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HIGHEST EU COURT STRIKES DOWN EC'S EXCESSIVE MERGER REVIEW PRACTICE BUT LEGAL UNCERTAINTY REMAINS FOR FUTURE M&A DEALS IN EUROPE

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On September 3, 2024, the Court of Justice of the EU ("CJEU") ruled that the European Commission ("EC") had no jurisdiction to review (and prohibit) Illumina's acquisition of early cancer detection test manufacturer Grail ("the Illumina/Grail deal").[1] The ruling marks the end of the EC's revised Article 22 referral policy under EU merger control rules that the EC announced in March 2021 and has applied in several cases since then.

The ruling eliminates the risk for M&A deals that national competition authorities in the EU ("NCAs") without jurisdiction under national merger control rules can establish EC jurisdiction by referring potentially problematic deals to the EC for merger review.

While a serious setback for the EC, the ruling only provides partial relief to M&A dealmakers. EU Member States have expanded their merger control toolboxes in recent years to intervene in potentially problematic deals falling below the EU and national filing thresholds, including so-called killer acquisitions, by introducing transaction value-based thresholds (*e.g.*, Germany, Austria) or permitting NCAs to call in deals that fall below the turnover thresholds (*e.g.*, Denmark, Hungary, Ireland, Italy, Lithuania and Sweden). These developments have significantly widened the scope for (*ex-ante*) merger scrutiny of M&A deals by NCAs, which now have more possibilities for referring cases to the EC than they had at the time of the referral of the Illumina/Grail deal. The EC is now likely to encourage these NCAs to refer deals for review under these new rules, and there is also a risk that NCAs and the EC will increasingly use abuse of dominance rules ("Article 102 TFEU") to conduct (*ex-post*) reviews of certain M&A deals in the future. Finally, the EC will further consider amending EU merger control rules to expand its powers to review potentially problematic, below-threshold deals but such EU legislative reform would require support from Member States and take years to implement.

This article summarizes the particularities of merger referrals under Article 22 of the EUMR and the EC's excessive referral policy since the Illumina/Grail deal and outlines the implications

IN THIS ISSUE:

Highest EU Court Strikes Down EC's Excessive Merger Review Practice but Legal Uncertainty Remains for Future M&A Deals in Europe — 1

Delaware Court of Chancery Finds Pharma Buyer Failed to Use Commercially Reasonable Efforts in Achieving Post-Closing Milestones — 5

Delaware Chancery Court Dismisses Claims Against Controlling Shareholder: Court Clarifies Two Issues of Delaware Law Regarding Lawsuits Challenging Mergers on "Unique Benefit" Grounds — 8

DOJ, FDIC and OCC Update Approaches to Bank Merger Review — 9

Lessons on Law Firm Legal Opinions from Chancery's Recent *Boardwalk* Decision on Remand — 17

Drafting and Diligence Matter in M&A: Lessons from *Save Mart* — 20

From the Editor — 23

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sure from their client to reach the legal conclusion that was reached; and the lawyers departed from their own firm opinion committee's practices (such as by delivering a "Preliminary Opinion" without the firm chairman's signoff). The General Partner, in the appeal to the Supreme Court, criticized the Court of Chancery for having "impugned the integrity and good faith" of the many big-firm lawyers involved in issuing, or advising with respect to, the Opinion of Counsel. The court responded in its remand decision: "[T]op-flight lawyers at big law firms are human, just like the rest of us"; they "*are* subject to the same pressures and cognitive biases as other humans, and perhaps especially so"; and they "can get themselves into messes," including acting in bad faith in delivering legal opinions.

Practice Points on Legal Opinions

We note the following practice points on legal opinions, arising from the decision on remand:

- **Law firms should deliver explained opinions when complex or difficult issues are involved.** The court indicated that explained opinions are appropriate when dealing with "issues involving legal uncertainties due to the nature of the process (*e.g.*, bankruptcy), conflicting authority or perhaps lack of authority." The court stressed that unexplained opinions "are inappropriate for complex and difficult issues."

- **Non-Delaware law firms should not issue opinions on complex issues of Delaware law.** The court acknowledged the common practice of—and had no issue with—non-Delaware law firms "thinking about or advising on issues of Delaware law" or "rendering opinions on straightforward issues of Delaware law." However, the court emphasized, non-Delaware law firms do not generally, and should not, render "formal opinions" on "complex issues of Delaware law."

