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RECENT LEGAL DEVELOPMENTS IN THE TRANSACTIONAL WORLD

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Twitter v. Musk

- Despite a Material Adverse Effect having been found in *Akorn v. Fresenius*, a Material Adverse Effect continues to be something we lawyers call very, very big.
- Musk faced an uphill battle to persuade the court that Twitter's "bot" accounts exceeded the number disclosed in Twitter's public filings, and even if they did, whether that fact constituted a Material Adverse Effect.
- After a series of defeats in discovery and pre-trial proceedings, Musk relented and agreed to close the transaction on its original terms on the eve of trial.
- As a result, M&A attorneys were left with no binding decision on the merits of the case. Disappointing? Not really. Why?

Twitter v. Musk

- THE CONTRACT WORKED
- The merger agreement that the parties had executed allocated the risks of the transaction between the parties.
- In this case, the allocation of risk meant that a buyer having second thoughts about the deal could not walk away without acceptable justification, which was a very high bar to clear.
- This result should be viewed as a good one by dealmakers.

Arwood v. AW Site Services, LLC

- Private equity sponsor was interested in privately held waste management company.
- Seller was "decidedly unsophisticated."
- Sponsor therefore conducted due diligence – including preparing financial statements for the company – for six months.
- Problems began to surface shortly after closing, including allegedly fraudulent billing practices.
- In the ensuing litigation, the sponsor asserted claims for fraud and breach of contract.

Arwood v. AW Site Services, LLC

Fraud Claim:

- In Delaware, plaintiff must prove that it reasonably relied on the inaccurate statements in the representations and warranties.
- Here, court held that the sponsor could not have reasonably relied on the reps and warranties due to its extensive due diligence – the sponsor passed "warning sign after warning sign" but proceeded with the transaction anyway.

Breach Claim and Sandbagging Defense:

- The seller tried to defend against the clear claims for breach of contract by arguing that the sponsor was engaging in inappropriate "sandbagging" – making claims for breach of a rep the buyer knew to be untrue at signing.
- The court held that Delaware is a "pro-sandbagging" state and will enforce both good and bad contracts, while acknowledging potential perverse incentives and ethical concerns raised by the practice.

ITAR and CFIUS and EAR, Oh My!

- National security now covers not only traditional defense, military and intelligence objectives, but also corruption, healthcare, biotechnology, telecommunications, public welfare, financial well-being, and climate change.
- Coupled with swift and significant expansions of export controls by the US Department of Commerce, the establishment or expansion by over 30 non-US jurisdictions since 2018 of foreign direct investment review laws, changes in the focus of International Traffic in Arms regulations and explosive growth in the use of sanctions as a result of Russia's invasion of Ukraine, buyers and investors now face an entirely new risk calculus.
- But it is not all bad news, in that the government is not necessarily focused on punishing non-bad actors
  - "Acquiring companies should be rewarded – rather than penalized – when they engage in careful pre-acquisition diligence and post-acquisition integration to detect and remediate misconduct at the acquired company's business…[W]e will not treat as recidivist any company with a proven track record of compliance that acquires a company with a history of compliance problems *as long as those problems are promptly and properly addressed in the context of the acquisition."* (emphasis added)*
- The key, however, is being diligent, both in pre-acquisition diligence and post-acquisition remediation.
- It is not enough to simply dust off time-tested checklists and questionnaires.

*Principal Associate Deputy Attorney General Marshall Miller Delivers Live Keynote Address at Global Investigations Review, at p. 2 (September 20, 2022, New York).

Non-Competition Covenants

- FTC proposed rule barring non-competes has generated a lot of press. Comment period closed last week, so still don't know what final rule will look like.
- However, don't forget about the states – Colorado, Illinois, and the District of Columbia are among the jurisdictions that implemented restrictions on non-competes in 2022.
- They all apply to an employee who lives or works in the jurisdiction, regardless of any choice of law provision to the contrary.
- Like the proposed FTC rule, they all contain exceptions in instances involving the sale of a company.
- However, those exceptions must be closely scrutinized to confirm applicability. The exception in the FTC proposed rule, for example, applies only to individuals that held more than 25% of the divested business.

THANK YOU