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The Risks of Not Strictly Complying with a “No Shop” Clause

The recent Delaware Court of Chancery decision to deny a motion to dismiss in *Genuine Parts Company v. Essendant Inc.*¹ provides worthwhile reminders of the necessity of deal participants in acquisition transactions to strictly comply with a “no shop” clause, and the fallacy of the view that substantially complying (or even worse, acting casually in complying with the no shop) suffices to avoid being found in breach.

Attorneys
Paul S. Scrivano
David Hennes
Jane D. Goldstein
John E. Sorkin
Sarah Young
Logan Elliott Pettigrew

In *Genuine Parts*, Essendant and Genuine Parts entered into a merger agreement pursuant to which Essendant would acquire Genuine Parts’ S.P. Richards business in exchange for the issuance of Essendant common stock, resulting in the Genuine Parts stockholders owning 51% of Essendant on a pro forma basis. Shortly before Genuine Parts entered into the merger agreement, Sycamore Partners, a private equity fund, made an all cash offer to acquire Essendant. Essendant did not inform Genuine Parts of that pre-signing offer and, post-signing, Genuine Parts alleged that Essendant breached a no shop clause in the merger agreement by, among other things: (i) failing to terminate existing discussions with bidders for Essendant; (ii) encouraging and facilitating a revised offer from Sycamore in violation of the no shop; (iii) failing to promptly inform Genuine Parts of the Sycamore offer that was made post-signing; (iv) failing to require Sycamore to sign a confidentiality agreement with a standstill provision in violation of the merger agreement provision requiring a “no less favorable...in the aggregate” confidentiality agreement; and (v) failing to properly determine that the Sycamore proposal amounted to a superior proposal in compliance with the no shop. Ultimately, the Essendant board of directors found that the Sycamore proposal (made through its portfolio company Staples) was a superior proposal, terminated the merger agreement with Genuine Parts, and paid Genuine Parts a termination fee of \$12 million. Genuine Parts accepted the termination fee but then sued Essendant for breach of contract. Essendant moved to dismiss the complaint on the basis that payment of the termination fee (and Genuine Parts’ acceptance of that termination fee) provided the exclusive remedy for any such breach of the merger agreement.

In denying Essendant’s motion to dismiss, Vice Chancellor Slight focused on the exclusive remedy language in the termination fee provision. The Court emphasized that the provision providing that the termination fee was the exclusive remedy required a termination by Essendant “in accordance with” and “pursuant to” its right to terminate the merger agreement for a superior proposal. That right, in turn, depended on compliance with the conditions that (i) the superior proposal “did not arise from any material breach of” the no shop by Essendant and (ii) the Essendant board properly determined, in conformity with the no shop clause, that the Sycamore proposal constituted a superior proposal. Accordingly, the Court found that the merger agreement left “room” for Genuine Parts to argue that the exclusive remedy provision did not apply. In doing so, the Court rejected Essendant’s argument that Genuine Parts’ acceptance of the termination fee precluded any argument that Essendant somehow failed to act “in accordance with” those provisions. According to the Court, absent express and unconditional contractual language making receipt of the termination fee exclusive of other legal or equitable remedies, acceptance of the termination fee did not by itself foreclose Genuine Parts’ right to sue Essendant for breach of contract. The Court then held that Genuine Parts’ complaint pled facts which plausibly alleged a material breach of conditions (i) and (ii) above.

Vice Chancellor Slight’s decision is yet another anchor in a line of recent cases in which Delaware courts have held parties to the terms of their contractual bargains. The Delaware Supreme Court’s decision in *Oxbow Carbon & Minerals Holdings, Inc. v. Crestview-Oxbow Acquisition, LLC* rejected the use of the implied covenant of good faith where the plain terms of an agreement between sophisticated parties covered the situation at hand. In addition, Vice Chancellor

¹ *Genuine Parts Company v. Essendant Inc.*, C.A. No. 2018-0730-JRS (Del. Ch. Sept. 9, 2019) (available [here](#)).

Glasscock's decision in *Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.* strictly construed the termination and break-up fee provisions in a public company merger agreement.

Genuine Parts reinforces the need for deal participants to carefully consider, during negotiations, how the “no shop” clauses, matching rights, termination provisions and break-up fee triggers will actually operate upon receipt of a topping bid. Deal participants often view the “no shop” and related provisions as “commoditized” provisions meriting little attention or negotiation, only to be surprised when the words of these provisions later come alive in an active topping bid situation. Sellers should brief the board of directors and management on how these provisions need to be complied with in the real world so that a carefully negotiated termination right for a superior proposal can actually be exercised when needed. Conversely, buyers should be vigilant as to a seller's actions leading up to and during a topping bid situation in order to preserve the buyer's ability to insist on strict compliance with contractual language to defend a highly coveted deal from an interloper.