# Court of Chancery Dismisses Consent and Unconscionability Claims Challenging Contract Between Parent and Wholly Owned Subsidiary

Contributors

**Arthur R. Bookout,** Counsel

**Jessica R. Kunz,** Associate

> See page 3 for takeaways

On March 30, 2020, in *The Chemours Company v. DowDuPont Inc., et al.*, C.A. No. 2019-0351-SG (Del. Ch. Mar. 30, 2020), the Delaware Court of Chancery issued an important decision reaffirming bedrock principles of Delaware corporate and contract law governing the relationship between parent and subsidiary corporations. In *Chemours*, the Court of Chancery upheld the validity of a separation agreement entered into by a parent corporation and its wholly owned subsidiary and enforced the delegation clause of a mandatory arbitration provision in the parties' separation agreement. Specifically, the Court of Chancery held that agreements between a parent and subsidiary corporation do not fail for lack of contractual "consent" and are not procedurally unconscionable simply because the parent company dictates the terms of the contract. Under settled Delaware law, wholly owned subsidiaries are expected to operate for the benefit of their parent corporations, and Delaware will not invalidate contracts because the parties operate accordingly.

The decision in *Chemours* reaffirms a foundational element of parent-wholly owned subsidiary jurisprudence and preserves an integral part of corporate structuring by expressly acknowledging the validity of parent-wholly owned subsidiary contracts under Delaware law.

## Background of the Parties' Dispute

In *Chemours*, the parties' dispute arose out of the 2015 spin-off of The Chemours Company (Chemours) from its former parent, E.I. du Pont de Nemours and Company (DuPont).[1] The terms of the spin-off were governed by a separation agreement (the Separation Agreement), which was approved by Chemours' board and signed by a Chemours officer prior to the spin-off. The Separation Agreement assigned certain assets and liabilities to Chemours, including historical environmental liabilities for which Chemours is obligated to indemnify DuPont.

The Separation Agreement also contained a mandatory arbitration provision requiring confidential arbitration of any disputes arising among the parties relating in any way to the Separation Agreement. Moreover, a "delegation provision" in the Separation Agreement stated that the parties "expressly agree" that "all issues of arbitrability ... shall be finally and solely determined by the Arbitral Tribunal."

In 2019, four years after the spin-off, Chemours filed a lawsuit in the Delaware Court of Chancery seeking to invalidate or limit its obligation to indemnify DuPont (and others) under the Separation Agreement. Chemours claimed that, at the time of the spin-off, the value of Chemours' indemnification obligations had been underestimated by DuPont and, if properly estimated, would have rendered Chemours insolvent at the time of the spin-off, in violation of Delaware law. Chemours sought an order from the court declaring the indemnification provisions of the Separation Agreement unenforceable, or imposing caps on its indemnification obligations. In the alternative, Chemours sought the return of a $3.91 billion dividend paid to DuPont in connection with the spin-off.

## Summary of the Court of Chancery's Analysis

Citing the mandatory arbitration provision, DuPont moved to dismiss Chemours' claims for lack of subject matter jurisdiction. In opposition, Chemours argued it was not required to arbitrate its claims because (i) it did not consent to arbitration, and (ii) the arbitration

[1] Skadden represented DuPont and the other defendants.

provision was unconscionable. The Court of Chancery rejected both of Chemours' arguments and dismissed its claims for lack of subject matter jurisdiction.

Unless specified otherwise in the agreement, agreements to arbitrate disputes involving interstate commerce, like the Separation Agreement, are governed by the Federal Arbitration Act (FAA). Under the FAA, issues of contract formation, like consent, are governed by principles of state contract law.

Chemours first argued that "as a subsidiary, pre-Spin-Off Chemours had no will of its own; it was animated solely by the will of its parent, DuPont, and thus was unable to independently and effectively consent to arbitration." Chemours alleged, among other things, that it had no opportunity to bargain with DuPont regarding the terms of arbitration and was not permitted to retain counsel, and that the arbitration provision was "conceived, drafted, and executed by DuPont alone." The Court of Chancery disagreed that these alleged facts rendered Chemours unable to consent. Applying Delaware law, the court found that "[w]hile Chemours challenges its consent to arbitration in this 'real world' or intuitive sense, it cannot show that it did not consent in the *contractual* sense required by the FAA." The court explained: "Simply because the parent dictates terms to its wholly-owned subsidiary is *not* grounds under Delaware law to infer lack of consent such that the contract would be unenforceable." Rather, consent is measured at the time of contract formation, and Chemours' board resolution and its acting vice president's signature on the Separation Agreement (even though all such parties were DuPont employees) evidenced Chemours' "overt manifestation of assent — and, therefore, Chemours's consent — to the Separation Agreement."

Chemours also argued that the arbitration provisions should not bind Chemours because the Separation Agreement was akin to a foundational document, such as a corporate charter, and thus not really a contract at all. The Court of Chancery again disagreed, finding that Chemours' argument would "violate the FAA's equal treatment principle," which required courts to place arbitration provisions on equal footing with other contracts. The Court of Chancery also explained that "Delaware law recognizes no subspecies of consent applicable to agreements such as the Separation Agreement," and thus "[a] rule that requires an elevated level of consent for purposes of an arbitration agreement ... would derivate from Delaware law contract principles."

Next, the Court of Chancery rejected Chemours' argument that the delegation provision was substantively and procedurally unconscionable. Chemours argued that the mandatory arbitration provision of the Separation Agreement was substantively unconscionable because, among other reasons, the Separation Agreement "den[ies] the arbitrator any 'authority or power to limit, expand, alter, amend, modify, revoke or suspend any condition or provision' of the Separation Agreement." Thus, Chemours argued, the arbitrator would have no power to take any action should it agree with Chemours that the arbitration provisions were unconscionable because any action would require the arbitrator to "modify" or "revoke" a provision of the Separation Agreement. The court rejected this argument, explaining that Chemours had failed to articulate a substantive unconscionability argument that was specific to the delegation clause (and that, in all events, the provisions Chemours complained about did not operate on the delegation clause, and therefore did not render the delegation clause substantively unconscionable).

Finally, the Court of Chancery rejected as a matter of Delaware law Chemours' argument that the Separation Agreement was "procedurally unconscionable." Similar to its consent arguments, Chemours argued the arbitration provisions were procedurally unconscionable because, according to Chemours, they were "'written into the Separation Agreement over Chemours's express objection.'" The Court of Chancery noted that unconscionability is measured at the time of contract formation, and that Chemours was a wholly owned subsidiary of DuPont at the time the Separation Agreement was executed. Reaffirming long-standing principles of Delaware corporate law, the Court of Chancery found

that, even if the delegation clause were the product of procedural unfairness, "it cannot be procedurally unconscionable because such a finding cannot be squared with settled Delaware law that 'wholly-owned subsidiary corporations are expected to operate for the benefit of their corporations; that is why they are created.'" The court stated that "the spirit of procedural unconscionability ... is wholly inconsistent with the routine enforcement of parent-subsidiary contracts," and "to find such a contract unenforceable based on procedural unconscionability would be nonsensical."

Chemours has appealed the decision to the Delaware Supreme Court. The briefing on the appeal is scheduled to conclude in July 2020.

## Takeaways

- Parent-subsidiary contracts are presumptively valid under Delaware law, even where the parent dictates the terms.
- As a general matter, agreements between a parent and wholly owned subsidiary cannot be procedurally unconscionable because wholly owned subsidiaries are created solely for the benefit of the parent.
- Companies should be in close contact with outside counsel in navigating these types of issues.