DELAWARE CORPORATE LAW BULLETIN

Chancery Court Enforces Contractual Termination Provision—but Questions Fairness of Related Termination Fee

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Court refuses to deprive target company of benefit of unambiguous, bargained-for contract right, but raises possibility that implied covenant of good faith and fair dealing might apply when parties fail to contemplate inequitable outcomes

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INTRODUCTION

In *Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.*, No. 2018-0927-SG, 2019 Del. Ch. LEXIS 87 (Del. Ch. Mar. 14, 2019) ("*Vintage Rodeo*"), the Delaware Court of Chancery ("*Chancery Court*") rejected claims of invalidity and unfairness in upholding a merger agreement's termination provision. Due to changed circumstances, a target company elected to abort the transaction when the buyer failed to exercise its right to extend the scheduled outside date. Vice Chancellor Sam Glasscock III found the contract clear and unambiguous and, therefore, was reluctant to ignore rights negotiated by "sophisticated" parties.

In an interesting twist, Vice Chancellor Glasscock requested supplemental briefing on whether the buyer should be relieved of its contractual obligation to pay a relatively large fee triggered by the termination. The Vice Chancellor questioned whether this fee represented, *under the circumstances*, an unintended consequence for which the implied covenant of good faith and fair dealing, which is inherent in every contract governed by Delaware law, might provide a remedy. Although the parties ultimately settled their dispute, this is a development warranting due consideration.

I. FACTUAL BACKGROUND

On June 17, 2018, Vintage Capital Management, LLC and two wholly owned subsidiaries (collectively "*Vintage*") entered into a merger agreement ("*Agreement*") providing for Vintage's purchase of Rent-A-Center, Inc. ("*Rent-A-Center*") via a merger ("*Merger*"). Another party to the Agreement was B. Riley Financial, Inc. ("*Riley*"), which provided acquisition financing to Vintage. Rent-A-Center "is a 'rent-to-own' retailer" with stores, franchises, and kiosks across North America, while Vintage controls a smaller "operator and franchisor of rent-to-own stores." Initially, the parties expected the Merger to close by the end of 2018, but, in light of their competitive "overlap," they "knew that Federal Trade Commission" ("*FTC*") "permission would be required for the merger, and that the review process could be lengthy."

Accordingly, the Agreement included several provisions relating to the FTC clearance process:

- Section 6.18 obliged the parties "to use 'commercially reasonable efforts' . . . to 'consummate and make effective as promptly as practicable' " the Merger, including by seeking FTC clearance.
- Section 8.01 designated December 17, 2018, as the "End Date." After the End Date, if the Merger had not yet been

consummated, either party could terminate the Agreement by written notice, but only if the failure to timely consummate was not caused by the terminating party's breach. Also, either party was entitled, by providing written notice to the other, to extend the End Date, first to March 17, 2019, and then to June 17, 2019, if the FTC had not yet cleared the transaction.

- Vintage was required to pay Rent-A-Center a $126.5 million "reverse termination fee" if the Agreement was terminated due to failure to obtain FTC clearance ("*Reverse Termination Fee*"). The Reverse Termination Fee was "15.75% of the equity value . . . of the prospective transaction . . . [and] two to three times higher than average in comparable deals." Riley guaranteed Vintage's obligation to pay the Reverse Termination Fee.

Despite efforts by Vintage and Rent-A-Center to placate the FTC, on September 13, the FTC issued a "second request" for additional information. This effectively extended the regulatory waiting period before the transaction could close, which forced Rent-A-Center to announce that the Merger was now expected to close "during the first quarter of 2019." The parties entered into a joint timing agreement ("*JTA*") with the FTC on October 29, promising that they would not close the Merger until 45 days after the FTC signaled "substantial compliance" with the second request. The parties continued to cooperate with the FTC through the fall, while Vintage worked on "integration planning" and worked with Riley on the acquisition financing.

During regularly scheduled meetings on December 5 and December 6, the Rent-A-Center Board of Directors ("*Board*") determined "improved" performance made it "no longer in the corporate interest" to complete the Merger. Accordingly, the Board resolved to exercise its right to terminate the Agreement *if* Vintage failed to extend the End Date by the December 17 deadline. However, because the Board expected Vintage to extend, it also decided Rent-A-Center would continue using commercially reasonable efforts to effectuate the Merger to avoid breaching the Agreement.

