Which Affiliates Are Bound by Restrictive Covenants Hinges on the Language the Parties Chose, Recent Rulings Stress

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In 2021, the Delaware Court of Chancery issued two decisions addressing when a contractual party's affiliates are bound to restrictive covenants in an agreement. In the first case, *Sixth Street Partners Management Company, L.P. v. Dyal Capital Partners III (A) LP,*[1] the plaintiff alleged that a transfer restriction in an investment agreement was breached when an investor's upstream affiliate agreed to sell a business division that included the investor's general partner. In the second, *Symbiont.io, Inc. v. Ipreo Holdings, LLC*,[2] the plaintiff alleged that a noncompetition provision in a joint venture agreement was breached when the other party to the joint venture was acquired by a competitor of the plaintiff.

The *Sixth Street* decision held that the restriction did not to apply to the upstream affiliate, while in *Symbiont*, the restriction was enforced against a nonparty to the original contract. However, both decisions turned on a close reading of the language of the parties' agreements, and both provide helpful guidance to drafters, highlighting why commercial entities and their attorneys should take care in defining what is encompassed by the term "affiliate."

Dyal Capital: When Are Up-Stream Affiliates Bound to a Transfer Restriction?

The Dyal Capital Partners division (Dyal) of Neuberger Berman Group, LLC (Neuberger) managed funds that acquired passive minority equity stakes in other private investment firms. In 2017, a limited partnership that Dyal managed (Dyal III) invested in Sixth Street Partners (Sixth Street), an alternative asset manager. Dyal III's relationship with Sixth Street was governed by an investment agreement that included certain restrictions on the transfer of Dyal's interest in Sixth Street, and, specifically, that "no Subscriber [*i.e.*, Dyal III] may Transfer its Interests in any Issuer [*i.e.*, Sixth Street]" without prior consent.

In December 2020, Neuberger announced that it had entered into a business combination agreement (BCA) to merge Dyal with Owl Rock Capital Group (Owl Rock) and a special purpose acquisition company called Altimar Acquisition Corporation. Importantly, the transaction was structured so the deal was exclusively between "upstairs' entities" – *i.e.*, Neuberger and Owl Rock – and "[t]he legal and economic relationships between Sixth Street and Dyal III … will not change."

Sixth Street sued, seeking to enjoin the transaction, alleging that the transactions contemplated under the BCA between Neuberger and Owl Rock constituted a prohibited transfer under Dyal III and Sixth Street's investment agreement. Sixth Street argued that, although Dyal III was the only defined "Subscriber" in the investment agreement, the definition of the verb "Transfer," which included "any other similar transaction involving an Affiliate," was intended to prevent any transfer of an interest in Sixth Street by any affiliate of Dyal III up the corporate ladder.

[1] *Sixth Street Partners Mgmt. Co., L.P. v. Dyal Capital Partners III (A) LP,* 2021 WL 1553944 (Del. Ch. Apr. 20, 2021), *aff'd*, 253 A.3d 92 (Table) (Del. 2021).

[2] *Symbiont.io, Inc. v. Ipreo Holdings, LLC*, 2021 WL 3575709 (Del. Ch. Aug. 13, 2021).

In April 2021, Vice Chancellor Morgan T. Zurn of the Delaware Court of Chancery denied Sixth Street's request for a preliminary injunction and held that the plaintiffs failed to demonstrate a likelihood of success in establishing that there was a breach of the investment agreement, and also failed to demonstrate a likelihood of success that Neuberger tortiously interfered with the investment agreement.

The court emphasized that "the Subscriber, Dyal III, is transferring nothing in the Transaction, so the Transfer Restriction is not triggered." The court noted that "Sixth Street's interpretation would have the Court enjoin a transaction at any level of Dyal's corporate pyramid, regardless of whether that entity was explicitly bound by the Transfer Restriction. This runs afoul of Delaware's well-settled respect for and adherence to principles of corporate separateness and freedom of contract, especially in the hands of sophisticated parties that could have expressly bound Dyal III's upstairs entities if doing so reflected their intended agreement."

