



Quorum - October 2024

October 30, 2024

Table of Contents:

- **Delaware Court of Chancery Weighs in on Earnout Provisions in Recent Cases**
- **FTC Substantially Expands HSR Merger Notification Form's Information and Documentary Requirements; Promises the Return of Early Termination**
- **FTC Appeals Recent Losses in Non-Compete Rule Litigation, and Another Litigant Drops Its Challenge**

Delaware Court of Chancery Weighs in on Earnout Provisions in Recent Cases



By [Eva Gobourne](#)
Associate | Corporate



By [Jonathan Seliger](#)
Associate | Corporate



By [Peter Bariso](#)
Partner | Corporate

The Delaware Court of Chancery has weighed in on a number of recent cases interpreting earnout provisions in transactional agreements. The Court has demonstrated a reluctance to rule against seller-plaintiffs during the pleading stage when the terms of earnout provisions are found to be ambiguous and a willingness to consider the parties' contract negotiations and course of dealing, to interpret any potential ambiguity when ruling on the merits in earnout cases. Contracting parties should be mindful that contractual language should be precise and unambiguous. Key terms and conditions should be clearly drafted to avoid disputes and ensure both parties' intentions are documented plainly in the agreement.

Medal v. Beckett Collectibles

On August 22, 2024, in [Medal v. Beckett Collectibles, LLC](#) the Delaware Court of Chancery denied Beckett Collectibles' motion to dismiss breach of contract claims brought by the former shareholders of Due Dilly Trilly, Inc. (DDT).

The specific dispute in *Medal v. Beckett Collectibles* arose from arguably ambiguous earnout provisions in the Stock Purchase Agreement (SPA), pursuant to which Beckett Collectibles acquired all of the outstanding shares of DDT. Beckett Collectibles paid consideration of \$6 million at the closing and the SPA required Beckett Collectibles to pay up to an additional \$5.625 million upon the achievement of certain milestones within 22.5 months of the closing. Also at the closing, DDT's founder, Andrew Medal (the plaintiff and sellers' representative), entered into an employment contract with Beckett Collectibles to serve as its Chief Innovation Officer for two years.

Acceleration of Milestone Payments

The primary issue before the Court was "whether the final sentence of SPA Section 2.05(b) provides for the acceleration of all unpaid Milestone Payments, or whether it only clarifies that Milestones could continue to be earned after one of the enumerated circumstances." Section 2.05(b) provides, in relevant part that, if Mr. Medal's employment was terminated by Beckett Collectibles or Mr. Medal resigned with good reason or Beckett Collectibles determined not to continue developing intellectual property: "[Beckett Collectibles] shall pay to [DDT's] Stakeholders the full amount of any unpaid Milestone Payments in accordance with Section 2.05(d)." The plaintiff focused on the wording "the full amount of any unpaid Milestone Payments," arguing that it required acceleration of all unpaid Milestone Payments. Conversely, Beckett Collectibles focused on the language, "in accordance with Section 2.05(d)," which provides that earned milestones be paid within 30 days. Therefore, Beckett Collectibles argued that the language merely offers clarification that milestones could continue to be earned.

Without weighing in on the merits, the Court acknowledged Mr. Medal's interpretation that the earnout payments accelerated was reasonable, and denied Beckett Collectibles' motion to dismiss.

Good Faith Negotiation as a Condition Precedent to Litigation

Additionally, Beckett Collectibles asserted that Mr. Medal brought this litigation without first satisfying a condition precedent set forth in the SPA, namely that in

the event of a disagreement, the parties must “cooperate in good faith for a period of 30 days to attempt to resolve such disagreement” before bringing a court action. Both parties admitted that no negotiation occurred prior to filing the litigation. However, the Court noted that Beckett Collectibles did not respond to a letter seeking justification for Mr. Medal’s termination, and that following submission of certain milestone qualifications by DDT, Beckett Collectibles summarily rejected each without any written explanation as was required by the SPA. Additionally, the Court noted that the present action was filed more than 40 days after the latest unanswered letter was sent by DDT.

