IN-DEPTH

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EDITION 4

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PREFACE

It is my great privilege to serve as the editor of the fourth edition of this volume on M&A litigation for the Law Reviews series. As with the previous editions, this volume is intended to be as much a resource for litigators handling M&A disputes as it is for the deal lawyers, general counsel and dealmakers aiming to assess and manage the potential litigation risks in connection with a transaction. The multi-jurisdictional approach taken here, as in other volumes in the Law Reviews series, reflects the profoundly global nature of business and corporate transactions and gathers a diverse body of law from around the world to provide a broad overlay of the global litigation terrain. The aim here is not to be comprehensive, in either the countries included or the depth of topics covered, but to provide more of a survey of key jurisdictions in the Americas, Europe and Asia and a high-level overview and analysis of the main litigation issues and trends in those jurisdictions.

Together, the chapters show a remarkably high level of consistency across jurisdictions in the types of common disputes and the kinds of claims that may be pursued, but also significant differences in procedural and substantive law affecting the legal merits of such claims and the frequency and means of their pursuit.

Shareholder actions for breaches of fiduciary duties provides a good example. The law in many countries imposes fiduciary duties on board members in the context of mergers or acquisitions, and many jurisdictions therefore provide for litigation to enforce those duties. Similarly common is some type of business judgement protection for certain board decisions that, in one form or another, prohibits parties and a court from second-guessing those decisions. The frequency with which such actions are brought, however, varies substantially from country to country. That is due to a variety of different factors, from the number of publicly listed companies in a country, to differences in the substantive law, to whether such claims may be brought as class actions, as permitted in the United States, and whether fees may be awarded to class action plaintiffs' lawyers. The class action procedural mechanism and the availability of attorneys' fees awards in particular are significant factors driving the disproportionate volume of shareholder litigation in the United States, as they provide strong incentives to the plaintiffs' bar that do not exist in many other countries.

In contrast, counterparty claims arising out of disputes over the parties' transaction agreement appear to be far more common across the countries in this edition and, in many countries, to be the dominant type of M&A litigation activity. Interestingly, that is less so in the United States, where shareholder actions continue to present the dominant risk. Although there is some meaningful overlap in the types of provisions and disputes that commonly arise, the chapters also display the significant variation in disputes, reflecting in part differences in business practices both within and across jurisdictions. As with class actions, one significant procedural component for counterparty claims is arbitration, which has become an increasingly common procedure for resolving post-closing disputes, particularly those involving cross-border transactions. This appears to be because, among other reasons, arbitration is confidential (unlike court proceedings) and thought to be cheaper, faster and more efficient.

Finally, I would like to thank the many distinguished contributors to *The Mergers and Acquisitions Litigation Review* and give particular thanks to the new authors in this fourth edition, whose contributions expand the range of jurisdictions covered. Their biographies can be found in Appendix 1 and display the impressive depth of experience and expertise they bring to this edition. I hope that you will find their analysis and insights valuable when dealing with issues arising in M&A disputes. Should you have any comments, questions or suggestions, please do not hesitate to contact me or any of the contributors directly.

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New York
October 2023

Chapter 4

ENGLAND AND WALES

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I OVERVIEW

Mergers and acquisitions (M&A) are typically significant events in the life of a buyer, a seller and a target and have an impact on a large number of stakeholders, often with conflicting interests, including shareholders, directors, employees, creditors, customers, suppliers and, on occasion, governments or other regulatory bodies. As such, it is no surprise that these transactions often give rise to disputes and litigation.

M&A disputes can be broadly classified into two categories: disputes that arise between a party to the transaction and a stakeholder in that party (e.g., a shareholder) and disputes that arise between the counterparties to a transaction (i.e., the buyer and the seller).

In this chapter, we examine the common traits of each of the two categories and how typical claims in each category are treated under English law.

II LEGAL AND REGULATORY BACKGROUND

Shareholder claims typically arise under the legal framework governing shareholder control and directors' duties as set out in the Companies Act 2006 (CA 2006). In recent years, claims by shareholders under the Financial Services and Markets Act 2000 (FSMA) have become more frequent, where a claim is made for loss claimed to have been incurred as a result of misleading or untrue statements in a company's public documents.

In the context of public M&A, bidders, targets and their respective advisers may face claims under the regulatory framework that sets out parameters on how such transactions should be conducted by the parties and disclosed to stakeholders, namely the Takeover Code, UK Listing Rules and Alternative Investment Market company rules, as well as related legislation, including the Market Abuse Regulation.

Counterparty claims may arise out of the parties' contractual documents governing the transaction or (less frequently) from non-contractual private law obligations owed in tort. The risk of such claims is, however, greatly impacted on by the surrounding political, regulatory and economic context in which deals happen. For example, over the past few years, the UK government has implemented various proposals aimed at giving itself greater powers to intervene in and block transactions on public interest and national security grounds.[2] These new regulatory initiatives have been seen, in part, as a response to Brexit and a desire

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2 For example, Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2020 and the National Security and Investment Act 2021.

for the United Kingdom to determine its own merger policy, and also to address wider public concerns about core national infrastructure, national defence and cybersecurity. These rules have implications for transaction timetables and how counterparties allocate completion risk in transaction agreements, both of which could lead to potential counterparty claims, particularly as a consequence of uncertainty in the initial years as the regime develops. In addition, governmental entities may also sanction counterparties for non-compliance with the regime, with the possible introduction of both criminal offences and civil sanctions such as fines.

