A GUIDE TO PREVENTING M&A LITIGATION: SLEEPING BETTER AT NIGHT
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Business and Corporate Litigation & Mergers and Acquisitions Committees

Program Chairs and Moderators:

Edward Deibert, Arnold & Porter, San Francisco, California
Sarah Tomkowiak, Latham & Watkins, Washington, District of Columbia

Panelists:

Vice Chancellor Joseph R. Slights III, Delaware Court of Chancery, Delaware
Lisa J. Hedrick, Hirschler Fleisher, Richmond, Virginia
Rachelle Silverberg, Wachtell, Lipton, Rosen & Katz, New York, New York

These days, many M&A transactions are likely to involve M&A litigation. M&A litigation comes in many shapes and sizes, and can represent a significant liability exposure. Although only so much of a deal is under the lawyers’ control, lawyers have a keen interest in anticipating disputes, and taking steps to try to prevent (or at least limit) M&A litigation.

A standard merger agreement has many provisions, some of which are the subject of frequent negotiation, attack, interpretation, and litigation. To sleep better at night, M&A transactional attorneys and litigators alike should be focused on the following provisions and issues, which will be addressed by the Panelists:

**Earnout Clauses.** An earnout clause is an agreement between parties who disagree over the value of the business being acquired, whereby the seller agrees to take a certain amount of cash at closing but can obtain additional cash if the business later achieves a certain performance target. Earnout clauses present several recurring legal issues, and the case law is uncertain and fact-specific. As the Delaware Chancery Court aptly observed in *Aveta v. Bengoa*, “since value is debatable and the causes of underperformance equally so, an earnout often converts today’s disagreement over price into tomorrow’s litigation over outcome.” Earnout disputes are frequently the norm, not the exception. With this in mind, parties should consider the merger agreement’s choice of forum for earnout disputes – court or arbitration. And both parties may want to get experts retained early, as earnout cases are often won in a battle of the experts when it comes to valuation and accounting issues.

**Material Adverse Effect (MAE) Closing Conditions.** Significant declines in the seller’s business or prospects between signing and closing may threaten the deal. Parties try to address this possibility by including a closing condition that no MAE has occurred. This condition generally provides that if a party has suffered an MAE (as defined in the merger agreement), the other party can refuse to close the deal. Although the definition of what constitutes an MAE is highly negotiated, what is “material” is not typically defined, often leading to litigation down the road. MAE definitions do and should attempt to allocate risks: typically, market or industry risks are allocated to the buyer, and company-specific risks are allocated to the seller, with heavily negotiated carve-outs and exclusions. Should litigation over
whether an MAE has occurred arise, Delaware courts place a high burden on a buyer to show that an MAE has in fact occurred, rather than mere buyer’s remorse. In October 2018, in Akorn v. Fresenius, the Delaware Chancery Court for the first time found that an MAE had occurred, which, combined with other breaches of the merger agreement, allowed the buyer to walk away. The Court’s lengthy decision is replete with practical lessons for parties in negotiating merger agreements, and reaffirms that buyers will continue to bear a heavy burden in establishing a stand-alone MAE to avoid a bad deal.

**Anti-Reliance Clauses.** An anti-reliance provision seeks to protect against extra-contractual fraud claims for misrepresentations allegedly made in connection with the deal, by making it clear that both parties eschew reliance on any facts but those recited in the merger agreement (for example, financial projections). Delaware law enforces clauses that identify the specific information on which a party has relied and foreclose reliance on other information. But as the Delaware Chancery Court recently emphasized in ChyronHego Corporation v. Wight, to be effective, the merger agreement must contain clear, unequivocal language by which a party “has contractually promised that it did not rely upon statements outside the contract’s four corners in deciding to sign the contract.” Delaware courts will not, however, condone a seller’s attempt to use anti-reliance language in order to avoid liability for (1) misrepresentations in the merger agreement; or (2) knowledge that representations made in the merger agreement are false.

**Exclusive Remedy Provisions.** Exclusive remedy provisions seek to limit the available remedies in the event of a future dispute over the parties’ performance of the contact. Buyers and sellers extensively negotiate the indemnification provisions in an acquisition agreement, including any survival periods, caps, baskets, and procedures for seeking indemnification in the event of a breach following closing. The parties then need to negotiate whether the indemnity is the exclusive remedy in the event of a breach of the agreement or if the buyer is entitled to other remedies outside of the indemnification provisions in the event of a breach, including for claims such as breach of contract or rescission.

**Exceptions to Damage Recovery.** The various rights to indemnification may be limited by time or be subject to caps or baskets. Oftentimes, however, a buyer will insist that these limitations are not applicable in the event of some “willful” or “intentional” misconduct by the seller, including as a result of the seller’s fraud. If left undefined, these vague standards can be subject to dispute or misunderstanding. Courts have found “willful” and “knowing and intentional,” to mean different things. In addition, there are multiple standards for fraud, including intentional fraud and negligent fraud. While buyers may want to leave the standards broad to give more flexibility to raise later claims, sellers may push for specific definitions to avoid later disputes regarding their liability.

**Ownership of Attorney-Client Privilege.** Ownership of the attorney-client privilege with respect to communications between the seller and its counsel regarding the negotiation of the transaction may be important in post-closing litigation relating to the transaction. If sellers or its former owners retain the privilege, those communications can be shielded from the buyer. If a buyer owns the privilege, however, it has the opportunity to use those communications against the seller in any dispute. Accordingly, the parties need to understand the extent to which the privilege may be automatically transferred to the acquirer under applicable law as well as ways in which the seller or its former owners can retain and continue to enforce the privilege.
**Defense of Litigation.** The parties will want to address who has the ability to control litigation pending at the time of a transaction as well as litigation arising after closing. If the seller is financially responsible for the litigation through its indemnity or otherwise, it will most often want the right to be in control of the litigation. A buyer, however, will want the ability to control such litigation, especially to the extent the outcome has an impact on its operations, its customers or its business following the closing. The party not in control will then want to negotiate rights with respect to participating in the defense as well as the scope of any consent rights to settle such litigation.