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Lessons from Derek Jeter's journey to court

By Marc Boiron

In *Derek S. Jeter v. RevolutionWear, Inc.*, the Delaware Court of Chancery addressed issues that arise when a director owes both fiduciary duties and contractual duties to a corporation. The court denied, in part, Derek Jeter's motion to dismiss claims that he breached his fiduciary duties as a director of RevolutionWear and violated the implied covenant of good faith and fair dealing.

RevolutionWear is a men's clothing company that engages in a reverse-endorsement strategy, whereby famous athletes become its owners, directors and advisors, rather than simply endorse its products, to more effectively market to consumers. On March 23, 2011, after a few months of negotiations, Derek Jeter and RevolutionWear entered into a memorandum of agreement for service upon the board of directors, pursuant to which Jeter agreed, among other things, that (i) RevolutionWear could disclose the identity and a brief biographical sketch of Jeter, and (ii) subject to Jeter's approval, RevolutionWear could issue a press release disclosing Jeter's role therewith. In addition, Jeter acquired 15 percent of the outstanding stock of RevolutionWear.

During the negotiations with RevolutionWear, Jeter was under contract with Nike, Inc. Jeter's representatives initially informed RevolutionWear that Jeter would need Nike's approval before he could become a "publically announced co-founder, substantial owner and director." RevolutionWear requested a copy of Jeter's contract with Nike on several occasions but Jeter's representatives refused to provide it. On several occasions, Jeter's representatives later advised that Jeter's contract with Nike did not prohibit Jeter from publically announcing that he was a co-founder, substantial owner and director of RevolutionWear.

New York Times

In November 2012, Jeter refused to approve the issuance of a press release announcing his role with RevolutionWear unless RevolutionWear changed the description of a product described in the press release. However, even after the description of the product was changed, Jeter continued to push back against the issuance of the press release.

In 2015, Jeter resigned from his position as a director of RevolutionWear.

In an action Jeter commenced against RevolutionWear in late 2015 in the Delaware Court of Chancery, RevolutionWear filed a counterclaim for, among other things, breach of the implied covenant of good faith and fair dealing and breach of fiduciary duties.

RevolutionWear argued that Jeter's failure to approve the press release stating that Jeter was a significant owner, co-founder and director of RevolutionWear breached the implied covenant of good faith and fair dealing contained in the memorandum of agreement. The parties agreed that Jeter's decision of whether to approve or reject the press release must be reasonable. The court found it reasonably conceivable that Jeter's refusal to approve RevolutionWear's press release was not reasonable because the potential conflict between Jeter's contract with Nike and the press release existed as a result of Jeter's prior false representations to RevolutionWear regarding the terms of that contract. Therefore, it was reasonably conceivable that Jeter's refusal to approve the press release in the form presented by RevolutionWear to Jeter constituted a breach of the memorandum of agreement.

RevolutionWear also made several arguments for Jeter's breach of his fiduciary duties as a director of RevolutionWear. The court noted that RevolutionWear's allegations "illustrate the difficulties that may arise in the fiduciary context when a corporation expects its directors to perform acts outside of their traditional fiduciary role." The provisions in the memorandum of agreement expanded Jeter's obligations beyond his fiduciary obligations, and though those "contractual obligations may give rise to breach-of-contract claims, they do not alter the fiduciary obligations of the director."

Given that the memorandum of agreement did not expand Jeter's fiduciary duties, the court dismissed all breach of fiduciary duties claims except for the claim based on Jeter's fraudulent statements to RevolutionWear's investors. Jeter informed RevolutionWear's investors that he would publically announce his role as co-founder, investor and director of RevolutionWear even though he knew that he could not make the announcement because of the purported contractual prohibition in his contract with Nike. The court found that Jeter's statements to RevolutionWear's investors were made in bad faith while he was acting as a fiduciary of RevolutionWear. Therefore, it was reasonably conceivable that Jeter breached the duty of loyalty.

The *RevolutionWear* decision is informative in the context of the governance of private Delaware companies and is an important reminder of the risks of incomplete due diligence. First, directors and officers should distinguish between their fiduciary duties and their contractual duties. Unlike in the context of Delaware limited liability companies, except as set forth in the General Corporation Law of the State of Delaware, the fiduciary duties of directors and officers of Delaware corporations may not be contractually altered to limit or expand those fiduciary duties. The actions of directors and officers may satisfy their fiduciary duties while simultaneously violating one or more of their contractual obligations or vice-versa. Therefore, when a director or officer enters into a contract with the corporation to which he or she owes fiduciary duties, that director or officer should recognize that any contractual obligations are in addition to and different from his or her fiduciary duties.

Second, although the corporate governance concerns that arise when it is unclear whether a corporate action is taken as a stockholder, director or officer of a corporation was not in question in *RevolutionWear*, that concern, like mixing fiduciary and contractual duties, often is overlooked in the context of private companies. Practitioners and clients often seek to have a sole stockholder act instead of the board of directors because the sole stockholder determines the direction of the corporation through his, her or its control of that board. However, the board of directors must approve actions that are within its powers and outside of the powers of the stockholder. A transaction that only a stockholder, acting on behalf of a corporation, approves and that requires approval of the board of directors of that corporation will not be valid despite the stockholder's control of the board of directors.

Similarly, circumstances exist where a person elected as both a director and an officer of a corporation must take an action in his or her capacity as a director and not as an officer or vice-versa. It is important to distinguish between an action taken as a director and one taken as an officer. A person acting in the capacity of a director may be exculpated for a breach of the duty of care, which is not the case with a person acting in the capacity of an officer. In addition, a person who is both a director and an officer of a corporation may have different indemnification rights and insurance coverage as a director than as an officer.

Lastly, the purpose of legal due diligence is to identify any unknown issues with the company. When performing due diligence it is common for companies to be unable to provide information requested because it cannot be found or does not exist. If a document that is requested is not provided, such as the agreement with Nike in *RevolutionWear*, then it is necessary to determine the likelihood that the document contains material information that may be detrimental to the company. If the company is not able to produce a document that contains material information, then counsel should identify the issue for his or her client. The client should then weigh the risk of not knowing potentially material and detrimental information against the benefits of the contemplated transaction to the client. Notwithstanding the risks of entering into an agreement without knowing all potentially material information, the client nonetheless may decide that the business opportunities are significant enough to pursue the transaction.


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