III SHAREHOLDER CLAIMS

i Common claims and procedure

Claims for breach of directors' duties

In the context of M&A transactions, shareholders may bring claims relating to the relevant company's directors' duties in considering, negotiating or recommending a particular transaction. The CA 2006 sets out the main directors' duties, which include the duty to act in a way that promotes the success of the company for the benefit of the shareholders as a whole.[3]

As a general rule, directors' duties are owed directly to the company and not to any one shareholder, so only the company can enforce a claim for their breach (although see below on derivative claims).[4] However, in exceptional circumstances, a fiduciary duty can arise between directors and shareholders where there are special or unusual circumstances giving rise to a relationship that replicates the prominent features of a fiduciary relationship.[5]

In *Sharp v. Blank*[6] (also known as the *Lloyds/HBOS* litigation because it arose from the acquisition by Lloyds Bank of Halifax Bank of Scotland during the 2008 financial crisis), the directors conceded that they owed a duty of care to shareholders in relation to statements made in shareholder circulars seeking approval for the acquisition, as this document also included statements of personal responsibility from the directors, but denied that they owed such a duty in relation to more generic statements to the wider market in the form of regulatory stock exchange announcements or statements on investor calls. The directors' position was accepted by the court. Ultimately, the directors were found not to have breached the duty of care they owed in relation to the shareholder circulars, as they were required only to provide shareholders with sufficient information to enable them to make an informed decision and not complete disclosure of every consideration that might affect shareholder voting.

3 Section 172 Companies Act 2006. Directors' duties may also be imposed on individuals who are not named directors but who act as directors by virtue of their conduct: *ACL Netherlands v. Lynch* [2022] EWHC 1178.

4 Section 170(1) Companies Act 2006; *Percival v. Wright* [1902] 2 Ch 421; *Sharp v. Blank* [2015] EWHC 3220 (Ch).

5 See, for example, *Coleman v. Myers* [1977] 2 NZLR 255. The duty owed by directors may also extend to considering the interests of creditors in circumstances where they know or ought to know that the company is insolvent or bordering on insolvency or that an insolvent liquidation or administration is probable: *BTI 2014 LLC v. Sequana SA and Others* [2022] UKSC 25. The duty does not, however, extend to considering the interests of fellow directors: *Patel v. Parker* [2023] EWHC 1979 (Ch).

6 *Sharp v. Blank* [2019] EWHC 3096 (Ch).

In general, claims for breach of directors' duties and fiduciary duties are subject to a limitation period of six years from the date the cause of action accrues.[7] Difficulties arise, however, when a breach of duty gives rise to multiple causes of action, in which case different limitation periods may apply to each cause of action. Care should be taken when advancing claims based on breach of directors' duties in the context of M&A transactions, particularly when the relevant events took place several years prior to the entry into of the relevant sale contracts.[8]

Derivative claims

Shareholders can also bring a derivative claim[9] on behalf of the company where there has been an actual or a proposed act or omission involving negligence, default, breach of duty or trust by a director or a third party. Such a claim may be brought only with the permission of the court (which has discretion whether to allow such a claim to proceed). Derivative claims are very rare in England, and in a recent decision, the English court confirmed the high bar for claimants seeking to bring a derivative claim under Part 11 CA 2006.[10]

Claims under the FSMA

Shareholders of a public company may also bring claims against the company or its directors on the basis of statements in published information in relation to the company's affairs, such as in prospectuses and listing particulars. Such claims may be brought under Section 90A and Schedule 10A of the FSMA, which impose statutory liability on issuers of securities for untrue or misleading statements or dishonest omissions in certain published information relating to the securities, or a dishonest delay in publishing such information. There appears to be increasing interest in the possibility of such litigation in England, although most claims to date have been outside the M&A context.[11]

However, an example of Section 90A and Schedule 10A of the FSMA being used in this context can be found in the recent High Court decision in *ACL Netherlands BV v. Lynch*,[12] which arose out of a post-closing M&A dispute. Here, the Court held that the former CEO and CFO of a listed English company, Autonomy Corporation plc (Autonomy), were liable to Hewlett Packard (HP) under Section 90A and Schedule 10A of the FSMA for misleading statements and misrepresentations contained in Autonomy's annual and quarterly reports in the period leading up to the announcement of HP's takeover offer for Autonomy in 2011. Significantly, the Court approved the 'dog-leg' structure by which the claim was brought. The difficulty for HP was that if it brought a straightforward claim against Autonomy, as issuer of the relevant securities (i.e., its own shares), under the FSMA, it would essentially be suing itself, as HP had since acquired Autonomy. A workaround was therefore required that enabled HP to sue the defendants: Autonomy's former CEO and CFO. This was achieved by a dog-leg claim, through which:

7 Sections 2, 5 and 9 Limitation Act 1980. The limitation period may be extended in certain circumstances, such as fraud, concealment or mistake.

8 *MW High Tech Projects UK Ltd v. Greenhalgh* [2022] EWHC 2000 (TCC).

9 Part 11 CA 2006.

10 *ClientEarth v. Shell Plc and others* [2023] EWHC 1897 (Ch).

11 e.g., *SL Claimants v. Tesco Plc* [2019] EWHC 2858 and, more recently, *Various Claimants v. Serco Group plc* [2023] EWHC 119 (Ch).

12 [2022] EWHC 1178 (Ch).

a HP notified its claim to Autonomy;
b Autonomy, under the control of HP, admitted liability to HP; and
c Autonomy then blamed and sued the two defendants, its former officers, for the loss.

In July 2023, the Financial Services and Markets Act 2023 came into force, which, among other things, imposes additional sustainability disclosure requirements.[13] These requirements require implementation by regulatory bodies such as the Financial Conduct Authority and the Prudential Regulation Authority, and once they are in place, they may give rise to litigation.

Unfair prejudice claims

A shareholder may also petition the court, alleging that the company's affairs have been conducted in a way that has unfairly prejudiced the interests of some or all of its shareholders[14] (e.g., if the directors take actions to block a potential transaction that is in the interests of the company and its shareholders). Although possible in an M&A context, unfair prejudice claims are rare as they are often complex and challenging. A mere breakdown in trust and confidence between shareholders does not, on its own, constitute unfair prejudice, and there needs to be a clear element of fault on the part of one of the parties.[15] A shareholder is generally not entitled to complain about the way in which another shareholder exercises the rights attached to their shares unless it amounts to actively managing the company's affairs. In *UTB LLC v. Sheffield United Ltd*,[16] the court held that even if a shareholder's actions amount to managing the company's affairs, another shareholder will not be 'entitled to complain of unfairness unless there has been some breach of the terms on which he agreed that the affairs of the company should be conducted'.