As with the acceleration claims, the Court found no basis for a pleading-stage dismissal, citing *Anvil Holding Corp. v. Iron Acquisition Co., Inc.* The operative agreement in *Anvil* required the parties to “negotiate the resolution of the claims for a period of not less than twenty-five (25) Business Days” before bringing litigation. The plaintiff in *Anvil* admitted that no negotiation had taken place, but the Court did not dismiss the suit. Instead, the Court noted a lack of detail as to mechanics regarding how such negotiations were to take place and the possibility that such negotiations might be futile. Likening the situation in *Beckett Collectibles* to *Anvil*, the Court held that Beckett Collectibles’ actions were “predetermined, which suggests negotiations would have been futile.”

Other Recent Case Law

Historically, Delaware courts have been reluctant to dismiss earnout disputes at the pleading stage. Recent Delaware case law reveals a potential trend toward allowing breach of contract claims to survive a motion to dismiss when the court considers earnout provisions ambiguous (see [WT Representative LLC v. Philips Holdings USA Inc.](#), decided by the Delaware Court of Chancery a few days before *Beckett Collectibles* on August 16, 2024). In *Philips Holdings*, the Court ruled in favor of the seller-plaintiff, holding that dismissal is appropriate only if the contract terms are unambiguous and that breach of contract claims for failure to pay earnout payments must survive the pleading stage “unless the plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances.”

Recent cases also indicate that the Court will distinguish whether the contractual language requiring the parties to undertake certain efforts is “outward-facing” (*i.e.*, in comparison to other industry participants) or “inward-facing” (*i.e.*, in comparison to an acquiror’s other business). In *Fortis v. Johnson & Johnson*, decided on September 4, 2024, the Delaware Court of Chancery ruled that Johnson & Johnson (J&J) breached its contractual obligation to use “commercially reasonable efforts” to achieve earnouts related to the development of Auris’ (the seller-plaintiff) surgical robot, iPlatform. As part of J&J’s \$3.4 billion acquisition of Auris Health, J&J agreed to use commercially reasonable efforts to achieve certain commercial and regulatory milestones which could provide up to \$2.35 billion in additional consideration to Auris’ stockholders. The merger agreement included an inward-facing earnout provision, requiring J&J to treat iPlatform similarly to its other medical devices for purposes of development and achieving certain milestones. The Court found that J&J’s actions, which involved causing iPlatform to compete directly with J&J’s own product, Verb, and ultimately combining the two products, significantly hindered iPlatform’s ability to achieve the earnout milestones. Based on the inward-facing language, the Court determined that J&J’s decision-making was not aligned with the requirements of the merger agreement, noting that J&J’s decisions caused iPlatform executives to be sidelined and the historic clinical engineering team to leave the company, which was “a devastating loss for the program.”

In another recent decision in Delaware, the Court of Chancery again ruled in favor of the plaintiffs, this time based on an “outward-facing” provision. On September 5, 2024, in [Shareholder Representative Services LLC v. Alexion Pharmaceuticals, Inc.](#) (*Alexion*), the Delaware Court of Chancery held that Alexion breached the terms of its merger agreement with Syntimmune Inc. by failing to use commercially reasonable efforts to achieve certain milestones.

The dispute in *Alexion* arose from the 2018 acquisition of Syntimmune Inc. by Alexion and the earnout provisions in the merger agreement. The merger

agreement included eight different milestones tied to different developmental stages of Syntimmune Inc.'s monoclonal antibody. The merger agreement required Alexion to use "commercially reasonable efforts" for seven years after the closing to achieve the milestones. The agreement defined commercially reasonable efforts as "such efforts and resources typically used by biopharmaceutical companies similar in size and scope to [Alexion] for the development and commercialization of similar products at similar developmental stages." The Court evaluated this outward-facing language by applying the standard used in another recent Delaware earnout decision, *Himawan v. Cephalon, Inc.* (*Himawan*) (previously discussed in Quorum [here](#)).

As it did in *Himawan*, the Delaware Court of Chancery in *Alexion* interpreted the commercially reasonable efforts provision in the contract to require what it referred to as an objective standard. The Court determined that there were "no adequate exemplar companies" and no competitors that operated under the same conditions as Alexion, the same conclusion it had reached for the buyer in *Himawan*. Based on the similarity of the disputed outward-facing language in *Alexion* as compared to the contractual language in *Himawan* and the conclusion in each case that no true similar companies existed, the Court in *Alexion* implemented the same objective, "hypothetical company" analysis it adopted in *Himawan*. Therefore, the Court reviewed Alexion's efforts against the efforts a similarly situated hypothetical company "would expend under the circumstances at hand" (emphasis added), rather than identifying a comparable peer company and applying a "yardstick approach" to evaluate Alexion's commercially reasonable efforts against "the efforts of [such peer company and its] actions in the real world."

