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Rent-A-Center: a $1.37 BN Reminder on Reminders

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Rent-A-Center Inc., a Texas based consumer goods rent-to-own retailer (R-A-C) most famous for enabling generations of North Americans to fill their homes with furniture, electronics and household appliances, agreed in June 2018 to a buyout by affiliates of the private equity firm, Vintage Capital Management, LLC (Vintage) in a deal valuing the R-A-C at $1.37 billion (including debt). The transaction, which was subject to customary closing conditions and regulatory approvals, included the nearly universal provision entitling either party to terminate the transaction if it did not close by a specified end date (which date could be extended by either party delivering a written notice to the other of its desire to extend). Perhaps unsurprisingly to readers, given the publication of this article (and many others) on what was otherwise a fairly straightforward merger, the specified end date came and went without either R-A-C or Vintage giving the other notice of a desire to extend. After complex litigation between the parties about an allegedly simple failure to give (an arguably unnecessary) notice, Vice Chancellor Glasscock, in *Vintage Rodeo Parent LLC, et al v Rent-A-Center,* determined that R-A-C need not go through with the sale even though the parties (at the time) had appeared to understand that the end date would be extended and had continued to work on satisfying the other closing conditions.

Background

R-A-C agreed last June to be acquired in an all-cash merger by Vintage, following pressure from activist shareholder Engaged Capital to explore strategic alternatives. R-A-C and Vintage understood the deal would require antitrust clearance from the Federal Trade Commission (FTC) as Vintage was and is the controlling shareholder of one of R-A-C's biggest competitors, Buddy's Home Furnishings. The Court found that Vintage and R-A-C were aware of, and responsive to, the anti-trust law component of the transaction, and vigorously negotiated the termination, notice, and breakup fee provisions against this background.

The merger agreement provided for an end date six months after signing. If the FTC review were ongoing and there were no legal restraint to consummation of the merger, Vintage and R-A-C would each have the right to elect to extend the end date from December 17, 2018 to March 17, 2019. Either could bind the other for this extended term by sending written notice of this election any time before midnight on December 17, 2018. If neither Vintage nor R-A-C elected to extend, the agreement would remain in place with either party having the option, in its discretion, to terminate at any time thereafter. The parties agreed that until the merger agreement was terminated, they would exercise commercially reasonable efforts to consummate the transaction. In conjunction with the termination rights and efforts covenants, the parties also negotiated a breakup fee and reverse breakup fee.

As the end date approached, the Board of R-A-C believed that Vintage would exercise its right to extend the term of the agreement given that each side to the transaction continued to expend efforts to advance the transaction and achieve the various approvals necessary to close. At Board meetings held on December 5 and 6, 2018, the Board discussed the financial and operational condition of R-A-C, which had improved since the merger agreement was signed, and resolved that in the event that Vintage did not elect to extend the end date the Company would thereafter immediately exercise its right to terminate the merger agreement and collect the reverse breakup fee, which would be owed to R-A-C by Vintage in the event that Vintage did not extend the agreement and either party subsequently terminated the agreement. It appears from court filings and records that although this matter was discussed and a plan of action determined by the R-A-C board, nobody at R-A-C realistically expected Vintage to not extend given the approaching finish-line. In fact, R-A-C and its attorneys waited anxiously for the notice of extension to arrive on the night of December 17, 2018. Vintage and its advisors simply forgot to give the notice. Having re-evaluated the merits of the proposed merger in light of R-A-C's improved financial and operational performance, R-A-C decided to walk away and collect the reverse breakup fee. Following R-A-C-'s termination of the merger agreement the next day, Vintage brought suit in the Delaware Chancery Court.