A shareholder may bring an unfair prejudice petition on the basis that another shareholder or other shareholders have not complied with the company's articles of association or other agreements between shareholders,[17] as long as they are not trivial or technical breaches that cause no real prejudice.[18]

ii Remedies

For claims for breach of directors' duties under the CA 2006, a claimant will typically be entitled to recover reparative equitable compensation (where the question is what would have happened but for breach), although, in some circumstances, substitutive compensation will be appropriate (in which case the court tries to restore to the company that which was wrongfully paid out).[19] In addition, remedies may include injunctive relief, setting aside the

13 Section 21 FSMA 2023.
14 Part 30, Sections 994–999 CA 2006.
15 *O'Neill v. Phillips* [1999] 1 WLR 1092.
16 *UTB LLC v. Sheffield United Ltd* [2019] EWHC 2322 (Ch) at [419].
17 *Re Compound Photonics Group Ltd* [2022] EWCA Civ 1371 (although, on the facts of that case, no breach was found in relation to the duty of good faith contained in the relevant shareholder agreement because the majority shareholders rationally and genuinely considered that their conduct was necessary and in the interests of the company). An appeal of this decision is currently outstanding before the UK Supreme Court.
18 *Re Saul D Harrison* [1994] BCC 475.
19 *Davies v. Ford* [2023] EWCA Civ 167.

transaction complained of or an account of profit, restoration of company property held by the director or, in the case of unfair prejudice, the purchase of a shareholder's shares at a certain value.[20]

A breach of duty may also be grounds for disqualification as a director under the Companies Directors Disqualification Act 1986.

Equitable compensation is compensatory in nature, meaning that it will be calculated such that the claimant is put in the position they would have been in had the breach not occurred. By contrast, an account of profits aims to strip the defendant of any gains made from the breach, rather than compensating the claimant. In either case, the remedy is discretionary, meaning that the court will have regard to all the circumstances and facts of a case when determining whether and how much to award, including whether it is just to do so.

Shareholders cannot bring a claim to recover losses in circumstances where their loss merely reflects the loss suffered by the company. This is known as the reflective loss principle. Following the decision of the Supreme Court in *Sevilleja v. Marex Financial Ltd*,[21] the reflective loss principle is engaged only where the loss claimed by the shareholder takes the form of a diminution in the value of its shareholding or its distributions as a shareholder. If a shareholder brings a claim for a different type of loss, even if the company has a concurrent right of action in respect of substantially the same loss, the shareholder will be permitted to recover its loss.[22]

Exemplary or punitive damages are very rarely awarded in England.

Injunctive relief can be sought, for example, in circumstances where a shareholder is seeking to prevent a transaction from going ahead on the basis that it constitutes or involves an alleged breach of the directors' duties. An injunction is, however, available only at the discretion of the court and is subject to the *American Cyanamid* test.[23] The claimant would need to demonstrate that there is a serious issue to be tried between it and the defendant and that the balance of convenience justifies the injunction. Under the balance of convenience element of the test, the court would consider, among other things, whether monetary relief at trial would be an adequate remedy for the claimant and whether irreparable harm would be suffered by the claimant in the event that the injunction were not granted.

The assessment of whether the test is satisfied in each case is highly fact-specific.

iii Defences

The type of defence to the claims set out above will depend on the particular circumstances of each case. Generally, if directors can establish that their actions had been honest and reasonable with regard to all circumstances, the court would reject a claim for breach of duty.[24] Directors will generally look to record in documents such as board papers the relevant considerations in the decision-making process and advice from professional or internal

20 See *Re Stratos Club Ltd* [2020] EWHC 3485 (Ch) in which the Court, in dealing with an unfair prejudice petition, held that a director breached his duties, which resulted in unfair prejudice to the petitioner The remedy the Court awarded was requiring the respondent to purchase the petitioner's shares at pre-covid value.

21 [2020] UKSC 31.

22 *Sevilleja v. Marex Financial Ltd* [2020] UKSC 31; *Naibu Global International Co plc v. Daniel Stewart & Co plc* [2020] EWHC 2719.

23 *American Cyanamid Co (No 1) v. Ethicon Ltd* [1975] UKHL 1.

24 Section 1157 CA 2006.

advisers. In addition, breaches of directors' duties can generally be ratified by an ordinary resolution of shareholders.[25] Similarly, claims based on false or misleading information in published statements can be countered by demonstrating that the directors had an honest belief in the statements at the relevant time.

iv Advisers and third parties

A claim by a shareholder against a third-party adviser can typically be asserted only in tort. It will be necessary to establish that the third party owed a duty of care towards the claimant. For a shareholder to establish such a duty, the shareholder must typically show that the loss suffered by the shareholder was foreseeable, that there was a sufficiently proximate relationship between the shareholder and the third-party adviser, and that it would be fair, just and reasonable for a duty of care to be imposed. In practice, this will be easier for the company to establish than for its shareholders, as the relevant adviser will customarily be engaged by the company (meaning that they will likely owe duties to the company in both contract and tort). If a parent company and its subsidiary bring joint claims on the basis of an adviser's breach of duty, the subsidiary's claims may be struck out on the basis of the reflective loss principle.[26]

v Class and collective actions

There are several processes by which claims involving multiple claimants can be managed in a single collective proceeding. These include consolidation of similar actions brought by multiple claimants into one proceeding under a group litigation order (GLO) issued by the court and a representative action where one claimant brings a claim as a representative of others with the same interest.[27]

Litigation under a GLO is an opt-in process, meaning that each claimant must be party to an individual action first, before the claims are made the subject of a GLO.

