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Litigator of the Week: The Paul Weiss Partner Who Made New Law in Delaware

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The Litigation Daily: Who was your client and what was at stake?

Lewis Clayton: Our client is Fresenius SE & Co., KGaA, a large global health care group headquartered in Germany, and several subsidiary companies.

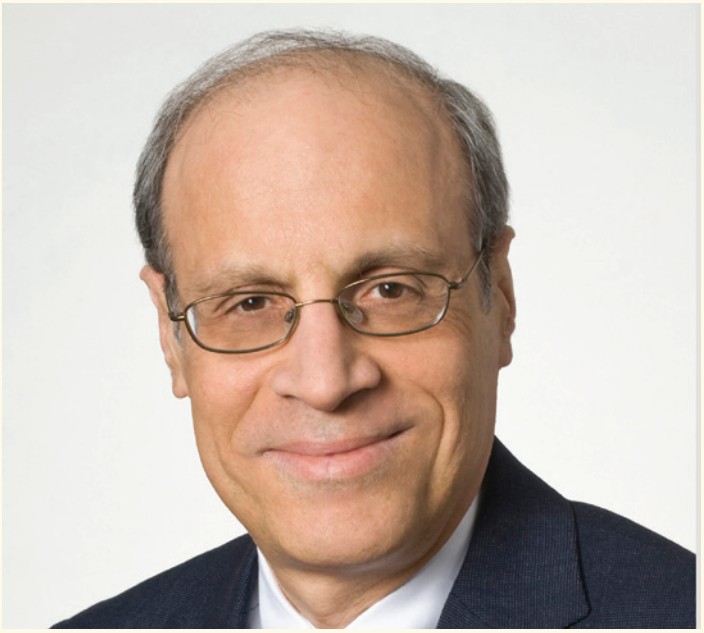
In April 2017, Fresenius' drug and medical device company, Fresenius Kabi, signed an agreement to acquire Akorn, an American generic pharmaceutical manufacturer, for $4.75 billion. The parties anticipated that closing would not occur for a year or more because of the need for antitrust approval. After signing, but before closing, Akorn's financial position collapsed and, separately, Fresenius discovered substantial evidence that Akorn was violating FDA rules and regulations.

To understand what was at stake, Fresenius Kabi had contracted to purchase Akorn for $34 a share. Akorn is now trading at less than $5 a share, a difference of over $3 billion.

Describe the lay of the land when you got involved in the case.

We were retained in late 2017 after Akorn reported very poor financial results. Our assignment was to evaluate Fresenius' rights under the agreement. Soon thereafter, but separately, Fresenius received the first of three anonymous whistleblower letters raising allegations about violations of FDA regulations.

Exercising its right under the merger agreement to obtain reasonable access to information about Akorn's operations, Fresenius began an investigation of compliance issues, using FDA regulatory counsel at Sidley Austin and a team of technical and forensic investigators. No Delaware court had previously sustained a [Material Adverse Effect] claim. Fresenius did not want to terminate the deal unless it had a solid basis to do so.



Tell us about the whistleblower letters. Did they arrive out of the blue? Was the person's identity ever revealed? How important were the letters to the outcome of the case?

They did indeed arrive out of the blue. We never learned the identity of the author (or authors).

Fresenius received the first whistleblower letter in October, but it contained only vague statements. When Fresenius received a second letter in November with more detailed allegations, it determined it had no option but to investigate.

The investigation produced evidence of serious violations of FDA regulatory requirements, which led Fresenius to terminate the merger agreement based in part on breaches of Akorn's representations and

warranties that it had complied with FDA laws and regulations. The letters were important in that they led directly to that investigation.

One of Akorn's arguments was that Fresenius hired your team to manufacture legal grounds to get out of the deal. What's your response?

That argument is not true and went nowhere in court. After hearing the witnesses testify and examining the evidence, the court rejected that claim.

The opinion concludes that it was prudent and appropriate for Fresenius to retain expert advisors to understand its rights—something any company in that position would do—and emphasizes that Fresenius lived up to its obligations and intended to close the merger if that was required. Instead, Fresenius "uncovered real problems," as Vice Chancellor Laster noted, and was entitled to terminate.

Vice Chancellor Laster in his opinion went out of his way to praise both sides for their conduct during the litigation, writing "This case exemplifies how professionals can simultaneously advocate for their clients while cooperating as officers of the court." Can you comment on your opposing counsel from Cravath, and also more generally, why it benefits the client if you litigate with civility.

We had an extremely expedited schedule, as requested by Akorn. The complaint was filed on April 23 and trial started on July 9. We took or defended over 50 depositions, produced millions of pages of documents and each side retained six experts.

Everyone recognized that we had to cooperate to get the necessary work done, and the parties were assisted by a discovery facilitator suggested by the court.

We had only two significant discovery disputes that went to the court. The agreements reached about discovery and trial procedure benefited both clients by reducing expense and uncertainty, and helped to resolve the matter quickly.

