



## Delaware Court Holds That Fiduciary Disclosure Principles Do Not Apply To ROFR Purchases

In an intriguing case of first impression, the Delaware Court of Chancery recently held in *Latesco, L.P. v. Wayport, Inc.*<sup>1</sup> that fiduciary disclosure principles do not apply to purchases by insiders pursuant to contractual “right of first refusal” (“ROFR”) provisions. The court essentially ruled that under Delaware law companies, as well as their officers and directors, are not required to disclose material non-public information to a seller before buying shares pursuant to ROFR provisions unless (1) the ROFR agreement expressly requires such disclosure or (2) the Company or the insiders purchasing the shares make statements to the seller that are misleading absent additional disclosure. We believe that *Latesco* is highly significant for venture capitalists, private equity investors, and others who frequently rely on ROFR provisions.

The court stated that a ROFR provision is “an unconstrained right to buy shares” and noted that “many factors ... distinguish the exercise of a right of first refusal from situations in which the law imposes strict fiduciary fidelity.”<sup>2</sup> In particular, the court reasoned that in a typical ROFR transaction: (1) the insiders act passively and do not actively solicit the transaction; (2) the parties do not engage in price negotiation at the time the ROFR is exercised; and (3) the ROFR agreement does not give the seller the right to receive, at the time the ROFR is exercised, material information about the company. In reaching its conclusion, the court was swayed by the exigencies of private equity financing, noting that “any broad rule of fiduciary disclosure would almost certainly disrupt the intended operation of any right of first refusal given to a corporation or one of its insiders.”<sup>3</sup> The court noted, for example, that ROFR provisions “generally operate on tight time schedules and certainly do not contemplate price renegotiation,”<sup>4</sup> which the court noted could result from the disclosure of material information by the insiders exercising the ROFR. However, the court held that fiduciary disclosure principles did apply to a concurrent sale of shares involving the same parties that was not pursuant to the ROFR provisions.

It is important to note that that the court reached this conclusion even though, before the ROFR sale was consummated, the seller expressed concerns to the insiders about whether they had greater access to information about the Company and were told only that the insiders “are not aware of any bluebirds of happiness in the Wayport world right now.”<sup>5</sup> In fact, as alleged by seller, the insiders knew that the Company had recently sold some of its patents to Cisco Systems at a price that, in the seller’s mind, implied a value for his shares higher than the price paid by the insiders. The court affirmed that companies and insiders exercising ROFR provisions could face liability if they make materially false or misleading statements to sellers.

<sup>1</sup> C.A. No. 4167-VCL (Del. Ch. July 24, 2009).

<sup>2</sup> *Id.* at 26.

<sup>3</sup> *Id.* at 27.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 11.

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The *Latesco* decision should provide comfort to companies and their insiders purchasing shares pursuant to ROFR provisions. In view of the court's reasoning, it seems that sellers who wish to obligate ROFR purchasers to disclose material non-public information should consider including a contractual disclosure obligation in purchase agreements. However, as the court noted,<sup>6</sup> such a disclosure obligation could adversely affect the practical effectiveness of ROFR provisions.

As noted above, the court's decision in *Latesco* applies Delaware fiduciary principles and does not necessarily imply a similar result under the federal securities laws. In addition, as it is a case of first impression by a lower court, other courts may or may not be in agreement.

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<sup>6</sup> *Id.* at 27-28.

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If you have any questions regarding the matters discussed in this briefing, please contact any of the Winston & Strawn attorneys listed below or your usual Winston & Strawn contact.

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