There have historically been few collective actions in England. There are, however, a number of recent examples in the context of shareholder litigation, including the *Lloyds/HBOS* litigation,[28] *The RBS Rights Issue Litigation*[29] and *SL Claimants v. Tesco*.[30] There are also a number of collective actions in other contexts, such as consumer litigation and product liability and in relation to environmental, social and governance (ESG) issues. The Competition Appeals Tribunal allows for class action litigation in certain antitrust-related disputes (including, more recently, in the cryptocurrency space).[31] As a result, group and collective litigation is rapidly evolving in England, leading to a number of recent developments in case law on subjects such as the level of damage required to sustain a representative action[32] and the lawfulness of litigation funding arrangements that are often used to support collective proceedings.[33]

25 Section 239 CA 2006.
26 *Naibu Global International Co Plc v. Daniel Stewart and Co Plc* [2020] EWHC 2719 (Ch).
27 Part 19 Civil Procedure Rules.
28 *Sharp v. Blank* [2019] EWHC 3096 (Ch).
29 *The RBS Rights Issue Litigation* [2017] EWHC 1217 (Ch).
30 *SL Claimants v. Tesco plc* [2019] EWHC 2858 (Ch).
31 *BSV Claims Limited v. Bittylicious Limited & Others* (CAT Case No. 1523/7/7/22).
32 *Prismall v. Google UK Limited* [2023] EWHC 1169 (KB).
33 *R (PACCAR Inc) v. Competition Appeal Tribunal* [2023] UKSC 28.

vi Insurance and indemnification

Although it is not generally possible for a company to exempt[34] or indemnify[35] one of its directors from liability in connection with any negligence, default, breach of duty or breach of trust, it is possible for a company to indemnify a director against liability and associated legal fees incurred by a director in the context of a third-party claim,[36] or to purchase and maintain insurance for its directors against any potential liability.[37] It is not, however, open to a company to indemnify its directors for any civil proceedings brought by the company, any fines or liability in respect of criminal proceedings or penalties imposed by a regulatory authority in respect of non-compliance.

Company policies are generally divided into those that cover directors for personal liability where indemnification from the company is not permissible (Side A coverage), those that reimburse the company where it has made payment pursuant to a director's indemnity (Side B coverage) and those that cover the company against claims made directly against it by third parties (Side C coverage). The scope of directors' and officers' insurance policies generally cover any error, misrepresentation or breach of duty committed by a director in connection with a transaction but exclude matters such as fraud, illegality and dishonesty, wilful or intentional acts of non-compliance, or civil or criminal fines.

vii Settlement

English court rules promote settlement discussions between parties and permit cases to be stayed for settlement discussions to take place, encouraging settlement offers by imposing consequences on a party that either unreasonably refuses to participate in settlement discussions or mediation or rejects a settlement offer that it fails to beat at trial. These consequences usually take the form of adverse cost orders being made against the party in question. A detailed regime is provided by Part 36 of the Civil Procedure Rules that allows settlement offers to be made with prescribed consequences if an offer is not accepted but is not subsequently beaten at trial.

Settlement dynamics in circumstances where there may be several thousand claimants and, as is increasingly the case for such matters, a litigation funder may be complex. There are competing interests, and there may be different groups of claimants sometimes represented by different counsel and with varying appetites for settlement. Often, disputes relating to the costs of proceedings continue after the court's decision or after the settlement of claims.

viii Other issues

The UK market is increasingly seeing shareholders actively seeking to monitor and influence the companies they invest in. In the context of M&A transactions, shareholders may be required to consent to the transaction (e.g., in the context of a Class 1 or related-party transaction under the Listing Rules). Alternatively, investors may seek to encourage or pressure a company to undertake a particular acquisition or sale as part of the broader strategy of the company. While activists predominantly rely on the various shareholder rights set out

34 Section 232(1) Companies Act 2006.
35 Section 232(2) Companies Act 2006.
36 Section 234 Companies Act 2006.
37 Section 233 Companies Act 2006.

in the CA 2006 to achieve their aims, the UK market has seen an increasing willingness of investors to pursue litigation to enforce these rights, including through the use of derivative and unfair prejudice claims.

Most public bids in the UK market are implemented by way of scheme of arrangement, which (provided that it has sufficient shareholder support) will bind non-accepting shareholders. The scheme of arrangement process requires court approval to determine whether applicable statutory requirements have been complied with, whether there has been coercion of minority shareholders by the majority and whether the scheme is such that a target shareholder may reasonably approve the bid. In recent years, there has been a trend of intervention by shareholder activists in public bids to attempt to force the bidder to improve the terms of their bid in a practice known as 'bumpitrage'. This is often done at court hearings on the basis that required disclosure in relation to the transaction was inadequate or the scheme unfairly undervalued the target, or both. There have been a number of recent examples that have not succeeded in blocking the relevant transaction but that illustrate that care needs to be taken by target companies and their boards in the context of public bids to ensure that the disclosure in scheme documentation does not open the door to criticism and challenge by bumpitraging activists.

IV COUNTERPARTY CLAIMS

i Common claims and procedure

Disputes and claims arising out of the contractual documents following an M&A deal are common and often relate to the parties' diverging interpretations of what has been agreed. Subjects that often arise include allegations of non-fulfilment of a condition precedent, breaches of warranty and indemnity disputes, and price adjustment disputes. Claims can also arise in misrepresentation where a party seeks to challenge statements made by the counterparty prior to the contract.

The limitation period for contractual claims is six years from the date of the alleged breach of contract,[38] although parties may shorten that for certain types of claims in the transaction documentation.

Conditions precedent

Parties will customarily set out what constitutes the required standard of fulfilment of a relevant condition (e.g., is the condition satisfied on making a notification to a particular regulatory authority or only once that authority provides an affirmative response, or only once an entirely unconditional affirmative response is provided by the authority?). In the absence of this detail, the court may be required to decide whether the condition is objectively satisfied and what the parties intended when they entered into the contract. Courts have upheld provisions that require fulfilment to the satisfaction of one of the parties, despite the fact that they confer wide discretion on the party in question.[39] Whether this determination must be made reasonably (or even in good faith) is an issue of construction; however, it may in some cases be possible to imply a period of time during which the satisfaction will

38 Section 6 Limitation Act 1980.

39 *R&D Construction Group Ltd v. Hallam Land Management Ltd* [2010] CSIH 96.

not be unreasonably withheld.[40] The courts have shown a willingness to hold that such power is not completely unqualified and that 'in the absence of very clear language to the contrary, a contractual discretion must be exercised in good faith for the purpose for which it was conferred, and must not be exercised arbitrarily, capriciously or unreasonably'.[41] A party benefiting from a provision requiring its satisfaction should therefore be prepared to demonstrate that its decision is made in good faith and for proper purposes.