- **In addition, law firms issuing legal opinions should:** be extra cautious about reaching legal conclusions that other firms have rejected or refused to address; not make assumptions or assert facts in the opinion that "contradict real-world facts"; and state how any ambiguous terms have been interpreted for purposes of the legal opinion. We would note, also, the court's practice in recent years of calling out, in the opinions it issues, law firms and lawyers (and others) by name and detailing the problematic conduct, even if the court determines there is no legal liability.

ENDNOTES:

[1]*Bandera Master Fund LP v. Boardwalk Pipeline Partners LP* (Sept. 9, 2024).

DRAFTING AND DILIGENCE MATTER IN M&A: LESSONS FROM *SAVE MART*

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Seemingly unusual outcomes and large numbers can distract from sound legal logic. But they should not, and there may be no better example of this than the arbitral ruling in Delaware's *Save Mart* dispute.[1]

The case also underscores two key lessons for dealmakers and their counsel. First, to draft with purpose and not rely on precedent or standardized clauses. Second, to carefully diligence the contract against the client's—and the transaction's—particular circumstances. As the arbitrator repeatedly explained, Delaware courts will hold sophisticated parties to their written agreement and a "less favorable outcome" will not "overcome the contract's plain language."

The Dispute in Brief

The target was a grocery store chain that also owned a majority interest in a joint venture ("the JV") relating to

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another grocery store business. The buyer was an affiliate of Kingswood Capital Management, LP, a private equity firm and sponsor of the transaction. At closing the JV carried debt in the form of a revolving line of credit and a real estate term loan in a total amount of $109 million ("the JV Debt").

The transaction was structured, and the equity purchase agreement ("the EPA") was drafted, to effect an acquisition that was both cash-free and debt-free. In line with this approach, to the knowledge of all parties the seller swept $205 million from the target's accounts prior to closing. However, in preparing its pre-closing statement under the EPA's purchase price adjustment ("the PPA"), the seller did not account for the JV Debt even though the JV Debt remained outstanding. The result was a calculus that required the buyer to make a closing payment of $39.6 million.

Following closing, and relying on the language of the PPA and its defined terms, the buyer included the JV Debt in its post-closing statement. This created an additional $109 million deduction in the buyer's favor and crediting this adjustment would obligate the seller to owe the buyer approximately $70 million.

This outcome led the seller to institute legal proceedings against the buyer and would later also lead to media attention, much of which focused on the large post-closing adjustment claimed by the buyer relative to the deal's closing purchase price. What this focus overlooks, however, is the plain wording of the parties' bargain and the cash-free, debt-free understanding behind it, and the benefit of that bargain enjoyed by the seller.

The Arbitrator's Reasoning: Plain Language Prevails

The seller's principal arguments were essentially twofold. First, that reading the PPA and its definitions against the EPA and its other terms as a whole supported its interpretation that the JV Debt was intended to be excluded from post-closing adjustment. Second, that certain extrinsic evidence outside of the contract also supported this interpretation.

The arbitrator—a former Vice Chancellor of the Delaware Court of Chancery—was unconvinced. He explained that the parties' dispute "distills down to a straightforward question of contract interpretation." He held that the JV Debt "clearly" fell under the definition of "Closing Date Indebtedness" (and thus under the PPA) and that "no other provisions of the EPA disrupt[ed] that construction . . ." He further explained that, viewed against the transaction's backdrop, this outcome was "not absurd or commercially unreasonable." Indeed, the arbitrator stressed the "choice, ultimately, is not difficult."

Regarding the terms of the PPA, the arbitrator held the EPA defined indebtedness "broadly" and that this broad approach extended to the definition of "Closing Date Indebtedness" and its sub-definition of "Group Companies," of which the JV was the first expressly identified entity. He highlighted that, should the parties have intended to exclude the JV Debt from the PPA, they were free to have done so. Moreover, that they seemingly intended not to do so was reinforced by several bespoke exclusions from the definition of "Indebtedness" *that had in fact been made*. The result was that the PPA's "unambiguously plain language" required the deduction of the JV Debt.

