the survival period, make sure the survival periods in the contract expressly refer to the notice of claims provisions.
  - *Notwithstanding anything in this Agreement to the contrary, no representation, warranty, covenant or agreement will expire to the extent [Buyer] has provided to the Stockholders' Representative written notice of Parent's claims for indemnification in accordance with [the notice provisions]*.
- Drafting tip: If the parties are permitted to file a lawsuit on a noticed claim after the survival period, how long after notice may they bring claims?
  - Consider specifying a time period.

MORRIS NICHOLS ARSHT & TUNNELL

Time Periods for Bringing Claims: Tolling

- Unlike other jurisdictions, Delaware's "discovery rule" as to when a breach of contract claim accrues is narrow, giving more teeth to shortened statutes of limitation.
  - In *ENI Holdings, LLC v. KBR Group Holdings, LLC*, 2013 WL 6186326 (Del. Ch. 2013), the Court of Chancery held that "application of the discovery rule to toll a contractual limitations period is inappropriate, at least, as here, where the inherent unknowability of a potential claim is itself knowable or predictable, and thus the proper source of negotiation and resolution between the parties to the contract".
- The court in *ENI* "assumed without deciding" that doctrines of "equitable tolling" and "fraudulent concealment" would apply to toll a contractually shortened statute of limitations.

Sandbagging

- As a default rule, may a party successfully plead breach of contract if it knew a representation was not true at the time it entered into the contract?

- Majority of Delaware cases provide that Delaware is a pro-sandbagging state. At least two cases, however, suggest the contrary. *MicroStrategy Inc. v. Acacia Research Corp.*, 2010 WL 5550455 (Del. Ch. Dec. 30, 2010); *Kelly v. McKesson HBOC, Inc.*, 2002 WL 88939, at *8 (Del. Super. Jan. 17, 2002).

- In *NASDI Holdings, LLC v. North American Leasing, Inc.* (Del. Ch. Oct. 23, 2015), Vice Chancellor Laster expressly stated that Delaware is "a 'sandbagging' state."
  - This portion of the transcript involved a fraud claim. One could read *NASDI as* suggesting that the pro-sandbagging rule extends to fraud claims based on representations inside the four corners of a contract and, in that context, cannot be contracted around. Such a reading, however, would be contrary to prior opinions from the Court. *Universal Enterprise Group, L.P. v. Duncan Petroleum Corp.*, 2013 WL 3353743 (Del. Ch. July 1, 2013) ("Universal relied on the representations in the sense that they contractually allocated to Duncan the risk that the representations would be incorrect, but Universal did not rely on the representations in the sense of being fraudulently induced by them to close the transaction.").

"Threatened" Claims

- Concept of "threatened" claim integral to many indemnification regimes (e.g., funds not released from escrow if a claim is "threatened"). What does the term mean?
- In *Rexam Inc. v. Berry Plastics Corp.*, 2015 WL 7958533 (Del. Ch. Dec. 3, 2015), a side agreement provided that buyer could elect to have seller retain pension liabilities if there was a "threatened legal or administrative action" with respect to such liabilities within 6 months of closing.
  - One week after closing, PBGC sends the following message: "While PBGC does not plan to initiate legal action . . . at this time, we have not yet decided whether we will pursue this matter through the IRS and/or professional actuarial organizations."
  - Could holds the above statement is not a threatened claim because it did not demonstrate a "present intention to take any action".
    - In doing so, the Court cited *i/m^x Information Management Solutions, Inc. v. Multiplan, Inc.*, 2014 WL 1255944 (Del. Ch. Mar. 27, 2014):
      - "[F]or QMC to have threatened to commence an Action against Multiplan, QMC would have to do more than simply notify Multiplan of a problem. Rather, QMC also must have expressed that it was going to do something about that problem, in such a way that a reasonable person would understand that QMC was intending to press the issue through a proceeding before a third party. In other words, ... that 'something' must be commencing an Action."

Fraud – Limits on Contracting Out

- As a matter of law, parties cannot eliminate the right to bring a claim for knowing fraud within the four corners of the contract. *ABRY Partners V, L.P. v. F&W Acq. LLC*, 891 A.2d 1032 (Del. Ch. 2006). *ABRY* suggests:
  - The combination of (i) an "indemnity as sole remedy" provision with no fraud carve out and (ii) sufficient nonreliance language should limit fraud claims to intentional fraud with respect to the reps and warranties in the contract.
  - The combination of (i) an "indemnity as sole remedy" provision with a fraud carve and (ii) sufficient nonreliance language should limit fraud claims to intentional and reckless fraud with respect to the reps and warranties in the contract.
- Some cases have suggested that the fraud carve out in the above combination may be taken into account in determining whether there is "sufficient nonreliance language." *E.g.*, *TrueBlue, Inc. v. Leeds Equity Partners IV, LP*, 2015 WL 5968726 (Del. Super. Sept. 25, 2015); *Airborne Health, Inc. v. Squid Soap, L.P.*, 984 A.2d 126 (Del. Ch. Nov. 23, 2009).