Generally, in the absence of express time limits or long-stop dates, a condition will need to be fulfilled within a reasonable time frame.[42] There is some ambiguity as to what constitutes a reasonable time frame; however, often, the court will look to the circumstances that actually existed, and a party responsible for fulfilment will generally not be in breach provided that any delay is attributable to factors it cannot control and if it has not acted in a way that is negligent or unreasonable on the facts.[43]

M&A agreements will usually set out which party is responsible for ensuring that the relevant condition is fulfilled and the standard of efforts it must apply to satisfy the condition. There is generally a spectrum of such endeavour obligations, ranging from reasonable endeavours, being the least stringent, to best endeavours, being the most.[44] Best endeavours are generally seen as requiring the relevant party to take all steps or courses of action that are capable of producing the desired results[45] and that a reasonable and prudent person acting in their own interests and desiring to achieve that result would take.[46] Although this is onerous, it is not an absolute obligation.[47] In contrast, a reasonable endeavours obligation seeks to balance the contractual obligation against any relevant commercial considerations, acknowledging that such an assessment should still reflect the circumstances and position of the obligor. Crucially, the obligor is not normally required to sacrifice its own commercial interests and may be entitled to consider the financial impact on its own business,[48] and may need to take only one reasonable course as opposed to all of them.[49] Despite their wide use, there is some uncertainty as to what efforts each different endeavours clause requires in practice, which can often result in disputes. Because of this uncertainty, parties will often set out the specific steps a relevant party should take to satisfy a particular obligation (e.g., specifying whether a party must take legal action or appeal to satisfy a particular obligation, or imposing a cap on the amount of expenditure a party may need to incur).

40 *Cream Holdings Ltd v. Davenport* [2010] EWHC 3096 (Ch).

41 *Novus Aviation Ltd v. Alubaf Arab International Bank BSC (c)* [2016] EWHC 1575 (Comm).

42 *Smith v. Butler* [1900] 1 QB 694; *United Dominions Trust (Commercial) Ltd v. Eagle Aircraft Services Ltd* [1968] 1 WLR 74.

43 *Jolley v. Carmel Ltd* [2000] 3 EGLR 68.

44 *Rhodia International Holdings Ltd v. Huntsman International LLC* [2007] EWHC 292.

45 *Rhodia International Holdings Ltd v. Huntsman International LLC* [2007] EWHC 292; *Jet2.com Ltd v. Blackpool Airport Ltd* [2011] EWHC 1529.

46 *Terrell v. Mabie Todd & Co Ltd* [1952] 69 RPC 234; *IBM United Kingdom Ltd v. Rockware Glass Ltd* [1980] FSR 335.

47 *Midland Land Reclamation Ltd v. Warren Energy* [1997] EWHC 375 (TCC); *Jet2.com Ltd v. Blackpool Airport Ltd* [2011] EWHC 1529.

48 *Phillips Petroleum Co UK Ltd v. Enron Europe Ltd* [1997] CLC 329; *Rhodia International Holdings Ltd v. Huntsman International LLC* [2007] EWHC 292; *Gaia Ventures Ltd v. Abbeygate Helical (Leisure Plaza) Ltd* [2019] EWCA Civ 823.

49 *Rhodia International Holdings Ltd v. Huntsman International LLC* [2007] EWHC 292.

Indemnity and warranty disputes

Common areas where specific contractual protection is sought to allocate risk include potential tax liabilities, environmental risks, doubtful debts and other significant but contingent diligence concerns. Typically, this protection is achieved through indemnities, although in English law-governed share purchase transactions, protection for pre-completion tax liabilities of the target group typically takes the form of a stand-alone covenant to pay an amount equal to the relevant tax liability.[50] Although the purpose of these indemnities and covenants is to provide parties with clarity on how a particular liability should be apportioned, disputes are common where drafting is not specific or clear enough or where a novel situation arises post signing of the agreement. A party claiming under an indemnity or covenant must prove that the relevant trigger event has occurred. There is no duty to mitigate loss, in contrast to claims for damages for breaches of warranties.

Common warranty claims following an M&A transaction include claims in relation to the seller's contractual warranties as to the financial health of the target (accounts warranties) or compliance with law or licensing requirements. A successful claimant will have to demonstrate that the party giving the warranty has breached it and that the effect of that breach is to reduce the value of the business being acquired. Disputes have also arisen in relation to coverage under warranty and indemnity (W&I) insurance, such as in *Finsbury Foods Plc v. Axis Corporate Capital Ltd & Ors*,[51] where a dispute arose between the buyer and the insurer over the scope and interpretation of the warranties, and whether the warranties given by the seller had been breached such that the W&I policy would respond.

In *Wood v. Capita Insurance Services*,[52] the Supreme Court analysed a sale and purchase agreement (SPA) with a large number of 'detailed and professionally drafted' indemnities. The Supreme Court recognised that in most transactional contexts, the desire to get a deal done and the nature of negotiations mean that unambiguous drafting may not always be achieved. As a result, to ascertain the objective meaning of the words used by the parties, it may be necessary for the court to take into account not just the literal meaning of the words used but also the commercial consequences of those words and the context of the contract in which they are used as a whole. A recent example involved the High Court considering the construction of an indemnity[53] for the costs of replacing damaged subsea export cables. The Court held that the relevant indemnity was limited to damage done to the cables during the period between signing and closing. This case underlines the potential importance, in deals involving a split exchange and completion, of giving individual consideration to what the parties intend by reference to the period 'prior to' or 'before' completion, in particular where used to delineate a party's contractual responsibilities or liabilities. The Court held that these terms have no common meaning, and that the provisions must be interpreted at the date they come into force with regard to specific wording of the provision, including the tense used, and the broader structure of the SPA, including the presence of overlapping warranties and their related limitations of liability.

