DELAWARE **CORPORATE LAW** UPDATE — September 2024

YOUNG CONAWAY

FEATURED:

Seva Holdings Inc. v. Octo Platform Equity Holdings, LLC

Fortis Advisors LLC v. Johnson & Johnson

S'holder Representative Servs. LLC v. Alexion Pharms., Inc.

***Seva Holdings Inc. v. Octo Platform Equity Holdings, LLC,* 2024 WL 3982187 (concluding that the absolute litigation privilege does not bar the exercise of a contractual equity repurchase right triggered by allegedly disparaging statements made in other litigation).**

In this decision, the Court of Chancery partially granted summary judgment for defendant after determining that an LLC agreement's membership interest repurchase right was triggered by plaintiff's breach of a non-disparagement restriction and that the repurchase was not voided by the absolute litigation privilege. Plaintiff had sued defendant in Virginia state court and in the Delaware Superior Court. Defendant then claimed that plaintiff's litigation filings triggered a non-disparagement provision in the LLC agreement and exercised its right to repurchase plaintiff's membership interests pursuant to that provision. Plaintiff brought another action in the Court of Chancery arguing that the repurchase was null and void because plaintiff's statements in the prior litigations were subject to the absolute litigation privilege. The Court rejected that argument, finding that the repurchase right did not "chill" litigation and that, in this specific case, Delaware's freedom of contract principles prevail.

***Fortis Advisors LLC v. Johnson & Johnson,* 2024 WL 4048060 (Del. Ch. Sept. 4, 2024) (holding an acquirer liable for more than $1 billion in damages for failure to exercise commercially reasonable efforts in breach of an "inward facing" earnout provision).**

In this post-trial decision, the Court of Chancery considered whether a seller was entitled to an earnout pursuant to an "inward-facing" contractual standard of effort. The seller stood on the brink of bringing a "potentially transformative" robotic surgical device to market. In parallel, the acquirer labored on its own similar device. The parties negotiated and agreed to a merger that contemplated the acquirer (Johnson & Johnson) paying the seller (Auris Health, Inc.) $3.4 billion in upfront cash consideration and a total potential earnout of $2.35 billion based on the device achieving certain post-acquisition regulatory approvals and certain net sales revenue.

The Court compared two approaches for measuring earnout efforts. Often seller-friendly, an "outward-facing" standard measures performance based on an objective, external industry standard. Often buyer-friendly, an "inward-facing" standard applies the buyer's own efforts or practices.

The earnout at issue called for an "inward facing standard" that required the acquirer to exercise "commercially reasonable efforts" according to the acquirer's "'usual practice' for 'priority medical device products.'"

After closing the deal, the acquirer compared its own product against the acquired product in a market "bake off"; the acquirer would only market the winner. The Court determined that the acquirer stymied the development and launch of the acquired device, including by: (i) the forced "showdown" between both products that caused "needless setbacks and resource drains"; (ii) combining the device platforms knowing it would negatively affect the development schedule and frustrate the regulatory milestones; (iii) prioritizing "commercialization, product differentiation, [and] short-term profitability at the expense of achieving the milestones"; and (iv) writing down the regulatory milestone earnout payments to $0 coupled with redirecting employee incentive efforts towards different goals. The Court concluded that these actions breached the effort requirement and warranted more than $1 billion in damages.

***S'holder Representative Servs. LLC v. Alexion Pharms., Inc.*, 2024 WL 4052343 (Del. Ch. Sept. 5, 2024) (finding acquirer failed to meet the standard of commercially reasonable efforts under an outward-facing earnout provision).**

In this post-trial decision, the Court of Chancery determined that an acquirer failed to meet an earnout provision's outward-facing standard of effort. In a pharmaceutical deal, the acquirer paid the target $400 million up front with another $800 million to be earned based on the drug achieving various milestones.

The merger agreement afforded the acquirer discretion over the drug's development. But an outward-facing standard of effort measured the acquirer's development efforts against those "typically used by biopharmaceutical companies similar in size and scope to [the acquirer] for the development and commercialization of similar products at similar development stages taking into account" various enumerated factors. Finding no comparable real-world companies, the Court employed a "hypothetical company approach" by comparing the litigant's efforts against a "more abstract and aggregated industry standard."

Examining the factors in the earnout provision applicable to the acquirer's decision to "drastically" reduce the drug platform's funding, the Court concluded that the reduction in development efforts failed to satisfy the hypothetical outward-facing aggregated industry standard. And, after a "holistic assessment," the Court found the acquirer's decision to terminate the drug platform breached the effort requirement. The Court did not immediately assess damages.