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MESSAGES FROM THE U.S. ANTITRUST ENFORCERS AT THE ABA ANTITRUST SPRING MEETING

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In late March in Washington, D.C., the American Bar Association Section of Antitrust Law held its annual Spring Meeting. Antitrust lawyers from around the world—including top antitrust and competition law enforcement officials from the U.S. and abroad—convened to ruminate on all things antitrust. Enforcer comments during Spring Meeting panels and roundtables provide useful insights to the private bar and their clients about enforcers' priorities and concerns.

All three current Federal Trade Commission ("FTC") commissioners, including FTC Chair Lina Khan, and several FTC attorneys participated on panels during this year's Spring Meeting. Additionally, Joseph Kanter, Assistant Attorney General for the U.S. Department of Justice Antitrust Division ("DOJ"), and several DOJ attorneys also spoke on panels. The antitrust chiefs of the New York, Washington, and Washington, D.C. state attorneys general also contributed to Spring Meeting programming. These federal and state enforcers spoke on a number of topics over the course of the meeting, many of which touch on M&A.

1. Aggressive Enforcement is Here to Stay

Neither the DOJ nor the FTC participants revealed any radical changes to the agencies' aggressive enforcement strategy. Leaders from the agencies reiterated claims that there has been systematic underenforcement of the antitrust laws in the U.S. over the past several decades, resulting in industry consolidation and anticompetitive conduct, ultimately harming the public. One Deputy Assistant Attorney General ("DAAG") from the DOJ even disputed that the DOJ's enforcement is "aggressive," instead describing it as "just enforcement." That same DAAG went on to discount the risks of overenforcement, claiming that the adversarial process during investigations and enforcement actions serve as a "check" to ensure overenforcement does not curb growth and innovation.

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Additionally, depending on the arguments put forward in the appeal, the court may have occasion to address several constitutional questions: in the administrative proceeding, Illumina raised defenses based on the FTC's structure, as well as due process and equal protection concerns.

ENDNOTES:

[1] https://www.paulweiss.com/practices/litigation/antitrust/publications/ftc-rescinds-vertical-guidelines-introducing-opacity-into-merger-review?id=40984.

[2] https://www.ftc.gov/system/files/ftc_gov/pdf/D09401InitialDecisionPublic.pdf.

[3] https://ec.europa.eu/commission/presscorner/detail/en/ip_22_5364. *See also* Jay Modrall, "Illumina/Grail and the M&A Implications of Expanded EU Merger Regulation Jurisdiction," *The M&A Lawyer*, Vol. 26, No. 9, October 2022.

[4] https://www.paulweiss.com/practices/litigation/antitrust/publications/takeaways-from-the-doj-s-unitedhealth-change-healthcare-merger-loss?id=44360.

DOES A DIFFERENT MAE ANALYSIS APPLY TO A "FINANCIAL" BUYER?

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"Financial" buyers are amongst the most active participants in M&A. Alleged material adverse effects ("MAE") are amongst the most complex disputes in M&A.

What happens when the two meet? Numerous Delaware decisions have indicated that a different MAE analysis might apply where the M&A transaction features a "financial" buyer (as opposed to a "strategic" buyer). Moreover, the scant Canadian caselaw that has considered the issue arguably points in the same direction.

Given that Canada is consistently the largest foreign destination for U.S. outbound M&A by deal volume,[1] we explore this issue for the benefit of M&A lawyers on both sides of the border.

"Financial" Buyers vs "Strategic" Buyers

Private equity ("PE") has become an increasingly important force in M&A, largely due to the classic PE model whereby a PE fund acquires an underperforming business to improve such performance before selling the business for a profit.

This "flipping" of businesses by PE (often called "financial" buyers) is in contrast to the typical goals of a "strategic" buyer. Being an established industry player, a "strategic" buyer usually acquires the business not for short-term improvement but for comprehensive and long-term integration into its operations and growth plans and for potential synergistic and operational savings.

Material Adverse Effect Disputes

A detailed dive into the MAE clause is beyond the scope of this article.[2]

What is important for the current discussion is that, first, MAE clauses allow the *buyer* to avoid closing the transaction where the target has experienced a "material adverse effect," and second, in deciding whether a "material adverse effect" has occurred, courts consider the anticipated *duration* of the adverse impact on the target. Simply put, an adverse development of only momentary conse-

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quence is unlikely to be considered "material" as intended by an MAE clause.