What strategies did you and your team use to cope with such an accelerated schedule?

We had an enormous factual record and a large number of issues—many of which could have been the subject of weeks or even months of discovery on their own.

We had an incredible trial team, including my partners Andrew Gordon and Susanna Buergel. From the outset, Andrew, Susanna and I knew we had to focus on key factual and legal issues and witnesses and avoid being diverted by matters that likely wouldn't play a significant role at trial.

It was a frenetic schedule. This case ordinarily might have taken many months to get ready for trial but we had just over nine weeks. There were weeks in which we had 20 depositions. There was one Saturday when we had five separate depositions.

We were fortunate to have an extremely knowledgeable and supportive client team. Client personnel—right up to the highest levels of the organization—supported our team and helped us understand complicated technical issues and identify the most important facts and issues for trial.

Top Fresenius executives, including the CEOs of both Fresenius SE and Fresenius Kabi, testified in court and attended every day of trial. We worked very closely on a daily basis with Fresenius' lead in-house counsel in the Germany and the United States, Jürgen Götz and Jack Silhavy.

What were some of the highlights of the trial before Vice Chancellor Laster? Did you make any unconventional strategic choices in your presentation?

Akorn's outside counsel had conducted the investigation into its regulatory issues. We successfully challenged Akorn's assertion of privilege over materials related to that investigation, obtaining documents from multiple law firms and their advisors. At the same time, Fresenius was also required to produce materials relating to its own investigation.

The privileged materials that we obtained from Akorn were extremely significant and many of them featured prominently at trial and in the Court of Chancery's comprehensive opinion.

And because Fresenius produced materials relating to the investigation by its regulatory counsel and advisors, those advisors testified extensively at trial.

We put on testimony from the lead lawyer from Sidley and the lead investigator at Lachman, our pharmaceutical experts. Both individuals provided compelling testimony that the court relied upon in its opinion.

The court called the Lachman investigator "among the most credible witnesses I have seen in court."

What about oral argument last week before the Delaware Supreme Court? How did you prepare? Were you surprised the court was so quick to issue a decision?

I had the great benefit of the trial court's detailed, closely reasoned 246-page opinion—one of the most impressive opinions I have ever read, both for its clear factual findings and careful legal analysis. I also reread the trial transcript and other significant documents. Because of the expedited schedule, the essential details were still fresh.

Covering even the basic points in a matter like this in 25 minutes for argument is challenging.

In a sense, this was three exceptional cases in one. We had three separate bases for terminating the agreement—Akorn's financial collapse, its breaches of its regulatory representations and warranties in the merger agreement, and its failure to operate in the ordinary course as required by the merger agreement.

Any one of those issues could have been a significant standalone case, each involving its own detailed facts and legal issues. On the other hand, there is no more sophisticated court on corporate law issues than the Delaware Supreme Court—the justices don't need background on legal issues or custom and practice in M&A agreements.

We were surprised that the decision came so quickly, just because of the size of the case and the attention the trial court opinion received.

The Supreme Court's speed may have reflected just how careful and detailed the trial court's opinion is. The Delaware Supreme Court's decision was less than three pages long. In effect, the Supreme Court made clear that it did not need to reach every detailed issue decided by the Court of Chancery, because Fresenius was clearly entitled to terminate on at least 2 of the 3 bases.

This is the first time a Delaware court found that a Material Adverse Effect, or MAE, was justified based on post-signing financial decline and other factors. Akorn warned the decision could add an element of unpredictability that would make companies more reluctant to pick Delaware as a forum. What's your response?

Quite to the contrary, this decision shows that Delaware will faithfully and explicitly enforce the terms of M&A agreements between sophisticated parties. As the trial court said, the parties had not agreed to merge "at all costs and on any terms"—they committed to the particular, detailed contract they had signed, which included representations, warranties, covenants and conditions to closing.

Far from discouraging the choice of a Delaware forum, the court's decision—and the speed and expertise with which the Delaware courts handled the case—actually makes Delaware a more attractive forum because parties can depend on Delaware courts to understand and honor an explicit agreement.

The Financial Times wrote that corporate lawyers and bankers have been sifting through Laster's decision "searching for tips on how to draft tighter merger contracts in the future." From the perspective of both an acquiring company and the one being acquired, how might this decision change things? What do you see as its long-term impact?

Commentators have said that this was a case of extraordinary facts as opposed to a change in Delaware law. But that said, there are some important takeaways.

Looking at the factors considered by the trial court, parties can negotiate over what events will qualify as an MAE, and Delaware courts can be expected to enforce specific definitions of what facts will be taken into account in determining whether an MAE has occurred. And parties will want to pay close attention to specific representations and warranties.

The trial court rejected Akorn's arguments that Fresenius could not enforce representations and warranties covering topics that may have been discussed in due diligence. And regardless of what the agreement provides, this case highlights the basic rules that parties to a merger agreement must act in good faith and that an acquirer has the right to investigate and act upon contractual breaches.