The court relied on two recent Delaware opinions that declined to extend contract provisions to nonparty upstream entities. The first was the Delaware Supreme Court's holding in *Borealis Power Holdings Inc. v. Hunt Strategic Utility Investment L.L.C.*,[3] where the court refused to bind an upstream owner to "a right of first refusal" provision in its subsidiary's contract. In doing so, the Supreme Court held that the "analysis was governed by the 'subject' of the right of first refusal," and the subject was only the subsidiary, not the owner.

Similarly, in *Sheehan v. Assured Partners, Inc.*[4] the Court of Chancery found that a tag-along right was not triggered, because the subject of the provision was not doing any transferring or selling of its units in the challenged transaction.

Applying these precedents, the court in *Sixth Street* concluded that "the Transfer Restriction is triggered only by the Subscriber's Transfer of its Interests in Sixth Street, which will not occur in the Transaction. Dyal III is not transferring any Interests. The Transfer Restriction applies only when Dyal III is doing the transferring, so an upstairs sale of control over Dyal III GP cannot trigger it. Dyal III, the Subscriber, is not a party to the Transaction and its investment in Sixth Street is unchanged. The Transaction does not trigger the Transfer Restriction."[5]

In addition, the court found that there was no irreparable harm and the balance of the equities favored the defendants.

The Delaware Supreme Court later summarily affirmed the Court of Chancery's decision after judgment was entered against Sixth Street.

Symbiont: Future Affiliates Are Subject to Restrictions in Joint Venture Agreement

In 2016, Symbiont.io, Inc. (Symbiont) and Ipreo LTS, LLC (Ipreo) joined forces with a plan "to revolutionize the secondary market for syndicated loans." They formed a joint venture, which involved the creation of a new limited liability company, Synaps (JV). Symbiont committed to provide the JV a distributed ledger and smart contract technology, and Ipreo committed to provide, among other things, a management team with expertise in the syndicated loan industry. Symbiont and Ipreo entered into several agreements, including a joint venture agreement (JV Agreement).

The JV's primary competitor, IHS Markit Ltd. (Markit), had a 99% share of the market for intermediary services for syndicated loans through its technology ClearPar. Symbiont and Ipreo thought that they had a superior technology that could take market share from Markit.

In 2018, as the JV was struggling to gain traction, rumors spread that Markit was in talks to acquire Ipreo. Ultimately, Markit

[3] 233 A.3d 1 (Del. 2020).

[4] 2020 WL 2838575 (Del. Ch. May 29, 2020).

[5] 2021 WL 1553944.

acquired Ipreo in its entirety, including its interests in the JV, for $1.86 billion. After the acquisition closed, Markit decided against continuing the JV, and Markit continued to operate its ClearPar business.

In May 2019, Symbiont filed suit against Ipreo and Markit, bringing breach of contract and tortious interference claims. In its headline claim, Symbiont asserted that Ipreo breached the noncompetition provision in the JV Agreement. That provision prohibited Ipreo and any of its "affiliates" from engaging in any joint ventures except through the Synaps JV. Symbiont argued that Ipreo breached the noncompetition provision as soon as the acquisition closed because "(i) Markit became an Affiliate of Ipreo as a result of the Acquisition, (ii) Markit engaged in the Joint Venture Business by offering its ClearPar product, and (iii) Markit did not run its ClearPar business through [Synaps]."

In a post-trial opinion, the Court of Chancery found that Symbiont proved that Ipreo breached the noncompetition provision under this theory. The only disputed issue was whether Markit qualified as an affiliate of Ipreo after the acquisition.

The JV Agreement defined "affiliate" to mean include any entity that "directly or indirectly, controls, is controlled by, or is under common control with" a party. The term was used in several places throughout the JV Agreement in addition to the noncompetition provision, even in the definition of "Ipreo" at the beginning of the agreement, which was defined to include "its Affiliates."