50 Some reasons for using a covenant, rather than an indemnity, are discussed in Sections IV.ii and IV.iii, below.

51 *Finsbury Foods Plc v. Axis Corporate Capital Ltd & Ors* [2023] EWHC 1559 (Comm).

52 *Wood v. Capita Insurance Services Limited* [2017] UKSC 24.

53 *Gwynt Y Mor Ofto Plc v. Gwynt Y Mor Offshore Wind Farm Ltd* [2020] EWHC 850 (Comm).

In relation to warranty claims, disputes often arise in relation to whether the seller disclosed a particular fact or circumstance negating the warranty or if the fact or circumstance was otherwise known to the buyer at the time of purchase. The contract will often specify the standard in relation to any disclosure – for example 'fairly and clearly disclosed in writing[54] – and there will be a factual dispute as to whether that standard has been met. There will often be a question of whether a breach of the warranty is material such that liability arises. In relation to breaches of an accounting warranty in which the seller typically warrants that the audited accounts of a certain date present a true and fair view of the target's financial position, the court has found that failure to comply with accounting standards is prima facie evidence that the resulting accounts do not present a true and fair view of the target's financial position.[55]

Almost all SPAs will include a provision requiring the buyer to give notice of any claims within a certain period of time. Often, these provisions will also prescribe what the notice is required to include. The English court has repeatedly required strict compliance with such notice provisions, in terms of both the deadlines and the notice contents. Recent examples of notices with which the English court has found to have failed to comply with the stipulated contractual requirements include:

a a notice that failed to identify the particular warranties and other provisions on which the claims were based;[56]

b a notice that failed to include a reasonable estimate of the amount of the claim;[57]

c a notice that did not assert a claim but merely stated that the claimant may have claims that it might make in the future;[58] and

d a notice that did not contain reasonable detail about the matter that gave rise to the claim.[59]

What constitutes reasonable detail will depend on all the circumstances of the case, including the recipients' knowledge. Requiring an explanation of details of which the recipients are already aware, unless such details are expressly required by the contract to be provided, has been found by the courts to be an unnecessary formality.[60]

Price adjustment disputes

Disputes frequently arise in circumstances where the parties have agreed to some form of post-completion price adjustment mechanism (such as a closing statement mechanism or earn-out).

For example, where parties have agreed to a closing statement mechanism, one party to the agreement is typically required to prepare and provide to the other a closing statement within a certain time period following the signing of the contract. The seller and buyer will

54 *Triumph Controls UK Ltd v. Primus International Holding Company* [2019] EWHC 565 (TCC).

55 *Macquarie Internationale Investments Limited v. Glencore UK Limited* [2010] EWCA Civ 697.

56 *Teoco UK Ltd v. Aircom Jersey 4 Ltd & Anor* [2018] EWCA Civ 23.

57 *Zayo Group International Ltd v. Ainger & Ors* [2017] EWHC 2542 (Comm).

58 *TP Icap Ltd v. Nex Group Ltd* [2021] EWHC 1375 (Comm). See also *Ipsos SA v. Dentsu Aegis Network Ltd* [2015] EWHC 1171 (Comm).

59 *Dodika Limited & Others v. United Luck Group Holdings Limited* [2020] EWHC 2101 (Comm) and also *TP ICAP Limited v. Nex Group Limited* [2022] EWHC 2700 (Comm).

60 *Dodika Ltd v. United Luck Group Holdings Ltd* [2021] EWCA Civ 638.

typically agree to the principles on which the closing statement is to be prepared, which often seeks to ensure consistency with the target's accounts and specify certain accounting principles and treatments for matters specific to the transaction. Notwithstanding the consistency principle, where the parties agree to certain principles on which the closing statements are to be prepared, and the reference accounts (with reference to which closing statements are prepared) contain errors or departures from such agreed principles, absent clear and unambiguous wording in the contract that such errors are to be carried forward, the closing statements must comply with the agreed principles first and then seek to be consistent with any reference accounts.[61] There are other common reasons why a price adjustment dispute may arise, including a difference of view in relation to the applicable accounting treatments (e.g., whether something should be treated as cash or debt).

Price adjustment disputes are typically resolved by way of an expert determination procedure, and the contract will set out the scope of the expert's determination and the process for any submissions by the parties. This is viewed as being a more cost-effective and simpler procedure than a court proceeding, where the expert (typically an accountant) is asked to determine whether the accounting treatments in the closing statements are correct. Where a dispute arises as to the jurisdiction of an expert, the court will have the final decision as to whether the expert has jurisdiction. This is the case even if a clause purports to confer that jurisdiction on the expert in a manner that was final and binding.[62] If there is a dispute that falls outside the scope of the jurisdiction of expert determination, it is within the jurisdiction of the court to make the decision. There may also be disputes about whether the expert's determination is binding. For example, if the expert departs from their instruction in a material respect[63] (e.g., valuing the wrong shares or the shares of the wrong company), then the determination may not be binding because the expert has not done what they were appointed to do.

The expert's decision will typically be final and binding unless there is fraud or a manifest error. The expert has a degree of discretion in interpreting contractual provisions without falling afoul of the manifest error limitation (e.g., with respect to determining the hierarchy of the prescribed principles to be applied when preparing completion statements).[64]

Misrepresentation

Claims of misrepresentation in the context of an M&A transaction governed by a contract can arise where a claimant alleges that a statement made by the defendant during negotiations induced them to enter into the contract. Establishing misrepresentation requires the claimant to show that the defendant made a statement that was not true and that induced the claimant to enter into the contract. Claims for misrepresentation can be for innocent, negligent or fraudulent misrepresentation.

61 *Shafi v. Rutherford* [2014] EWCA Civ 1186.

62 *Barclays Bank PLC v. Nylon Capital LLP* [2011] EWCA Civ 826.

63 *Jones v. Sherwood* [1992] 1 WLR 277.