When a "Financial" Buyer Meets an MAE

What is the consequence of the convergence of an M&A transaction with a "financial" buyer and an alleged MAE on the target such that the "financial" buyer argues it is entitled to walk away from the deal?

The answer is that several courts have indicated—although none to the knowledge of the authors definitively—that the *required duration* of the adverse impact experienced by the target may be *briefer* where the buyer is a "financial" with a short-term investment horizon. Stated differently, these courts have shown an appreciation of the distinction in acquisition motivations and intentions between "strategics" and "financials" and have implied that such differences may in part drive their MAE analysis.

Delaware Caselaw

Indeed, such indications are relatively longstanding, at least in Delaware.

In *IBP* the Court of Chancery noted the MAE clause "must be read in the *larger context* in which the parties were transacting" before distinguishing between "a short-term speculator" and a "strategic buyer." For the former, the failure of the target "to meet analysts' projected earnings for a quarter could be highly material." For the latter it would be "odd" to "view a short-term blip in earnings to be material . . ."

Both *Hexion* and *Bardy* stated that, in the absence of evidence otherwise, "a *corporate acquirer* may be assumed to be purchasing the target as part of a *long-term strategy*." *Level 4 Yoga* remarked that "durational significance is particularly important here because [the buyer] was seeking to acquire [the target] as part of a *long-term strategy*."[3]

Another recent example is *Snow Phipps*, which involved the sale of a cake decorations company by a mid-market PE firm to a larger PE group. The Court of Chancery summarized:

> [The buyer] argues that, in a debt-financed acquisition, the timeframe for evaluating durational significance should align with the timing of post-closing covenant compliance testing. [The buyer's] argument effectively invites the court to *view private equity transactions dissimilarly from strategic acquisitions when interpreting an MAE*, an idea that is the subject of a wealth of scholarly commentary that the parties neither cited nor discussed. This decision flags the issue without engaging in it . . . (emphasis added)

This "wealth of scholarly commentary" was also noted in *Akorn*, where the Court of Chancery recognized that "[c]ommentators have suggested that 'the requirement of durational significance may not apply when the buyer is a financial investor with an eye to short term gain.' "

Canadian Caselaw

Noteworthy for U.S. "financial" buyers eyeing a Canadian target is that these themes recurrent in Delaware MAE caselaw were recently echoed by the Ontario Superior Court of Justice (the Court) in *Fairstone*.[4]

First, the Court endorsed the statement in *IBP* that, "[f]or a short-term speculator, the durational requirement may be relatively short to constitute a MAE."[5] The Court also acknowledged that, in other instances, U.S. courts have required adverse changes that "persist significantly into the future," including adverse changes "consequential to the [target's] long-term earnings power . . ."[6]

The result for *Fairstone* was that "[t]he length of the durational requirement *depends on the context*."[7]

This led the Court to base its required adverse duration of "approximately two years" in reference to the buyer's expected "synergies," "scale," and "diversification."[8] Furthermore, there are other instances of *Fairstone* emphasizing the importance of context, including when, in considering the MAE's carve-outs, the Court explained that "[o]ne of the factors that Canadian and American courts have identified as relevant to interpreting MAE clauses is the *identity of the parties*."[9]

Practical Takeaways for U.S. Private Equity Considering a Canadian Acquisition

Canadian and Delaware law generally align on many key M&A issues, but on certain others they do not.[10] One difference pertinent to the intersection of "financial" buyers and MAE clauses is that between the "factual matrix" and the "four corners."

In Canada, per the Supreme Court of Canada's decision in *Sattva*, the "factual matrix" surrounding a contract's execution is considered in *every case* and can impact the court's interpretation of the contract's terms. By contrast, in Delaware, courts adhere to the "four corners" principle whereby they generally strive to resolve contractual interpretation disputes, where possible, without looking beyond the document.[11]

Among other things, this difference in basic principles of contract interpretation could facilitate an argument by a "financial" buyer that its nature as such reduces the required duration of an adverse impact on the target in an MAE dispute governed by Canadian law.[12] Also notable towards this end is *Fairstone*'s repeated statement that MAE clauses should be "interpreted from the perspective" of the buyer.[13]

Overall, the practical takeaways for PE buyers are clear. First, should an MAE arguably occur, a PE buyer's nature as such *may* function to *reduce* the *duration* of adverse impact on the target a Delaware court would require as part of an MAE analysis. Second, given that, at a high level, Canadian law gives more consideration to the "factual context" in deciding contractual interpretation disputes than does Delaware law (*i.e.*, given Delaware's "four corners" principle), this argument *may* be more open to a PE buyer where the M&A agreement is governed by Canadian law (*i.e.*, where the target is a Canadian company).