Symbiont argued that the definition of affiliate called for "determining whether a party qualifies as an Affiliate at the time when contractual compliance with the JV Agreement is measured." In other words, according to Symbiont, the court needed to determine whether a party qualified as an affiliate at the time that the prohibited competition took place. Under this reasoning, once an entity qualified as an affiliate, that entity could not engage in a "Joint Venture Business" without causing a breach of the noncompetition provision.

Ipreo countered, arguing that the definition of affiliate only encompassed parties that qualified as affiliates on the date the JV Agreement became effective.

The court sided with Symbiont, saying that, "[f]or purposes of the Non-Competition Provision, there are other textual indications that compliance with the Affiliate Definition is determined when contractual compliance is measured." Those "textual indications" included, among other things, language in another restrictive covenant that showed that the parties knew how to limit the scope to events that occurred as of a specific date, while the noncompetition provision and the definition of affiliate failed to use similar language, thus indicating an intent that the affiliates should be determined as of the date contractual compliance is measured.

The court found that *Universal Studios Inc. v. Viacom Inc.*[6] was directly on point. That court did not limit the affiliate definition to companies that qualified as affiliates when the joint venture agreement was signed. The *Symbiont* court held, "[w]hen Symbiont and Ipreo entered into the JV Agreement in 2016, the Viacom case was settled precedent. It had been on the books for nineteen years. The decision not only illuminates the plain language of the JV Agreement, but it also shows that if the drafters wanted to achieve a different result, such as limiting the coverage of the Affiliate Definition to those Persons that qualified as affiliates on the effective date, then they needed to include additional language to achieve that result."

The court went on to conclude that, in addition to the plain language of the agreement and case law, the "real-world" commercial context also favored Symbiont's interpretation of the noncompetition provision and definition of affiliate. The court found that "[i]t would not make sense for the Non-Competition Provision to acknowledge

[6] 705 A.2d 579 (Del. Ch. 1997).

that the members' relationships with the Company could change over time, yet for the Affiliate Definition to treat those relationships as forever fixed at the time of signing." If that were the case, "either Symbiont or Ipreo could form a new entity immediately after executing the JV Agreement, then conduct Joint Venture Business through that entity. That outcome is absurd."

"Ipreo's interpretation of the Affiliate Definition seems like something dreamed up after the fact, for purposes of litigation," the court said. "It is not an interpretation that Ipreo held in real time, when negotiating and agreeing to the Transaction Agreements."

The court therefore held that Ipreo was liable for breach of the noncompetition provision in the JV Agreement when Markit became Ipreo's affiliate and operated its ClearPar business outside the JV.[7]

[7] *Symbiont* is currently on appeal to the Delaware Supreme Court.

Takeaways

- *Sixth Street* emphasizes that the court will carefully examine the contract at issue and enforce its plain meaning when determining whether nonparty upstream entities are bound. Ultimately, *Sixth Street* concluded that upstream entities that were not a party to the agreement were not bound by the agreement's anti-transfer provisions. *Symbiont* further reinforces that the court will look to the plain language of the agreement to interpret what entities are "affiliates," examining how that term is defined and used throughout the document, as well as the commercial intent of the parties.
- Given Delaware's strong respect for corporate separateness and freedom of contract, the plain language of a contractual provision, and, particularly, which entity is named as the subject of the provision at issue, will guide the court's determination of which entities are bound to its terms.
- Drafters of a contract should state explicitly which entities are being bound by and subject to the terms of the provision. Among other things, parties should carefully consider how "affiliates" are defined and how that term is used throughout the contract so as to encompass only those parties the parties intend to bind.
- A nonparty to a contract may still be bound when the contract contains "textual indications" that demonstrate the parties did not intend to limit the scope of the restrictive provision as they did in other provisions.
- The court may also look to the real world commercial context surrounding the agreement to determine if a party's interpretation is reasonable.

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