



# M&A Litigation Webinar Series

Pre-Closing Disputes

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# Presenters



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Meryl Macklin is a trial lawyer with over 30 years of experience trying and resolving complex business disputes. Ms. Macklin has served as lead trial counsel for clients ranging from major corporations to small startups in dozens of high-exposure cases in state and federal courts around the country, and regularly practices in both Northern and Southern California. Her trial experience has enabled her to develop targeted litigation strategies even when handling cases likely to settle, avoiding unnecessary and costly motion and discovery practice where possible. Her practice focuses not only on defending companies in litigation but also on counseling clients on ways to quickly resolve disputes. She is a strong team leader, with proven success partnering with clients and other professionals to accomplish results.



**Kent D. Wittrock, Partner, Kansas City**  
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Kent Wittrock has spent more than 13 years partnering with his clients on their most strategic matters, having closed well over \$1.5 billion of middle-market merger and acquisition transactions. Clients have recognized Kent for his quality legal advice, industry knowledge, strategic thinking, responsiveness, collaboration, tailored fee structures, use of technology, loyalty and ethics. Today, he serves as lead deal counsel closing transactions in a wide range of industries including agribusiness and food, manufacturing, distribution, business services and health care, and regularly acts as outside general counsel to mid-sized companies on contractual and general business matters.

# Disclaimer

- The information presented today is for educational purposes only. Your participation in this webinar does not create an attorney-client relationship between you and Bryan Cave Leighton Paisner LLP or any of its attorneys. Do not use the information presented as a substitute for specific legal advice from a licensed attorney.

# Basic Transaction Structures

- Simultaneous sign and close
- Sign and delayed close (staggered sign and close)
- Factors to consider in structuring the transaction:
  - Protracted negotiation
  - Anticipated regulatory approvals and timing
  - Third party consents
  - Financing
  - Sale process leading to potential transaction
  - Leverage of the parties
  - Others

# Key Purchase Agreement Differences – Sign and Delayed Close

- Conditions to Obligations to Close
  - Closing conditions generally refer to certain events that must occur, or certain facts that must continue to be true, after the purchase agreement has been signed in order for the parties to be obligated to consummate the transaction
- Pre-Closing Covenants
  - Affirmative covenants
  - Negative covenants
- Termination Provisions
  - Termination rights
  - Effect of termination

# Common Closing Conditions

- Conditions to Obligations of Both Parties to Close
  - No injunctions
  - No illegality
  - Antitrust approvals
  - CFIUS approval
  - Others

# Common Closing Conditions

- Conditions to Obligations of Each Party to Close
  - Accuracy of representations and warranties (“bring down”)
  - Compliance with covenants
  - Third party consents
  - Shareholder approvals
  - Financing
  - Absence of a Material Adverse Effect
  - Issuance of RWI Policy
  - Completion of due diligence (?)
  - Others

# Accuracy of Representations and Warranties (“bring down”)

- A “bring down” requires that a party’s representations and warranties be true and correct as of the closing date
- It may also require that a party’s representations and warranties be true and correct as of the date the purchase agreement is signed
  - Where representations and warranties are made as of a particular date, seller should be careful to specify that such representations and warranties are accurate only as of the date when made (as opposed to a future date)
- Standards generally applied to the bring down of a party’s representations and warranties include:
  - True and correct in all respects
  - True and correct in all material respects
  - True and correct except for such failures to be true and correct as would not have or reasonably be expected to have a Material Adverse Effect
  - Exceptions/qualifications (fundamental representations; materiality scrape)



# Material Adverse Effect (MAE)

- Generally serves as a standalone condition and as a qualifier to the bring down of the seller's representations and warranties
- Sample formulation:  
“Material Adverse Effect” means any event, occurrence, fact, condition, change or effect that has had, or could be reasonably expected to have, a material adverse effect on the condition (financial or otherwise), results of operations, business, properties, or liabilities of the Target taken as a whole.