ENDNOTES:

[1]*See* Paul Weiss' "M&A at a Glance Year-End Roundups" for each of 2022, 2021, 2020, 2019, and 2018.

[2]For further discussion, *see* P. Blyschak, "Material Adverse Effect (MAE) Clauses in Canada: What U.S. Counsel Needs to Know" (2022) 16(2) *Virginia Law & Business Review* 327.

[3]*See also Frontier Oil v. Holly*, which cautioned that the "notion of [an MAE] is imprecise and varies both with the *context of the transaction* and *its parties* . . ." (emphasis added).

[4]*Fairstone Financial Holdings Inc. v. Duo Bank of Canada*, 2020 ONSC 7397 (CanLII) ["*Fairstone*"].

[5]*Fairstone* at para. 78.

[6]*Fairstone* at paras. 78 and 79, citing *IBP*, *Hexion*, *Frontier Oil,* and *Akorn*.

[7]*Fairstone* at para. 78 (emphasis added).

[8]*Fairstone* at paras. 81, 84, and 85.

[9]*Fairstone* at para. 93 (emphasis added).

[10]*See*, for example, P. Blyschak, "Material Adverse Effect (MAE) Clauses in Canada: What U.S. Counsel Needs to Know" (2022) 16(2) *Virginia Law & Business Review* 327.

[11]*See* E. Norman Veasey & Jane M. Simon, "The Conundrum of When Delaware Contract Law Will Allow Evidence Outside the Contract's 'Four Corners' in Construing an Unambiguous Contractual Provision" (2017) 72 *The Business Lawyer* 893.

[12]Note, however, that as a decision of the On-

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tario Superior Court of Justice, *Fairstone* would not be binding in Canada's other provinces and territories. That said, it could be considered persuasive in such other jurisdictions. The authors are unaware of any Canadian caselaw other than *Fairstone* discussing this issue in any meaningful detail.

[13]*See Fairstone* at paras. 25-26, 72, and 86. *See also* paras. 162 and 166.

DELAWARE COURT OF CHANCERY DISMISSES BREACH OF CONTRACT CLAIMS AGAINST BUYER, FINDING SELLER RETAINED POST-CLOSING LIABILITY RELATED TO CERTAIN PRODUCT-LIABILITY LITIGATIONS

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On April 3, 2023, in *Merck & Co., Inc. v. Bayer AG*,[1] Vice Chancellor Nathan A. Cook of the Delaware Court of Chancery dismissed the breach of contract claims by one pharmaceutical company ("Seller") against another ("Buyer") in connection with Buyer's acquisition of Seller's consumer product lines in 2014 pursuant to a Stock and Asset Purchase Agreement (the "Agreement").

After closing, product liability claims relating to talcum powder used in one of the product lines were filed against both companies. Seven years after the closing, Seller informed Buyer that as of the seventh anniversary, it would no longer pay for defense and liability stemming from the claims and, after Buyer refused to assume the liability, sued Buyer for breach of the Agreement. The Court found that the Agreement—which was negotiated by sophisticated parties—unambiguously established that Seller was indefinitely liable for the products liability claims for products sold before closing.

In the "Assumption of Liabilities" provision of the Agreement, Buyer assumed liability for all purchased assets, except for "Retained Liabilities" that remained with Seller. Seller "absolutely and irrevocably" retained "all obligations and liabilities" for the Retained Liabilities, which included products liability claims relating to products purchased prior to the closing date. Seller asserted that if the parties had intended Seller to retain the liability indefinitely, the Agreement would have used words like "perpetual" or "forever." The Court disagreed, explaining that the words "absolutely" and "irrevocably" established that Seller retained the liability into perpetuity.

Seller also argued that the "Expiration of Representations and Warranties" clause (the "Expiration Provision") imposed a seven-year limitation on its obligations to defend product liability claims, asserting that "the general language" describing the Retained Liabilities was "qualified by the specific language" of the Expiration Provision. The Court, however, found that (i) the Expiration Provision imposed limits only on claims that the parties might bring against each other, not tort claims by third parties, and (ii) the sections of the Agreement were neither in conflict nor ambiguous.

The Court noted that Seller's reading would have unwound the carefully assigned liabilities explicitly established in the Agreement, which also contained