Strict Compliance with Negotiated Notice Procedures Required

Vintage argued that the Court should find that express or implied notice to extend the end date had been given by its ongoing expenditure of efforts to close the transaction, applying a standard of "substantial compliance" rather than literal compliance. Vintage also argued that R-A-C had in effect waived the requirement for formal notice by providing for a closing several weeks after the end date in a joint timing agreement filed by R-A-C and Vintage with the FTC. The Court rejected both arguments, finding that Vintage's efforts were mostly, if not entirely, required under the covenant to exercise commercially reasonable efforts to get the deal done and conflated (a) an anticipation to close after the end date with (b) an intention to exercise a termination right, if given the opportunity. Vice Chancellor Glasscock explained that "substantial compliance" may be available despite clear and unambiguous contractual language where necessary to avoid a harsh result in cases where the counterparties' bargain may be preserved and the deviation from literal compliance is justified by the purpose of the notice provision having been satisfied. For example, if notice is required to be given to a certain executive who has left the intended recipient's employ, in the event notice is otherwise given to said recipient in substantial compliance with the terms of a contract, a court may be justified in accepting a standard of substantial compliance. In this case, however, compliance with the notice provision was not impossible and the purpose of the notice provision—to timely inform a counterparty that it would be bound to an extended end date—had not been satisfied. The Court found that the end date extension mechanics were carefully negotiated, and the very purpose of negotiating and prescribing the extension mechanics was to ensure the parties would have certainty as to their rights and obligations existing past the initial end date.

No Duty to Warn of an Intention to Terminate

Another argument advanced by Vintage was that the obligation to exercise commercially reasonable efforts to close the deal imposed a duty on R-A-C to warn Vintage of its decision to terminate the transaction agreement. In rejecting this argument, the Court found that to hold the

opposite, and create a duty to warn, would be inconsistent with the terms of the merger agreement, which set out the manner and content required in order to properly give notice under the agreement.

The Court cautioned that it has left the door open in regard to the question of whether a covenant to exercise reasonable best efforts to get a deal done includes a duty to warn a counterparty that it is operating under a mistaken understanding regarding the contract. In this case, however, R-A-C had no knowledge of Vintage's purported confusion regarding the contract, and could not therefore have been required to work towards consummating the transaction by solving the "problem." We note that to find such a duty exists would be a major development in the law; complicating the way parties negotiate and carry out contractual terms and with whom they contract, in the context of a "reasonable best efforts" clause.

Reverse Breakup Fee Called Into Question

Vice Chancellor Glassock introduced a second cliffhanger, asking the parties to the litigation to submit supplementary arguments relating to the interaction between the $126.5 million reverse breakup fee (amounting to 15.75% of the equity value of the R-A-C) and the implied covenant of good faith and fair dealing, which is to be relied on "[o]nly when it is clear from the writing that the contracting parties would have agreed to proscribe the act later complained of . . . had they thought to negotiate with respect to that matter". While the Court is set to consider judicial possible limits around liability for the reverse breakup fee, it seems that the primary reason Vice Chancellor Glassock invited further argument on this was his expressed doubt as to whether the parties considered the scenario presented in this case in contracting for the reverse breakup fee.

Simple Steps to Ensure Your Transaction Stays on Track

We offer below a series of practical questions and steps to consider in light of the mess between R-A-C and Vintage, in order to keep the minutia of a complicated transaction on-track, despite potential hair triggers and cluttered transaction agreements.

1. Build a closing checklist as soon as possible after finalizing and signing a transaction; include responsible parties and if possible, individuals leading the steps; set-up periodic and regular closing checklist calls to ensure the legal teams on each side of the transaction are connected and communicating regularly (even if some updates have less substance than others, the regular communication will reduce the chance of items falling between cracks and getting lost in the clutter).

2. Diarize all dates, whether seemingly important or not, including estimates and notices prior to closing, end dates and extensions, filing deadlines for particular approvals, waiting period expiries, shareholder meetings and proxy mailing deadlines (as applicable).

3. Begin preparing templates for pre-closing and closing notices earlier than later so the parties fully understand and are familiar with documents that are required to move around the mechanics of the deal; the upfront investment of this time and drafting will reduce closing stress, the number of documents moving around, and the room for human error.

4. Keep the board appraised of various end date scenarios and, in advance of key dates, have forward-looking board resolutions executed to enable a fast paced and informed response should unlikely events manifest, following R-A-C's lead.

5. Consider automatic notice and extension provisions to reduce administrative burdens of managing end dates. Under the R-A-C-Vintage merger agreement, it was agreed the end date would be extended if either party sent notice to the other. While that construct is common in many transaction agreements, parties agreeing to such a provision generally understand that it is very likely that an extension will occur, if necessary to complete a transaction, and would likely agree to an automatic extension under the same circumstances that would give either party the right to extend. Such an alternative and automatic extension mechanism achieves the same negotiated expectations, without necessitating a formal notice at or near the end date, and reduces the likelihood of human error.

We appreciate the suggestions and steps noted above are not particularly radical or innovative, but as the R-A-C-Vintage case demonstrates, failing to focus on the mundane can sometimes have disastrous consequences.

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