Fraud – Disclaiming Reliance

- Standard in Delaware for disclaiming reliance on (and thus ability to bring a fraud claim based on) extra-contractual representations:
  - The contract "must contain language that, when read together, can be said to add up to a clear anti-reliance clause by which the plaintiff has contractually promised that it did not rely upon statements outside the contract's four corners in deciding to sign the contract." *Kronenberg v. Katz*, 872 A.2d 568 (Del. Ch. 2004).
- A line of Delaware case, culminating in *TrueBlue, Inc. v. Leeds Equity Partners IV, LP*, 2015 WL 5968726 (Del. Ch. Sept. 25, 2015), suggests that, to have strong antireliance language, should include:
  - A standard integration clause.
  - Express "nonreliance" representation, including as to the "accuracy and completeness" of information provided in diligence.
  - Extra-contractual disclaimer, and acknowledgement of that disclaimer by buyer.
  - Indemnity as sole remedy (or, if there is a fraud carve out, limit that carve out to intentional fraud based on representations within the four corners of the agreement).
  - Agreement that no person will have liability for claims relating to information supplied to buyer in course of due diligence.

Fraud – Disclaiming Reliance

- In *Prairie Capital III, L.P. v. Double E Holding Corp.*, 2015 WL 7461807 (Del. Ch. Nov. 24, 2015), Vice Chancellor Laster stated that Delaware law "does not require magic words" to disclaim reliance.
  - The Court held that reliance on extra-contractual representations and completeness of information provided in due diligence was disclaimed by combination of an (i) extra-contractual representation disclaimer (that did not include "nonreliance" or "accuracy and completeness of information" language) and (ii) integration clause, notwithstanding a fraud exception to the sole remedy provision.
- Nonetheless, in light of prior caselaw, best to include the suite of provisions set out in previous slide to have as strong an argument for nonreliance as possible.

Fraud – Who Is Liable

- In most transactions, it is the company itself, and not the seller or management, that is making the business representations. So, how can seller or management be liable for fraud?
- Direct Liability: Test in Delaware, recently reaffirmed in *Praire Capital*, is that the "1) [alleged tortfeaser] knew that the Company's contractual representations and warranties were false; or 2) that the [alleged tortfeaser] itself lied to the Buyer about a contractual representation or warranty."
  - *Prairie Capital* suggests the first test can be satisfied, for purposes of a motion to dismiss, (i) with respect to "the humans through which the Company made its representations" – *i.e.*, the corporate officers and (ii) with respect to behind-the-scenes funds who make statements to corporate officers "intending for those statements to be repeated" to the buyer.
  - In at least one ruling on a motion to dismiss, the Court found it reasonably conceivable that a selling fund knew that the Company's representations were false because a stockholders agreement gave that fund seats on the Company's board and veto rights over certain decisions. *DLJ S. Am. Partners, L.P. v. Multi-Color Corp.*, tr. at 60 (Del. Ch. Dec. 19, 2012).
- Secondary Liability: Either conspiracy or aiding and abetting. Test is whether seller/management "acted in concert with" the Company or gave "substantial assistance" to the Company.

Fraud – Who Is Liable

- *Great Hill Equity Partners v. SIG Growth Equity Fund*, 2014 WL 6703980 (Del. Ch. 2014).
  - Court declines to decide whether a fraud carve out to indemnification caps applies just to the fraudsters or to innocent stockholders as well.
    - The court suggested that the better view may be that the limits on indemnification would apply to limit the exposure of innocent stockholders, but the court declined to resolve the issue on a motion to dismiss.
  - The court also declined to dismiss claims for unjust enrichment against innocent stockholders.
    - Unjust enrichment requires a showing of (1) an enrichment, (2) an impoverishment, (3) a relation between the enrichment and impoverishment, (4) the absence of justification and (5) the absence of a remedy provided by law.
    - The defendants argued that, by establishing the indemnification provisions, the parties intended to bar quasi-contractual claims against innocent stockholders who were not party to the agreement.
      - *This matter has not been adequately addressed in the briefing, and I cannot say based on the record before me that the existence of a contract precludes recovery from innocent stockholders of benefits wrongfully obtained through fraud of those acting on their behalf.*
  - Take Away: Draft fraud carve out to apply only to those committing the fraud and the sole remedy language expressly to exclude claims for unjust enrichment.

MORRIS
NICHOLS
ARSHT &
TUNNELL

mnat.com (302) 658-9200

1201 North Market Street, 16th Floor
P.O. Box 1347
Wilmington, DE 19899-1347