The Court did distinguish the contractual language in *Himawan* from *Alexion*, explaining how the two provisions could lead to different outcomes. Whereas in *Himawan*, the provision in question explicitly permitted the buyer to consider its own efforts and costs of engaging in commercially reasonable efforts, the provision in *Alexion* only permits the defendant to evaluate its own efforts against a hypothetical company. As a result, because the buyer's decision not to further pursue the milestones was driven in part by a unilateral initiative to launch 10 products by 2023 (a goal not likely to be shared by a hypothetical company), the Court determined that Alexion breached the merger agreement and failed to use commercially reasonable efforts to achieve earnout milestones. *Alexion* illustrates (i) how the Court will review extremely specific language and (ii) underscores the Court's focus on the contract language and the specific facts presented in earnout disputes.

Conclusion

Both *Alexion* and *Auris* emphasize the need for clear drafting regarding efforts obligations and awareness of competitive dynamics that may affect earnouts. Contracting parties should be mindful of the distinction Delaware courts may place on inward-facing as opposed to outward-facing earnout provisions. Recent cases also demonstrate the Court's willingness to scrutinize earnout provisions closely, to examine the facts and circumstances underlying the dispute and to ensure that parties fulfill their obligations as outlined in purchase agreements. The Court's emphasis on the need for clear contractual language highlights the importance of defining terms like "commercially reasonable efforts" in a manner that can withstand judicial review.

Beckett Collectibles highlights the ongoing challenges surrounding the interpretation of earnout provisions in purchase agreements. Additionally, the Delaware Court of Chancery's refusal to dismiss the breach of contract claims in *Beckett Collectibles* and *Philips Holdings* highlights the Court's tendency to favor seller-plaintiffs at the pleading stage if the contractual language is arguably ambiguous. By acknowledging multiple reasonable interpretations of the SPA language, the Court in *Beckett Collectibles* emphasized the importance of clear communication and negotiation between parties involved in earnout disputes and was careful not to weigh in on the merits. The outcomes of these cases serve as reminders of the critical need for precise drafting in contracts to mitigate disputes and ensure that both parties' intentions are clearly documented. Given the

significance of earnout provisions, and their value implications to both buyers and sellers, it is crucial to articulate the mechanics and parameters of the efforts required and triggers to achieve earnouts.

FTC Substantially Expands HSR Merger Notification Form's Information and Documentary Requirements; Promises the Return of Early Termination



By [Bilal Sayyed](#)
Counsel | Antitrust

The information and documentary materials (filing requirements) necessary to complete the Hart-Scott-Rodino merger notification filing form have been significantly expanded. The [new filing requirements](#) will fall most heavily on transactions that combine current or future competitors, or where the parties to the transaction have a significant supply relationship. For such transactions, it may be necessary to **anticipate a 3-5 week process to submit an HSR filing and receive confirmation that the filing is in compliance with the new filing requirements.** However, every HSR filing party will be affected by at least some of the new requirements. In a significant change to long-standing practice, parties to a negotiated transaction may **no longer file on a "bare-bones" letter of intent.** Additional details on the scope of a possible transaction will be required for submission of the HSR filing.

Satisfied that the new filing requirements will give them the information necessary to analyze the potential competitive effects of notified transactions, the Federal Trade Commission also announced that it would **rescind the "temporary suspension" of grants of early termination of the HSR waiting period,** coinciding with the effective date of the new reporting requirements. The new filing requirements will take effect 90 days after their publication in the Federal Register; thus, no earlier than late January 2025.

The new filing requirements were adopted unanimously by the FTC (but with separate statements by each of [Chair Khan](#) (joined by Commissioners Slaughter and Bedoya), and [Commissioner Holyoak](#) and [Commissioner Ferguson](#)), with the concurrence of the Department of Justice.

The new filing requirements expand the reporting requirements for all transactions, but the burdens do not fall equally on filing parties, with **acquired persons having fewer new filing requirements than acquiring persons.** The FTC has also taken steps to minimize or limit the increased burden for certain categories of transactions, with transactions more likely to raise competitive concerns having greater information and document requirements.