Then, to the Board's surprise, Vintage failed to communicate with Rent-A-Center by the original End Date to terminate the Agreement. Therefore, at 6:55 a.m. on the first day following the End Date, Rent-A-Center emailed Vintage a notice of termination, along with demand for payment of the Reverse Termination Fee. Shortly thereafter, Rent-A-Center issued a press release announcing termination of the Merger. Vintage responded that same day with a letter challenging the validity of the termination and insisting Rent-A-

Center continue performing under the Agreement. Rent-A-Center did not respond.

On December 21, Vintage sued Rent-A-Center in Chancery Court, seeking a declaratory judgment together with an injunction to force Rent-A-Center to continue working on the Merger. For its part, Rent-A-Center asked the Chancery Court to require payment of the Reverse Termination Fee. Vice Chancellor Glasscock entered a Status Quo Order on January 7, setting up a two-day trial in February. The Vice Chancellor issued his decision on March 14.

II. VICE CHANCELLOR GLASSCOCK'S ANALYSIS

Vintage did not dispute Rent-A-Center's interpretation of the Agreement but, in essence, blamed actions taken, or not taken, by Rent-A-Center for Vintage's failure to extend the End Date. In fact, Vintage went so far as to claim that Rent-A-Center had a "duty to warn" Vintage when it first decided to terminate if Vintage failed to extend. Vice Chancellor Glasscock rejected all these arguments, labelling them "after-the-fact rationalizations." After listening to all the evidence and arguments, the Vice Chancellor reached the "startling conclusion" that Vintage "simply forgot" to extend the End Date.

Accordingly, the Vice Chancellor ruled that Vintage "failed to show that the . . . End Date was extended or that [Rent-A-Center] should . . . be barred from exercising its right to terminate. As a result, [Rent-A-Center's] termination of the Merger Agreement . . . was valid." However, in an interesting twist, Vice Chancellor Glasscock left the door open for "supplemental briefing" of an argument that the Reverse Termination Fee was "untethered to actual damages, and is, therefore, unenforceable."

A. Termination Provisions Unambiguous and Enforceable

At the outset, Vice Chancellor Glasscock declared that the relevant provisions of the Agreement were "clear and unambiguous, and all the provisions are assumed to have meaning." Simply stated, when Vintage failed to extend by the original End Date, Rent-A-Center had a clear right to terminate. To overcome the Agreement's plain language, Vintage resorted to equitable arguments to support their belief that the Vice Chancellor should not honor Rent-A-Center's exercise of its contract rights.

First, Vintage claimed the JTA, "in addition to other communications between the parties, represented notice to Rent-A-

Center that [Vintage] had *elected* to extend the End Date, because the parties represented to the FTC therein that closing would not take place until after the End Date." Because "[c]ontracts are to be interpreted as written," the Vice Chancellor found this contention wanting. The JTA could not be deemed an extension because it did not adhere to the Agreement's procedures for giving notice. Further, under the JTA's literal language, the parties were agreeing *with the FTC* not to close within a 45-day period, not *with each other* that they would close when that period ended.

Second, Vintage argued its actions and related expenditures over the six-month period working towards a closing evidenced its intention to extend. In rejecting this argument, the Vice Chancellor observed that demonstrations of intent cannot replace the written notice to extend required by the Agreement. Both parties were bound to use commercially reasonable efforts to obtain FTC clearance and work towards completion of the Merger. Interpreting contractual adherence as an election to extend would render the notice provision "surplusage," a bridge the Vice Chancellor was not prepared to cross. The Vice Chancellor also observed that if the parties wanted to provide for automatic extension or alternative methods of notice, they could have done so.

Third, Vintage claimed that even if the JTA did not qualify as an election to extend, its signing by both parties was either a waiver or an extension of the Agreement's notice requirement. Vice Chancellor Glasscock disagreed, noting that the Agreement required an *explicit* release of rights to function as a waiver, something not included in the JTA. Also, the JTA "governs the relationship between the FTC, on one side, and Vintage and Rent-A-Center, on the other side" and, as such, said nothing about "the relationship between Vintage and Rent-A-Center" under the Agreement.

Fourth, Vintage argued that a "financial model" provided by Rent-A-Center to Vintage, which projected a January 31, 2019, closing date, "effectively gave a written notice of election to extend the End Date, because the closing date assumption was past the End Date." Again, because this financial model did not satisfy the Agreement's explicit requirements for an election or a waiver, the Vice Chancellor rejected this argument.

