Delaware Court of Chancery Upholds Merger Agreement Termination Based on Failure to Deliver Formal Notice of Extension

On March 14, 2019, the Delaware Court of Chancery upheld the disputed termination of a merger agreement in *Vintage Rodeo Parent LLC et al. v. Rent-A-Center Inc.*, holding that a party's notice of termination that formally complied with the agreement's requirements was effective, even though parties had been taking steps together to move the transaction to closing, because the counterparty had failed to give written notice extending the termination date in the manner provided in the merger agreement.[1]

I. Background

Pursuant to an agreement and plan of merger dated June 17, 2018 (the "Agreement"), Vintage Capital Management, LLC ("Vintage Capital") agreed to acquire Rent-A-Center, Inc. ("Rent-A-Center") in a transaction that would require review by the Federal Trade Commission (the "FTC"). Given that the FTC's review process could be prolonged, the Agreement included a termination date of 11:59 p.m. on December 17, 2018, six months after signing (the "End Date"). If the FTC review process was still ongoing as the End Date approached, either party could unilaterally extend the Agreement by written notice to the other party before the original End Date. If the End Date passed and neither party had elected to extend, they would still remain bound by the Agreement and be obligated to proceed towards closing of the merger, but either party could terminate the Agreement at will by giving written notice to the other party before closing. Additionally, the Agreement provided that if Vintage Capital did not extend the End Date, Vintage Capital and its banker, B. Riley Financial, Inc. ("B. Riley"), would be liable for a substantial reverse breakup fee (the "Termination Fee") if either Vintage Capital or Rent-A-Center terminated thereafter.

Recognizing the FTC review process was still ongoing and the End Date was approaching in less than two weeks, Rent-A-Center's Board of Directors privately determined it was no longer in the company's best interest to proceed with the merger and they would exercise their right to terminate the Agreement if Vintage Capital failed to extend the Agreement before the End Date. The End Date arrived, and Vintage Capital still had not given notice it was electing to extend the Agreement. The following morning, Rent-A-Center gave written notice that it was exercising its right to terminate the Agreement and demanded payment of the Termination Fee. Vintage Capital, believing both parties intended to proceed with closing after the End Date, was reportedly blindsided.

Vintage Capital brought this action in the Delaware Court of Chancery, arguing that Rent-A-Center's notice of termination was ineffective and sought specific performance to compel Rent-A-Center to proceed with obtaining FTC clearance and closing the merger. B. Riley asserted similar charges and also argued the Termination Fee was an unenforceable penalty. Rent-A-Center counter-argued that their notice and the resulting termination of the Agreement were effective and sought payment of the Termination Fee.

Vintage Capital argued that the parties' actions in the six months following the signing of the Agreement either (1) satisfied or waived the notice of election to extend the Agreement or otherwise invalidated Rent-A-Center's right to terminate the Agreement under various contractual theories and/or (2) barred Rent-A-Center from exercising the right to terminate under a theory of estoppel. Ultimately, the Court disagreed with all of Vintage Capital's claims, holding that Rent-A-Center validly exercised its right to terminate the Agreement. The Court did not opine on the Termination Fee and sought additional briefing on whether the implied covenant of

[1] *Vintage Rodeo Parent LLC et al. v. Rent-A-Center Inc.*, C.A. No. 2018-0927-SG (Del. Ch. March 14, 2019).

good faith and fair dealing should relieve the contractual obligation to pay the Termination Fee, given that Vintage Capital remained willing and able to proceed toward closing.

II. Contractual Arguments

Vintage Capital asserted several contractual arguments in support of its position that Rent-A-Center's notice of termination was ineffective: (1) Vintage Capital satisfied the "purpose" of the Agreement's notice requirements and thus no "additional" notice of an election to extend was required, (2) Rent-A-Center had through its actions extended the End Date or waived the Agreement's notice requirements, (3) a financial model prepared by Rent-A-Center that listed an extended closing date fulfilled the notice requirements, (4) Rent-A-Center lost its right to terminate when it breached the Agreement through failing to use commercially reasonable efforts to close, and (5) the implied covenant of good faith and fair dealing barred Rent-A-Center from terminating the Agreement.[2] The Court rejected each of these contractual arguments in turn, deferring to the plain language of the Agreement's notice requirements, which both the parties and the Court agreed were clear and unambiguous.[3]