64 *Flowgroup Plc (in liquidation) v. Co-operative Energy Limited* [2021] EWHC 344 (Comm).

Fraudulent misrepresentation involves a claim in deceit and requires the claimant to establish that the defendant was acting dishonestly and had the intention to induce the claimant into the contract.[65] The principles are well established in case law and each case will turn on its own facts.

It is necessary to show that the misrepresentation induced the claimant to enter into the contract in question, which again is a question of fact, although where a fraudulent misrepresentation is established, there is a presumption that the claimant was induced.[66] Notably, statements made during a due diligence process can be actionable misrepresentations.[67]

ii Remedies

The principal remedy for breach of contract is an award of damages calculated on a compensatory basis, meaning that the claimant should be put in a position it would have been in had the breach not occurred.[68] A claimant will be required to prove that the breach of contract caused the damages claimed and also that the damages are not too remote. A claimant may also recover interest on damages that accrue before judgment, on the basis that it could have made alternative investments and has suffered loss by being kept out of its money. Any claim for interest is subject to the usual rules about proof of loss, causation and remoteness.[69]

The time of assessment is at the time of the breach, and subsequent events influencing the claimant's loss should not be taken into account. Departure from the prima facie position that damages are assessed at the date of breach without hindsight must be justified and must occur only where it is 'necessary to give effect to the overriding compensatory principle'.[70]

The claimant is under a duty to mitigate its losses. In essence, this principle is complementary to the causation requirement, namely that the defendant's breach caused the damage to the claimant. If the claimant unreasonably fails to act to mitigate its loss or unreasonably acts so as to increase its loss, the law treats those actions as having broken the chain of causation and measures damages as if the claimant had instead acted reasonably.

By contrast, a claim under an English law tax covenant is a claim for a debt, rather than damages. Accordingly, if a seller is held liable, it will typically be for an amount equal to the relevant tax liability of the target company, rather than for the damage suffered by the buyer as a consequence of such tax becoming due. This prevents any arguments about what the buyer's loss (in contrast to the target's) actually is in a particular case and means that no mitigation is required.

65 *The Kriti Palm* [2006] EWCA Civ 1601.

66 *BV Nederlandse Industrie Van Eiprodukten v. Rembrandt Enterprises Inc* [2019] EWCA Civ 596; *Kings Security Systems Ltd v. King & Anor* [2021] EWHC 325.

67 *MDW Holdings Limited v. Norvill and Others* [2021] EWHC 1135 (Ch). The decision was upheld on appeal: [2022] EWCA Civ 883.

68 *The Hut Group Ltd v. Oliver Nobahar-Cookson and others* [2014] EWHC 3842 (QB).

69 *Sempra Metals Ltd v. HM Commissioners of Inland Revenue and another* [2007] UKHL 34.

70 *Ageas (UK) Limited v. Kwik-Fit (GB) Limited, AIG Europe Limited* [2014] EWHC 2178 (QB).

The basis of the calculation of damages in indemnity claims will depend on the precise wording of the contract, but, on a general level, the claimant seeking to claim under an indemnity will not be under a duty to mitigate its losses. Questions as to causation and remoteness of loss also do not arise in indemnity claims.

Rescission is available as a remedy for successful misrepresentation claims. The consequence of rescission is that the parties are put in a position as if the contract had never existed. By contrast, the remedy for breach of contract is to put the parties in the position as if the contract had been performed. This has an impact on the calculation of damages, and in certain circumstances it may be an advantage for the claimant to seek rescission rather than damages in a misrepresentation claim. When assessing damages in claims for misrepresentation, consideration of what the buyers had subjectively factored into the purchase price is irrelevant. Instead, the court will assess the objective value of the assets purchased at the relevant date.[71] It is important to note that a claimant is unlikely to be successful in claiming misrepresentation where the claim is made on the basis of a contractual warranty. Contractual warranties have been held not to amount to representations of fact and were not capable of founding an action for misrepresentation.[72] It is for this reason that when drafting English law transaction documents, it is common practice to avoid the use of the word 'representation' throughout.

iii Defences

Defendants to a breach of warranty claim will typically seek to argue that:

a there has been no breach;

b the breach was not material, so no liability can arise; and

c the particular fact or circumstance giving rise to the claim was known to the buyer and therefore it cannot bring a claim.

In a claim under an indemnity, a defendant will seek to argue that the particular trigger event has not occurred. In either case, a defendant may argue that the claimant has failed to comply with notice provisions (which, as set out above, are construed strictly) and therefore the claim should be dismissed.[73] In addition, there may be contractual defences or limitation on liability. Almost all agreements will include some form of limitations on the seller's liability with respect to the warranties they give, and these sometimes extend to other provisions such as indemnities, tax covenants or even the agreement as a whole. Common limitation provisions include individual and aggregate liability caps, *de minimis* and thresholds to limit less material disputes, and time limitation periods (and one agreement may contain a number of different caps, thresholds and time limits in respect of different types of claim). Tax covenants will typically also contain their own set of exclusions from seller liability.

71 *Glossop Cartons and Print Ltd and others v. Contact (Print & Packaging) Ltd and others* [2021] EWCA Civ 639.

72 *Idemitsu Kosan Co Ltd v. Sumitomo Co Corp* [2016] EWHC 1909 (Comm).

73 *Dodika Limited & Others v. United Luck Group Holdings Limited* [2020] EWHC 2101 (Comm).

Broadly, losses will be calculated according to normal contract law principles, which, as noted above, means that a loss must arise naturally in the ordinary course of things from a particular breach or must be within the reasonable contemplation of the parties as a result of specific circumstances known to the parties at the date of the contract.[74] Sellers will often seek to exclude liability for indirect or consequential losses. A common issue that arises is that the distinction between direct and indirect or consequential losses is not always an easy distinction to draw. For example, there have been a number of cases where loss of profits has been held to be a direct loss and therefore recoverable.[75] As a result, parties will often look to expressly exclude loss of profits (and sometimes loss of goodwill) in addition to indirect or consequential losses.

iv Arbitration

Arbitration as a method to resolve commercial contractual disputes is very common, and sophisticated parties to M&A transactions will often choose to refer their disagreements to an arbitral tribunal.