Regarding the seller's arguments that other provisions of the EPA altered the PPA's meaning, the arbitrator held that each of these attempts were unsuccessful because of the "clear wording" of the PPA and its defined terms. As a matter of interpretation, the arbitrator would not allow "different and mostly unrelated clauses" to be used as a "backdoor" for "altering the critical definitions and economic terms of the parties' business deal." The arbitrator also highlighted how, in respect of certain key financial terms, the parties had agreed to bespoke treatment. As with the bespoke exclusions from the definition of "Indebtedness," the parties tailored treatment of such matters as "Working Capital" indicated that, had they intended to carve the JV Debt out of the PPA, they would have specifically done so.

This lack of ambiguity in the PPA's terms led the arbitrator to conclude that considering evidence extrinsic to the contract was neither warranted nor permissible.

Moreover, the arbitrator emphasized that his reading of the contract "honored" the "realities of the parties' business relationship," being their agreement to a "cash-free and debt free transaction." The arbitrator stressed that the seller had "enjoyed the benefit" of its side of the agreement. This being the case, the seller had to "bear the burden" of the buyer enjoying its side. So too did the arbitrator emphasize that, given the seller's cash sweep, the seller had "still received significant and meaningful consideration" from the sale.

Lastly, the arbitrator saw "no evidence" the buyer had not acted in good faith in connection with the PPA and its preparation of the post-closing statement. Nor did the arbitrator see any basis to consider whether the buyer had engaged in forthright negotiations or whether the EPA should be reformed for mistake, noting, among other things, that "witnesses from both sides repeatedly testified that the two sides simply never discussed the treatment of the [JV Debt] in the Acquisition."

The Court of Chancery Confirms the Arbitral Award

Although the Court of Chancery disagreed with certain aspects of the arbitrator's ruling, it did not hesitate to confirm the award.[2] The following passages are telling, and speak for themselves:

> [T]he Arbitrator strictly applied the literal words of the definition of Closing Date Indebtedness. The Arbitrator analyzed the Agreement as a whole and interpreted its language consistent with recent trends in Delaware law towards a highly contractarian jurisprudence. Given this record, it is not possible to find that the Arbitrator manifestly disregarded the law. He diligently applied the law. . . . The parties litigated the issue before the Arbitrator, and the Arbitrator relied on a strict interpretation of the language of the contract to rule in favor of the Buyer. That determination . . . flows entirely from the language of the Agreement, with particular emphasis on one definition in the Agreement. That means the Award is grounded in the Agreement. The Arbitrator also did not willfully flout the governing law. To the contrary, the Arbitrator cited and followed many Delaware precedents that set out principles of contract interpretation which, when applied strictly, support the result he reached . . . [T]here is no basis to set aside the award.

Key Takeaways for M&A Lawyers and Dealmakers

We return to the two key lessons for dealmakers and their counsel. First, to draft with purpose and not rely on precedent or standardized clauses. Second, to carefully diligence the contract against the client's—and the transaction's—particular circumstances.

As the arbitrator made clear, the fact that parties dispute the meaning of the contract they signed does not render the terms at issue ambiguous. There is also good reason why the courts strive to keep the parties within the "four corners" of their contract by setting a high bar to the admission of extrinsic evidence: it is messy, unreliable, and ultimately subjective in nature. What a contract says is under the parties' direct control. How extrinsic evidence is digested is not.

Overall, the arbitrator's parting advice is apt to repeat here:

> Buyer and Seller deliberately agreed that their transaction would be governed by Delaware law and its strict contractarian regime. That election has consequences. Sophisticated parties bound to a contract governed by Delaware law may rest secure in the knowledge that their agreement's plain language will control the outcome of their contract-based disputes. Delaware is more contractarian than most states, and our law respects contracting parties' right to enter into good and bad contracts. Our courts enforce both. For this reason, parties should ensure their contracts say what they mean and mean what they say.

ENDNOTES:

[1]*See RMP Seller Holdings, Inc. LLC, f/k/a New Save Mart Corp. v SM Buyer LLC and SM Topco LLC*, Final Award (Sept. 5, 2023). While the arbitration award was private, the award has since been made public and can be found, *inter alia*, on the American Bar Association (ABA) Business Law Section website: https://www.americanbar.org/groups/business_law/resources/business-law-today/2024-may/post-closing-purchase-price-adjustments-gone-wrong/ (last accessed September 25, 2024).

[2]*See SM Buyer LLC v. RMP Seller Holdings, LLC*, 2024 WL 865918 (Del. Ch. Feb. 28, 2024)..

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