First, Vintage Capital argued that the "purpose" of the written notice requirement was to define the parties' rights if the merger did not close by a certain date due to the ongoing FTC review process and provide notice that the counterparty intends to proceed to close even after the End Date.[4] Vintage Capital argued this purpose was satisfied when the parties executed a joint timing agreement with the FTC (the "Joint Timing Agreement"), which represented to the FTC that closing would not take place until after the End Date. Because the Joint Timing Agreement showed an intent to extend the End Date, it "substantially complied" with the notice requirements, and thus, Vintage Capital argued, no "separate" or "additional" formal notice was necessary.[5] Although the Court acknowledged that it has accepted substantial compliance with notice provisions in place of literal compliance when deviation is reasonable in light of the circumstances, the Court emphasized that relevant precedent focused on the *manner* in which notice was provided, not the *substance* (as Vintage Capital argued).[6] The Court rejected Vintage Capital's argument, concluding that going beyond clear and unambiguous notice provisions of the Agreement to examine the purpose of those provisions was unwarranted.[7] Furthermore, the Court highlighted that, because the Agreement otherwise required both parties to use commercially reasonable efforts to obtain FTC clearance, executing the Joint Timing Agreement was a contractually-required action and holding it as equivalent to a notice of an election to extend the End Date and therefore binding on the counterparty would render the notice provisions meaningless.

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[2] *Id*. at 35-36.

[3] *Id*. at 36.

[4] *Id*. at 39-40.

[5] *Id*. at 40-41.

[6] *Id*. at 41-42 (citing *Corporate Property Associates 6 v. Hallwood Group Inc.*, 792 A.2d 993, 1000–01 (Del. Ch. 2002), *rev'd on other grounds*, 817 A.2d 777 (Del. 2003) (the Court found substantial compliance with a notice provision when the executive designated to receive the notice had left the company but executives at the receiving company did receive and review the notice) and *Gildor v. Optical Solutions, Inc.*, 2006 WL 4782348, at *7 (Del. Ch. June 5, 2005) (the Court found substantial compliance would have sufficed when the notice provision did not contain an address for a required recipient)).

[7] *Id*. at 41 (citing *Willie Gary LLC v. James & Jackson LLC*, 2006 WL 75309, at *5 (Del. Ch. Jan. 10, 2006), *aff'd*, 906 A.2d 76 (Del. 2006) ("Contracts are to be interpreted as written") and *Gildor*, 2006 WL 4782348, at *6 ("The language of [the notice provision] is clear and unambiguous, which means that the language alone would typically dictate the outcome.").

Second, Vintage Capital asserted that the Joint Timing Agreement operated as an extension or waiver under the Agreement, which specified that an agreement of extension or waiver is valid if "set forth in an instrument in writing signed on behalf of" the party agreeing to extend or waive.[8] The Court disagreed, finding that because Agreement required a writing to operate as an extension or waiver, it contemplated an explicit, not implicit, release of rights, and Rent-A-Center had never expressed in writing an intent to extend or waive its rights under the Joint Teaming Agreement.

Third, Vintage Capital contended that even if written notice in literal compliance with the Agreement was required, it was satisfied when Rent-A-Center sent a financial model to one of Vintage Capital's designated notice recipients that assumed a closing date beyond the End Date. As with the Joint Timing Agreement, the Court found a reference to an expected extended closing date was insufficient as a written notice of an express election to extend the End Date.[9]

Fourth, Vintage Capital argued that Rent-A-Center failed to use commercially reasonable efforts to consummate the merger when it chose not to disclose that the Rent-A-Center Board had determined to terminate the Agreement if Vintage Capital failed to extend the Agreement before the End Date. According to Vintage Capital, Rent-A-Center had lost its right to terminate the Agreement, which provided that a party lost such right if they breached the Agreement and their breach "cause[d] the failure of the Closing to be consummated by the End Date."[10] To support their claim, Vintage Capital analogized the situation to *Williams Companies. V. Energy Transfer Equity, L.P.* (in which a party was obligated to use reasonable best efforts to fulfill a condition precedent in a merger agreement and stayed silent when they became aware of a problem threatening the condition)[11] and *Hexion Specialty Chemicals., Inc. v. Huntsman Corp.* (in which the Court found the buyer did not use reasonable best efforts when it had concerns about the solvency of a proposed combined entity in a merger and chose not to share those concerns).[12] Emphasizing the Court's decision in *Williams* that "reasonable best efforts" and "commercially reasonable efforts" clauses "placed an affirmative obligation on the parties to take all reasonable efforts to obtain the [condition precedent] and otherwise complete the transaction,"[13] Vintage Capital claimed that Rent-A-Center breached such obligation by failing to inform Vintage Capital that Rent-A-Center considered the agreement to be terminable as of the End Date. The Court found that this case was distinguishable from *Williams* and *Hexion*; in those cases, the defendants were aware of a "problem" and chose not to inform their counterparties, whereas in this case, there was no "problem" for Rent-A-Center to disclose, the issue being Vintage Capital's failure to understand their explicit rights to extend the End Date.[14] The Court refused to impose what would essentially be a "duty to warn" on Rent-A-Center[15].

