

M&A Update

Delaware Court of Chancery Enforces Oral Agreement to Settle Proxy Contest

December 27, 2017

In a December 8th decision (*Sarissa Capital Domestic Fund LP, et. al. v. Innoviva, Inc.*), the Delaware Court of Chancery ruled in favor of Sarissa Capital Domestic Fund LP and certain of its affiliates in concluding that Sarissa and Innoviva, Inc. entered into a binding, oral agreement to settle a proxy contest prior to Innoviva's 2017 annual meeting of shareholders. As a result, the court enforced the oral agreement, and required Innoviva to appoint two Sarissa nominees to its board of directors, despite the absence of a written executed settlement agreement between the parties. While the facts of this case occurred in connection with the settlement of a corporate proxy contest, this decision offers valuable insight into the factors a court will consider persuasive in determining whether an enforceable oral contract has been formed between parties.

Background

In February 2017, Sarissa commenced a proxy contest to elect three directors to Innoviva's seven-member board at Innoviva's annual meeting of shareholders scheduled to be held on April 20, 2017. As of April 18, with the vote too close to call, the parties intensified settlement negotiations with Sarissa proposing a settlement of the proxy contest if Innoviva would agree to (i) expand its board from seven to nine directors; (ii) appoint two of Sarissa's director nominees to the board; and (iii) forgo a standstill agreement. Innoviva agreed on the first two points of this proposal, but insisted that Sarissa enter into a standstill agreement.

On April 19, the day before the annual meeting, the results of the proxy contest remained in doubt, as two of Innoviva's largest shareholders had yet to cast their votes. Upon learning that one of the holders (Vanguard) planned to vote for Sarissa's nominees, the Innoviva board orally conveyed to Sarissa its willingness to settle without a standstill. Sarissa promptly accepted and the parties commenced preparation of a written settlement agreement.

With the written settlement agreement finalized but not executed and the press release nearly finalized, Innoviva learned that the other large holder (BlackRock) had voted in favor of the board's slate, which ensured that none of Sarissa's nominees would be elected. Innoviva then informed Sarissa that it was no longer willing to agree to a settlement and instead held its annual meeting the

next day, at which all of its nominees were elected. The court, however, found that Sarissa and Innoviva had entered into an oral agreement to settle the contest before the vote and ordered Innoviva to appoint two of Sarissa's nominees to its board.

Takeaways

- A Court Will Look to the Conduct of the Parties in Determining Whether an Oral Agreement Exists. The case serves as a reminder that a binding agreement can be formed even if the parties do not enter into a written agreement. In the absence of a written agreement, a court will review the conduct of the parties in determining whether “(1) the parties have made a bargain with ‘sufficiently definite’ terms and (2) the parties have manifested mutual assent to be bound by that bargain.” The court viewed the parties’ discussion on April 19 as an agreement of the “essential terms to settle the proxy contest.” And in the court’s view, the parties had reached a meeting of the minds as to all material terms of the settlement, the last being Innoviva’s agreement to forgo a standstill.

The court further looked to “the objective, contemporaneous evidence” of the parties’ actions to determine that they had each manifested mutual assent to be bound by the oral agreement. In doing so, the court provided valuable guidance as to the factors that will be considered in determining whether an oral agreement exists:

- The Court Will Evaluate the Board’s State of Mind. The court first examined the board’s deliberations and viewed as persuasive the board’s view that it was “on the brink of an electoral shellacking” and that the board had authorized its lead negotiator to “negotiate to see if a [Sarissa-Innoviva] settlement agreement [on those terms]...could be reached” without a requirement that any additional board approval be obtained prior to finalizing an agreement.
- The Court Will Review Prior Draft Agreements. The court reviewed various versions of draft settlement agreements that had been shared between the parties. The court noted the absence of language in the final draft settlement agreement proposed by Innoviva providing that the agreement would become effective only when a written agreement had been entered into; language that had been included in prior versions. Furthermore, the court noted as persuasive the fact that the settlement agreement had been finalized by the parties and highlighted Innoviva’s acceptance of Sarissa’s proposed changes to such settlement, which provided that the purpose of the settlement agreement was “to confirm our agreement” and to move the concept of the issuance of a joint release to be a covenant, as opposed to a condition precedent.
- The Court Will Analyze Interactions Between the Parties. Lastly, the court looked to the interaction between the parties’ lead negotiators, noting that they had confirmed to each other that they “had a deal”, agreed to “prepare the ‘paperwork...to get it done’” and did

not state that the agreement was contingent upon the execution of a written agreement or the completion of a joint press release.

- Parties Should Take Steps Not to Inadvertently Enter Into a Binding Oral Agreement. Parties engaged in discussions or negotiations with respect to a potential transaction should be mindful not to inadvertently enter into an oral agreement before intending to be bound. The case highlights certain steps parties may take to ensure they do not prematurely enter into a binding agreement.
 - *First*, consider including a statement in any preliminary communication or agreement entered into with respect to a potential transaction indicating that no agreement with respect to a final transaction will be deemed entered into unless a definitive agreement has been executed by all parties. Further, consider including similar language in any draft agreements shared with counterparties in connection with the potential transaction.
 - *Second*, boards of directors should keep clear meeting minutes and other contemporaneous records of its intention not to be bound until a written agreement is in place. To the extent possible, these records should be prepared and reviewed by the board in real time, in advance of any threat of litigation. Moreover, the board should require that its lead negotiator obtain additional board approval to enter into any final agreement.
 - *Third*, the lead negotiator should not indicate to any potential counterparty that a final deal has been struck, and, to the extent appropriate, should expressly communicate during late-stage negotiations that no final agreement will be deemed entered into without the receipt of additional internal approvals and execution of a written agreement.
 - *Fourth*, to the extent practicable, it may be prudent to withhold agreement on one or more material terms until the final stage of negotiations in order to eliminate any argument that all material terms had been agreed by the parties.
- Parties Should Not Wait Until the Last Minute to Consider Settlement Options. This case highlights the power of passive index funds in determining the outcome of proxy contests given the size of their holdings and willingness to cast their votes on the eve of the election. In this case, Vanguard and BlackRock did not cast their votes until the day before Innoviva's scheduled meeting date. Passive index funds represent a significant portion of the voting power of almost every company in the S&P 500 and their votes often become swing votes coming in at the last moment. In this case, Vanguard and BlackRock voted contrary to the expectations of the Innoviva board. This is not an uncommon scenario as these funds often hold their cards close to the vest until the very end. Given this reality, parties to a proxy contest that would be willing to enter into a settlement should try to explore the feasibility of reaching an agreement at an earlier stage – rather than leaving things for the night before.

The full text of *Sarissa Capital Domestic Fund LP, et. al. v. Innoviva, Inc.* can be found [here](#).

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