- **Select 801.30 Transactions:** Parties to transactions that: (i) **do not** (a) confer control of an entity or (b) grant (or contemplate granting) the right to serve as, appoint, veto, or approve board members (or members of a similar body) of any entity within the acquired person (or the general partner or management company of any entity within the acquired person) and (ii) **are** acquisitions of shares from a party other than the issuer of the shares, **have only limited new filing requirements.**
- **No Overlap / No Supply Relationship Transactions:** Parties to transactions that **are not the combination** of: (i) present or future competitors; or (ii) firms with an existing significant supply relationship, have significant new filing requirements.
- **Overlap / Supply Relationship Transactions:** Parties to transactions that **are the combination** of: (i) present or future competitors; or, (ii) firms with an existing significant supply relationship, have substantial and significant new filing requirements.

Not all new requirements apply to each type of transaction and to each party to a transaction. Below, we first identify the new and modified information and document requests, and then summarize them in a chart by type of transaction and by filing person.

The new and modified document requests include:

- Expansion of the existing “Item 4(c)” document request to include all “studies, surveys, analyses, and reports” prepared by or for the **Supervisory Deal Team Lead** for the “purpose of evaluating or analyzing the acquisition with respect to market shares, competition, competitors, markets, potential for sales growth, or expansion into product or geographic markets.
- Requirement that the filing parties produce “plans and reports” that analyze “market shares, competition, competitors, or markets” for overlap products (including products known to be in development by the target) that were provided to the Chief Executive Officer or Board of Directors within one year of the date of the HSR filing;
- Corporate organization chart, if it exists;
- Agreements negotiated as part of the transaction, including agreements not to compete (or solicit), and certain other agreements between the parties not associated with the transaction;
- A transaction diagram, if it exists;
- Translation of documents (or information) that are in a language other than English;
- Narrowing of what constitutes a “draft” document for purposes of identifying “final” documents to be produced with the filing.

The new and modified information requests include identification of:

- limited partners, where such person (i) currently holds (or will hold as a result of the transaction) 5% or more, but less than 50% of the non-corporate interests of the limited partnership, **and** (ii) has, or will have, the right to serve as, nominate, appoint, veto, or approve board members (or individuals with similar responsibilities), of any entity within the filing person, or of the general partner or management company of any entity within the filing person;
- officers and directors who also serve as an officer or director of another entity that derives revenue in the same NAICS code as the target;
- overlapping products or services, and sales data (or data measuring use) and customer information for each overlapping product or service;
- significant supply, licensing, and purchase relationships between the parties, or with competitors to the parties, including sales and purchase data, and identification of top customers or suppliers;
- acquisitions, within five years prior to the date of HSR filing, of 50% or more of the voting securities or non-corporate interests (or all or substantially all of the assets) of an entity that, prior to its acquisition, earned revenue in one or more “overlap” products;
- broader minority ownership interests than previously required;
- broader geographic market information than was previously required (for certain transactions);
- subsidies from foreign entities or “governments of concern”;
- existing or pending defense and intelligence contracts; and
- whether the transaction will be notified to non-U.S. competition agencies.

The new narrative requirements include identification of:

- strategic rationale for the transaction;

- “principal categories of products and services” of the filing person, including products known to be in development and that compete with the products or services of the other filing person;
- supply and purchase relationships between the parties to the transaction and to businesses that compete with one or both filing persons; and
- ownership structure of the filing person.

Summary Chart of New Filing Requirements, By Transaction Type and Filing Person

	Select 801.30		No Overlap / No Supply Relationship Transaction		Overlap / Supply Relationship Transaction	
	Acquiring Person	Acquired Person	Acquiring Person	Acquired Person	Acquiring Person	Acquired Person
Translation of Documents	✓	✓	✓	✓	✓	✓
Identification of Additional Minority Interest Holders	✓	✓	✓	✓	✓	✓
Organization of Controlled Entities	✗	✗	✓	✓	✓	✓
Description of Ownership Structures	✓	✗	✓	✗	✓	✗
Organizational Chart (if one exists)	✓	✗	✓	✗	✓	✗
Identification of Certain Officers and Directors	✓	✗	✓	✗	✓	✗
Description of Business of the Acquiring Person	✓	✗	✓	✗	✓	✗
Transactions Subject to International Antitrust Notification	✓	✗	✓	✗	✓	✗
Transaction Rationale	✗	✗	✓	✓	✓	✓
Transaction Diagram (if one exists)	✗	✗	✓	✗	✓	✗
Competition Documents from Supervisory Deal Team Lead	✓	✗	✓	✓	✓	✓
Plans and Reports	✗	✗	✗	✗	✓	✓
Transaction Agreements	✗	✗	✓	✓	✓	✓
Other Agreements Between the Parties	✓	✗	✓	✗	✓	✓
Overlap Description	✗	✗	✓	✓	✓	✓
Supply Relationships Description	✗	✗	✗	✗	✓	✓
Geographic Market Information	✓	✓	✗	✗	✓	✓
Minority-Held Entity Identification to Overlaps	✓	✓	✗	✗	✓	✓
Prior Acquisitions	✓	✓	✗	✗	✓	✓
Subsidies from Foreign Entities or Governments of Concern	✓	✓	✓	✓	✓	✓
Defense or Intelligence Contracts	✗	✗	✗	✗	✓	✓