Fifth, Vintage claimed Rent-A-Center breached the Agreement and consequently lost its right to terminate. Specifically, Vintage argued that Rent-A-Center "failed to use commercially reasonable efforts to consummate the Merger" by neglecting to inform Vintage of the Board's decision "to terminate the Merger if it did not

receive a written notice [from Vintage] electing to extend . . . ." Moreover, Vintage added that Rent-A-Center "took affirmative action to conceal" the Board's decision.

In rejecting this claim, the Vice Chancellor pointed out that "[u]nder Delaware Law, parties are assumed to have knowledge of their own contractual rights." Rent-A-Center understood Vintage's right to extend and proactively planned for that eventuality. When Vintage failed to do so, Rent-A-Center took what it deemed the best course of action. To force Rent-A-Center to do otherwise would turn "an agreement to use commercially reasonable efforts to comply with obligations in a contract" into a restriction on Rent-A-Center's ability to "exercise its bargained-for right to terminate that contract," effectively rendering that right "illusory."

At this point, Vice Chancellor Glasscock recognized that all that "remains of [Vintage's] argument is, effectively, that commercially reasonable efforts means that Rent-A-Center had a 'duty to warn.' " Imposing this duty would be "inconsistent with the terms of the Merger Agreement," which did not "require advance notice, either of the election to extend or of termination." Vintage, as a "sophisticated" party, ought to have understood its negotiated rights under the Agreement. As such, the Vice Chancellor chose to "refrain from writing a provision into a contract when the parties could have done so themselves, but chose not to."

Lastly, Vintage asked Vice Chancellor Glasscock to apply "the implied covenant of good faith and fair dealing . . . to prevent [Rent-A-Center] from exercising its termination right . . . because the implied covenant provides a 'no deception' term." Even though, as the Vice Chancellor explained, "the implied covenant attaches to every contract," it does so only "cautiously . . . to fill gaps in the express provisions of a specific agreement." The Vice Chancellor did not view Vintage as seeking to fill a gap, but rather seeking "equitable fairness." This, however, is not the function of the implied covenant. In "vigorously negotiat[ing] the right to extend the End Date," Vintage and Rent-A-Center left "no gap . . . for the implied covenant to fill."

B. Reverse Termination Fee

While the implied covenant of good faith and fair dealing was not available to prevent Rent-A-Center from terminating the Agreement, Vice Chancellor Glasscock held open the possibility that the covenant impacted Vintage's obligation to pay the Reverse Termination Fee. Because Vintage was not engaged in "gamesmanship" but "simply

forgot to exercise its contractual right" to extend and remained "ready to move to closing," the Vice Chancellor "question[s] whether the parties considered this scenario in contracting for the reverse break-up fee." Because neither side had addressed this argument, the Vice Chancellor requested "supplemental briefing." Rather than contesting the matter further, the parties settled, with Vintage agreeing to pay Rent-A-Center $92.5 million.

CONCLUSION

Because the Agreement's termination and related provisions were clear and unambiguous, Vice Chancellor Glasscock rejected Vintage's extracontractual arguments. Rent-A-Center bargained for the right to cancel the Merger if Vintage failed to extend the End Date. Even if, as the Vice Chancellor speculated, Vintage "simply forgot" to extend or had a "lack of understanding" of its rights, Rent-A-Center was entitled to terminate. The Vice Chancellor was loath to allow equitable concerns to interfere with strict enforcement of unambiguous contract terms, particularly with sophisticated parties represented by able counsel.

On the other hand, it is interesting that the Vice Chancellor held open the possibility that the implied covenant of good faith and fair dealing might, under the circumstances, bar payment of the Reverse Termination Fee. Reverse termination fees are a standard feature of Merger and Acquisition ("*M&A*") agreements where the target company has concerns over an acquirer's ability to obtain regulatory clearance or arrange financing. In fact, reverse termination fees can pave the way for parties to come to terms on a transaction when closing uncertainties otherwise might prevent them from doing so. As a pro-contractarian state, Delaware generally favors these types of devices.

Admittedly, the Reverse Termination Fee was relatively large—15.75% of the transaction price and "two to three times higher than average in comparable deals"—and the circumstances under which Rent-A-Center sought payment were somewhat unusual—regulators had not yet moved to block the transaction and Vintage remained willing to work towards closing. Going forward, M&A deal practitioners ought to consider the concerns raised by Vice Chancellor Glasscock when drafting outside date and termination fee provisions. Automatic extensions (perhaps subject to an opt-out term) and two-tiered termination fees are two possibilities.