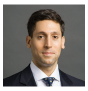
Delaware Chancery Court Enforces Specific Performance and Forces Merger to Close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A recent decision of the Delaware Court of Chancery reinforces the importance of deal certainty, particularly when it comes to efforts-based covenants in merger agreements. In *Desktop Metal Inc. v. Nano Dimension Ltd.*, the Court considered whether a buyer breached its obligations by not diligently pursuing regulatory approvals. The case not only demonstrates the strength of a "reasonable best efforts" standard but also highlights the Court's willingness to enforce "hell-or-high-water provisions" when it has concerns that a buyer is stalling to avoid a closing.

Desktop Metal Inc. and Nano Dimension Ltd. are both public companies in the 3D printing industry. On July 2, 2024, Nano and Desktop entered into a Merger Agreement setting forth the terms by which Nano would acquire Desktop. Following execution of the Merger Agreement, both parties underwent substantial change.

An activist investor in Nano with observer representation on its board had opposed a transaction with Desktop from the outset. Following board approval of the deal and execution of the Merger Agreement, the investor launched a proxy contest and successfully replaced, or caused to resign, the full board of Nano and removed key Nano executives, through a campaign focused primarily on unwinding the Desktop deal. During merger negotiations, Desktop was concerned about its cashflow and therefore pushed Nano to agree to limited closing conditions and an accelerated timeline. After execution of the Merger Agreement, Desktop's cash position continued to decline and the company included a going concern qualification in its next 10-Q Quarterly Report disclosing "substantial doubt as to [its] ability to satisfy [its] obligations as they become due within one year from the date of filing".

The Court pointed out that as part of merger negotiations, speed and certainty of closing were critical to Desktop and, as a result, the parties carefully negotiated the regulatory approvals covenants and conditions in the Merger Agreement. Pursuant to the executed Merger Agreement, Nano was required to (1) use its "reasonable best efforts" to close the deal "as soon as reasonably possible," and (2) "use its reasonable best efforts to resolve any objection" from "any Governmental Entity", including taking all steps necessary to obtain approval from the Committee on Foreign Investment in the United States ("CFIUS"). As to this second term, often referred to as a "hell-or-high-water" provision, the Merger Agreement required Nano to take all actions necessary to obtain CFIUS approval, with one exception allowing Nano to terminate the agreement if CFIUS required Nano to cede control of 10% or more of Desktop's business based on revenues. This exception was further limited by a schedule of mitigation measures that Nano had already agreed to accept, regardless of their impact on control; a factor the Court pointed to as evidence that the parties deliberately negotiated a high bar on CFIUS efforts. The opinion notes that during negotiations, Desktop had offered Nano the option of a reverse termination fee if Nano decided not to close the transaction and accept mitigation measures imposed by CFIUS, but that the parties agreed instead on the "hell-or-high-water" efforts covenant included in the Merger Agreement.

When the transaction did not close on the expected timeline, Desktop filed a complaint in the Delaware Court of Chancery alleging that Nano did not comply with its obligations, including to use "reasonable best efforts" to obtain CFIUS approval, and requested an expedited trial to enforce the Merger Agreement.

After a two-day bench trial, the Court found that Nano breached its contractual obligations, noting that the new leadership at Nano had openly pledged to "scuttle the Desktop deal," and deliberately stalled discussions with CFIUS, including a delay of 38 days to respond to minimal CFIUS comments on requested mitigation measures and subsequent delayed back and forth and introductions of new positions, on the part of Nano. As a result, the Court ordered specific performance, compelling Nano to consummate the merger.

The Court found that reasonable best efforts provisions require each party to "take all reasonable steps to solve problems and consummate the transaction" and to take "appropriate actions to keep the deal on track," including forthright discussions between the parties. Further recognizing "the range of concessions to a reasonable-best-efforts provision that a seller may secure from a buyer," the Court noted that "hell-or-high-water provisions are the most 'extreme.' They are the strongest possible commitment a party can make in a merger agreement with request to regulatory approval." Further stressing the high level of efforts required by the best efforts covenant, the Court highlighted the fact that the parties specifically negotiated a 10% carveout to give Nano flexibility, but that this carveout was not implicated by the mitigation measures imposed by CFIUS.

While Nano argued it did not breach the CFIUS provision, much of Nano's arguments focused on the worsening financial condition of Desktop as a reason for not consummating the transaction. However, the Court was not swayed citing to the fact that (1) Desktop's cash issues were known and existed at signing and (2) Nano had negotiated numerous provisions in the Merger Agreement to protect it in the event Desktop's condition substantially worsened, including contractual provisions addressing a potential bankruptcy of Desktop, the need for additional financing and limitations on Desktop's spending, including a condition requiring Desktop to keep its cash burn below certain levels.

Nano argued that Desktop breached the bridge-loan provision in the Merger Agreement which obligated Nano to provide Desktop a multi-draw bridge loan up to $20 million if additional cash flow was necessary due to delays in regulatory approvals. Under the Merger Agreement, Desktop was obligated to work in good faith with Nano to finalize loan documentation no later than 30 days after signing the Merger Agreement. Nano claimed Desktop breached this by halting negotiations, but the Court found Desktop's refusal reasonable and consistent with continued negotiation of the terms. The Court also noted it was "hard to make sense of Nano's claim" since the bridge loan provision was included in the Merger Agreement to benefit Desktop, if it needed cash. Nano also claimed that Desktop breached the transaction-expenses covenant set forth in the Merger Agreement. This provision capped Desktop's transaction-related costs at $15 million. While Desktop stayed under the cap, Nano argued litigation costs to enforce the merger should count, but the Court disagreed, finding those costs outside the covenant's scope and rejecting an interpretation that would unfairly penalize Desktop for defending its rights.

Additionally, Nano argued that it had the right to terminate the deal because Desktop had entered "bankruptcy," citing the company's deteriorating financial condition. Under the Merger Agreement, "bankruptcy" included an admission in writing by Desktop that it could not pay its debts as they matured. The Court rejected Nano's argument, stating that insolvency itself does not constitute "bankruptcy" under the agreement, noting that the parties had discussed a solvency representation during negotiations but agreed not to include one in the executed Merger Agreement. Furthermore, even if it did, the Court found that Nano "materially contributed" to Desktop's financial distress in delaying regulatory approval.

This decision is an affirmation of Delaware's commitment to deal certainty, especially when a buyer agrees to strong efforts-based covenants. Additionally, the case provides timely guidance on the interpretation of “hell-or-high-water” provisions, especially in the context of CFIUS. For parties negotiating cross-border deals, this ruling underscores the importance of clearly defining obligations and understanding the weight that Delaware courts will place on efforts provisions.

Finally, the swift timeline, from complaint to decision in just over three months, demonstrates the Chancery Court’s ability to handle disputes on an expedited basis when necessary.