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M&A Closings: "It Ain't Over Till It's Over"

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Contrary to Yogi Berra's sage advice, business sellers too often assume once an agreement is signed, closing is a mere formality, even if the business has hit a speed bump. In Delaware, no court had ever excused a merger partner from a deal based on a failure by the target company to meet the closing condition that the target company not have suffered a material adverse effect. That is, until October 1, 2018, when the Delaware Chancery Court ruled in *Akorn, Inc. v. Fresenius Kabi AG*.

The *Akorn* Decision

Akorn, Inc., a pharmaceuticals company, agreed to be merged into another pharmaceuticals company, Fresenius. In the merger agreement, Akorn made "extensive representations" regarding its regulatory compliance and committed to operate in the ordinary course of business between signing and closing. The court found that Akorn's business earnings and practices had suffered to such a material degree after signing that Fresenius was justified in terminating the deal on account of both a material adverse effect and failure to comply with the merger agreement's covenants.

First, Akorn's business fell off a cliff after signing. Akorn reported revenue of $199 million compared to its business plan of $243 million in July of 2017, representing a 29 percent year over year decline. The poor performance persisted into the following quarter and the rest of the following year.

The court characterized a "material adverse effect" as an "adverse change in the target's business that is consequential to the target's long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months." Here, the court found that Akorn's business downturn had persisted for a full year and showed no signs of abating; ergo, a material adverse effect.

Second, Akorn had pervasive data integrity and regulatory compliance issues, which an independent auditor described as among the "top three worst" of the 120 pharmaceutical companies he had assessed. The systemic failures at Akorn raised questions about the accuracy and reliability of all its data – an essential aspect of Akorn's value. After signing the merger agreement, Akorn exacerbated its compliance issues by coordinating internal efforts to mislead both the FDA and Fresenius about the extent of and investigation into these issues. The court found that Akorn was merely attempting to placate Fresenius as opposed to running the company in the ordinary course of business.

Although the court went to great lengths to examine all the issues with Akorn, the court's analysis did not just focus on Akorn's pre-closing woes. The court also analyzed Fresenius's pre-closing conduct. It determined that Fresenius had every intention to follow through with the deal even after the poor financial quarterly reports and the initial discovery of compliance issues until it became irrefutably established that there was indeed a material adverse effect.

Will "Akorn" Become a Big "Oak"?

Even though this decision involved a public company merger, there are lessons for both buyers and sellers of mid-market private companies as well.

Sellers should be mindful that the business is theirs until the purchase price has been wired to their bank accounts. They must remain vigilant and relentless in continuing to run the business as if there were no sale – because, guess what, there may not be. One way sellers can combat the risk of post-signing terminations is to thoroughly prepare for the acquisition process by conducting extensive self-due diligence, especially as to key aspects of the business that would likely affect long-term value.

For buyers, acquirers would be careful not to read this new guidance as a panacea for pre-closing termination due to "buyer's remorse." The bar to terminating a deal pre-closing is still considerably high. If there is litigation over the termination, a court will examine acquirer's intent as to whether it earnestly attempted to close the deal but could not get there because of a real material adverse effect, as compared to looking for the nearest exit upon hearing of potential problems that might ultimately turn out to be a mere hiccup.

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