Commentary

For some transactions, the new filing requirements will require a substantial increase in the time and effort necessary to prepare an HSR filing. To help minimize the new filing requirement’s impact on a filing timeline, parties can collect, maintain, and update certain information – such as minority ownership positions, geographic locations of operations, officer and board positions, relevant contracts and subsidy information, prior acquisitions, and ordinary course plans and reports – on a regular basis or substantially earlier in the transaction negotiation process.

The most significant items to manage are likely to be the collection and review of documents that analyze, or that relate to the analysis of, the competitive impact of the transaction. The new requirements are a significant expansion of the past requirement that such documents be prepared by or for an officer or director of the filing person by adopting a third category – documents (including emails) that may have been produced by or for a significantly lower-ranking employee of the filing person. The FTC has also narrowed the scope of what qualifies as a draft document (which do not have to be produced with the filing), increasing the volume of documents to search for, review and submit with the filing.

Filing parties may find they disagree with the antitrust agencies over the identification and description of their products, including overlap products (or services); although the narrative description of products (or services) is not, on its face, a market definition exercise, it may naturally devolve to that. Market definition is often the most important factor in an antitrust analysis. The requirement to define overlap products looks very much like an effort by the agencies to “lock-in” a market definition at the start of the merger review period, not after an investigation. Disagreements on the description of products (or services) may, at times, lead the agency staff to reject a filing as non-compliant. For transactions that may raise competitive concerns, the notification process may begin to look substantially more like the process in Europe, where “second-phase” investigations are often accompanied by settlements worked out in the “filing-phase” discussions. Transactions where the parties have a horizontal overlap or

where they have a significant supply/purchase relationship with each other or with competitors to the other, are likely to be significantly harder to get on file quickly, and may also be more likely to be challenged because of “admissions” in the parties’ filing document.

FTC Appeals Recent Losses in Non-Compete Rule Litigation, and Another Litigant Drops Its Challenge



By [Bilal Sayyed](#)
Counsel | Antitrust

We [reported](#) last month that the district court in the northern district of Texas had “set aside” the Federal Trade Commission’s recently [finalized rule](#) prohibiting employers from entering into, and enforcing, non-compete agreements with employees (the Rule). *Ryan, LLC v. Federal Trade Commission*, N.D. Texas, Aug. 20, 2024. *The set-aside operates to enjoin enforcement of the Rule, nationwide.* The FTC, on October 18, gave notice that it will appeal the district court’s ruling to the 5th Circuit.

We also reported last month that the district court in the middle district of Florida had granted a preliminary injunction enjoining the FTC from enforcing the Rule against plaintiff Properties of the Villages. *Properties of the Villages v. Federal Trade Commission*, M.D., Florida, August 14, 2024. On September 24, the FTC gave notice that it will appeal that decision to the 11th Circuit.

Our prior report also reviewed the denial by the district court in the eastern district of Pennsylvania of a request for a preliminary injunction against the FTC’s enforcement of the Rule. *ATS Tree Services LLC v. Federal Trade Commission*, E.D. Pa., July 23, 2024. On October 4, ATS Tree Services filed a notice of a voluntary dismissal of its action. The district court had earlier denied the plaintiff’s effort to stay litigation, pending disposition of the cases in Texas and Florida.

These developments do not affect the Texas district court’s set-aside of the Rule. At present, the FTC cannot enforce the Rule. However, it may continue to bring individual enforcement actions against the use of, or enforcement of, non-compete agreements governing employees and may allege that, in the circumstances of the case, they are either or both of an unfair method of competition or an unfair or deceptive act.