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[8] *Id*. at 45.

[9] Joint press releases, and even press releases issued separately by Rent-A-Center, had all indicated that the closing was expected in the first quarter of 2019 (the quarter after the End Date). While the Court mentions this in the factual background, this fact does not seem to have been significant in the decision.

[10] *Id*. at 48-49.

[11] *Id*. at 50 (citing 159 A.3d 264 at 273 (Del. 2017)).

[12] *Id*. (citing 965 A.2d 715 at 755-756 (Del. Ch. 2008)).

[13] *Id.* (citing *Williams*, 159 A.3d at 272).

[14] *Id*. at 51, noting that the parties to a Delaware law-governed contract are assumed to have knowledge of the contract's terms. (*Chapter 7 Tr. Constantio Flores v. Strauss Water Ltd*., 2016 WL 5243950, at *6 (Del. Ch. Sept. 22, 2016)).

[15] "Commercially reasonable efforts do not require that sophisticated parties remind one another of their contractual rights." *Id*. at 57.

Finally, Vintage Capital argued that the implied covenant of good faith and fair dealing barred Rent-A-Center from exercising its unilateral right to terminate the Agreement.[16] Underscoring that the implied covenant only applies where a gap exists in the express provisions of an agreement and that the parties had extensively negotiated the provisions of the merger agreement governing the extension of the Agreement, the Court rejected Vintage Capital's argument, finding there was no gap to fill in the explicit provisions of the Agreement.[17]

III. Estoppel

Vintage Capital's final argument asserted that equitable estoppel and quasi-estoppel barred Rent-A-Center from exercising its termination right because the parties' course of conduct during the six months following the signing of the Agreement anticipated closing after the End Date. The Court rejected Vintage Capital's equitable estoppel argument, finding that Vintage Capital had failed to show (1) that they lacked knowledge or the means of obtaining knowledge of the truth of the facts in question (that Rent-A-Center's Board planned to terminate the Agreement after the End Date), (2) that they reasonably relied on Rent-A-Center's conduct (continuing to act as though they supported the merger after the Board's decision), and (3) that they suffered a prejudicial change of position as a result of their reliance on Rent-A-Center's conduct.[18] Because Vintage Capital negotiated for and thus was constructively aware of their ability to unilaterally extend the Agreement and bind Rent-A-Center by simply giving written notice, the Court found that Vintage Capital could not have reasonably relied on the conduct of Rent-A-Center nor did they change their position based on such conduct. Rather, it appeared to the Court that Vintage Capital simply forgot the approaching End Date and its ramifications.

Similarly, the Court rejected Vintage Capital's argument that quasi-estoppel would bar Rent-A-Center from terminating the Agreement. The Court stated that quasi-estoppel applies "when it would be unconscionable to allow a person to maintain a position inconsistent with one to which he acquiesced, or from which he accepted a benefit."[19] As described above, Rent-A-Center's conduct during the time of signing the Agreement up until the End Date was in line with its contractual obligations to use commercially reasonable efforts to proceed to closing. Rent-A-Center maintained the right to terminate the Agreement after the End Date, and thus the two courses of action were not inconsistent.

IV. Conclusion

The Court's decision in this case rested on the express language of the contract, holding that Rent-A-Center properly complied with the explicit provisions of the Agreement in exercising its right to terminate the Agreement and that nothing in the parties' course of conduct otherwise extended the Agreement's End Date, waived the notice requirements, or justified barring Rent-A-Center from exercising such right. We will continue to monitor this matter to see what determinations are made with respect to the Termination Fee and what, if any, changes to the outcome arise from any appeals.

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[16] *Id*. at 59.

[17] "'The implied covenant will not infer language that contradicts a clear exercise of an express contractual right.'" *Id*. at 59-60 (citing *NAMA Hldgs., LLC v. Related WMC LLC*, 2014 WL 6436647, at *16 (Del. Ch. Nov. 17, 2014) quoting *Nemec v. Shrader*, 991 A.2d 1120, 1127 (Del. 2010)).

[18] *Id*. at 61 (citing *Nevins v. Bryan*, 885 A.2d 233, 249 (Del. Ch. 2005)).

[19] *Id*. at 63 (quoting *RBC Cap. Mkts., LLC v. Jervis*, 129 A.2d 816, 873 (Del. 2015) (internal quotation marks omitted)).

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Helene R. Banks at 212.701.3439 or hbanks@cahill.com; Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Elai Katz at 212.701.3039 or ekatz@cahill.com; Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; Ross Sturman at 212.701.3831 or rsturman@cahill.com; or Devon L. McLaughlin at 212.701.3584 or dmclaughlin@cahill.com.