# Material Adverse Effect (MAE)

- Exceptions, exceptions, exceptions:
  - Changes in global or national economic conditions
  - Changes in industry trends
  - Changes in global or national political conditions, including the outbreak or escalation of war or acts of terrorism
  - Earthquakes, floods or other force majeure events
  - Changes in law or GAAP
  - Failure to meet projections
  - Effects arising out of the announcement or pendency of the transaction
  - Many others

# Material Adverse Effect (MAE) Case Highlights

- In *In re IBP*, the Delaware Chancery Court, applying New York law, held that a MAE clause is “best read as a backstop protecting the acquirer from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner.”
  - Tyson sought contract termination under MAE provision
  - High Burden
  - Designed to protect buyers against unknown risk
  - Will not be construed as an escape clause for buyer’s remorse
    - See *In re IBP, Inc. Shareholders Litigation*, 789 A.2d 14, 2001 Del. Ch. LEXIS 81 (Del. Ch. 2001); *Frontier Oil Corp. v. Holly Corp.*, 2005 Del. Ch. LEXIS 57 (Del. Ch. 2005)

# Material Adverse Effect (MAE) Case Highlights

- “In determining whether a material adverse effect has occurred within the meaning of a merger agreement, so as to allow avoidance of obligation to close, the important consideration is whether there has been an adverse change in the target’s business that is consequential to the company’s long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months.”
  - *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, 965 A.2d 715, 738 (Del. Ch. 2008)
- Reaffirmed *In re IBP*
  - “Heavy burden”
  - Holistic approach

# Material Adverse Effect (MAE) Case Highlights

- *Akorn, Inc. v. Fresenius Kabi AG*, No. CV 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018)
  - The only case in which the Delaware Supreme Court has found an MAE to exist
  - Material Adverse Effect/Change Standard:
    - “significant in the context of the parties’ contract”
    - “a deviation from the buyer’s reasonable expectations regarding what it would receive at closing”
  - The Court cited:
    - A “dramatic, unexpected, and company-specific downturn”
      - Akorn’s year-over-year quarterly decline in revenue, operating income and EPS were 34%, 292% and 300%, respectively
    - A 21% decline in the company’s standalone equity value
    - Akorn’s full-year 2017 EBITDA declined 86% and full-year 2017 Adjusted EBITDA declined 51% on a year-over-year basis.
    - “Persistent, serious” FDA violations
      - The court, using expert witness testimony, estimated that the regulatory compliance issues at Akorn would result in a loss in value of \$900 million, representing a 21% decline from the equity value implied by the merger agreement

# Compliance with Covenants

- Pre-closing covenants
  - Pre-closing covenants often regulate the activities of the target during the pre-closing period in order to preserve the value of the target and its business before the closing or to facilitate closing matters
  - Consist of affirmative and negative covenants
  - Examples:
    - General efforts to cause conditions to be met (“best” versus “commercially reasonable” efforts)
    - Specific efforts with respect to regulatory approvals (HSR/CFIUS)
    - Conduct of the business in the ordinary course
    - Specific listing of negative covenants (employees, material contracts, capital expenditures, etc.)
    - Exclusive dealing
    - Access to information/notification of breaches of reps and warranties
    - Financing
    - Public disclosure/confidentiality

# Compliance with Covenants

- Closing condition with respect to performance of covenants typically qualified by lowercase “m” materiality
- As a general matter, the party obligated to perform the covenant can choose whether or not to comply
- Consistent theme with the treatment of covenant breaches for indemnification purposes
- Several of the standalone conditions relate back to the general “efforts covenant” requiring the parties to take all actions necessary to consummate as promptly as practicable the transactions contemplated by the purchase agreement

# Buyer Pre-Closing Dispute Options/Strategies

- Close and seek indemnity
  - Consider implications of limitations on recovery (rep breach versus covenant breach)
  - Consider seller group and its impact on post-closing relationships
  - Assess likelihood of recovery
  - Assess potential exposure for failing to close
- Terminate the purchase agreement and sue for damages
  - Termination right for breach of reps, warranties and covenants will link back to failure of conditions to be satisfied
  - Often subject to cure rights depending on the nature of the breach giving rise to the termination right
  - Recourse may be contractually limited (e.g., agreed upon termination fees, limits related to unintentional breaches, etc.)
- Threaten to terminate and renegotiate deal terms
  - Consider the severity of the breach
  - Assess leverage of the parties and implications for failing to close
  - Highly dependent on deal dynamics



# Buyer Pre-Closing Dispute Options/Strategies

- Seek specific performance
  - Compel compliance with the purchase agreement
  - Highly dependent on provisions in the purchase agreement
  - Monetary damages must be inadequate
- Pursue a fraud claim
  - May allow buyer to get outside the four corners of the purchase agreement
  - Purchase agreement likely contains provisions designed to counter extra-contractual fraud claims

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