A wide range of international transactions may be subject to arbitration seated in England, and London is a well-known centre for international arbitration. The Arbitration Act 1996 applies to all arbitrations seated in England, and there is a considerable body of case law relating to issues arising out of arbitrations seated in England. England is widely considered to be arbitration-friendly, and the court will give effect to arbitration agreements and have wide discretion, where requirements are met, to issue anti-suit injunctions to restrain a party from continuing proceedings initiated in breach of an arbitration clause. The court also has the power to order disclosure and compel witness evidence in support of arbitration proceedings (seated in London or elsewhere). Further, the grounds on which a party can apply to the court to challenge an arbitral award are limited. It is possible (unless the parties have agreed otherwise) to appeal an arbitration award on a point of law,[76] although the applicant is required to demonstrate that the tribunal made an obvious error.

v Other issues

Disclosure in English court proceedings can be extensive. In recent years, reforms have been introduced to seek to streamline the process. A new disclosure regime (which was initially introduced as a pilot scheme) under the Civil Procedure Rules[77] came into force in October 2022, which requires parties to give initial disclosure aimed at providing the opposing party with documents relied on towards the beginning of proceedings. In addition, parties are required to agree a list of issues for disclosure to seek to limit disclosure on issues that do not require substantial volumes of documents to be reviewed and produced. Notwithstanding the new regime, the basic principle of disclosure in the English court remains the same: the

74 *Hadley v. Baxendale* (1854) 9 Ex. 341.

75 *British Sugar v. NEI Power Projects Ltd* (1998) 87 BLR 42; *Deepak v. ICI* [1999] 1 Lloyd's Rep 387.

76 Some arbitral institutions' rules exclude appeals on points of law. See, for example, the LCIA Arbitration Rules, Article 26.8, which provides for the parties' waiver of a right to any form of recourse regarding the award, insofar as such a waiver is not prohibited by the applicable law. Under the Arbitration Act 1996, parties are permitted to opt out of Section 69 allowing challenges to an award on a point of law.

77 Civil Procedure Rules, Practice Direction 57AD, which applies in the business and property courts. The business and property courts deal with the majority of commercial disputes in England and Wales and comprise, for example, the Commercial Court and the Technology and Construction Court.

parties are expected to conduct proceedings with their cards on the table, namely providing to the opposing party documents that either undermine a party's case or support the other party's case.

England is also an adverse costs jurisdiction, where the court has broad discretion to award legal fees in favour of one party or the other. The default position is that the unsuccessful party to litigation will be ordered to pay the successful party's legal costs. This applies both to the case as a whole and on an ongoing basis to any interim applications made to the court. This can result in significant costs orders being made against unsuccessful parties and in a successful party recovering the majority of its legal costs from pursuing or defending a claim.

V CROSS-BORDER ISSUES

In the context of M&A transactions, the process of initiating a claim against a foreign defendant may be simple if the parties have agreed that any dispute arising out of the contract will be subject to the jurisdiction of the English court.

If other parties not domiciled in the United Kingdom are also involved, the English court has wide-reaching jurisdictional rules that allow claimants to bring defendants into proceedings in England even if they have no nexus to England, provided that certain jurisdictional thresholds are met.

There are certain circumstances where the English court will reject or stay a claim against an English defendant (e.g., if the proceedings are brought in breach of an arbitration clause or if the parties to the contract expressly agreed that the courts of another jurisdiction should determine any dispute).

Following Brexit, the Recast Brussels Regulation, which previously governed the English court's jurisdiction over parties domiciled in the European Union, has ceased to apply. Common law rules on jurisdiction now apply to defendants instead. Common law rules start with the question whether the defendant can be properly served with the proceedings in England and Wales. Where a defendant cannot be served within the jurisdiction, the court's permission may be required to serve a defendant out of the jurisdiction. To obtain the court's permission, the claimant must show that a jurisdictional ground giving the English court jurisdiction over the matter applies,[78] the claim raises a serious issue to be tried and England is the proper place in which to bring the claim.[79]

The court's permission to serve out of the jurisdiction is not required where the contract contains a jurisdiction clause in favour of the English court.[80]

78 A number of different jurisdictional grounds are available, which are contained in Paragraph 3.1 of Practice Direction 6B of the Civil Procedure Rules, Part 6. In October 2022, the grounds for service out of the jurisdiction were expanded to facilitate, for example, certain claims for breach of fiduciary duty that occurred in England and Wales and for claims in tort, breach of confidence and breach of fiduciary duty where the claim is governed by English law.

79 Civil Procedure Rules 6.36 and 6.37.

80 Civil Procedure Rules 6.33(2B).

VI YEAR IN REVIEW

The courts' approach to M&A disputes remained consistent with established principles and past practice, with cases over the past year largely focusing on the application of those established legal principles in different factual contexts. There have, however, been some notable developments in the M&A context in relation to contractual interpretation, as well as more broadly in commercial contexts that may have an impact on M&A disputes (in relation to litigation funding, directors' duties and derivative claims).

In the *Finsbury Foods*[81] decision (discussed in Section IV.i, above), the Court considered the construction of a no material adverse change warranty in the share purchase agreement when determining whether the claimant was entitled to an indemnity from its W&I insurers for breach of that warranty. The relevant warranty provided that there had been 'no material adverse change in the trading position of [the target group] or their financial position, prospects or turnover and no [target group company] has had its business, profitability or prospects adversely affected by the loss of any customer representing more than 20% of the total sales of the [target group]'. The Court held that this provision in fact constituted two separate warranties with two separate sets of criteria. On the facts, the Court found that no breach of warranty had occurred and so no claim could be made under the W&I insurance. The case is an important reminder that parties should take care to draft warranties with clear and concise criteria.

The English court also considered a point of contractual construction in *Re Compound Photonics Group Ltd* (discussed in Section III.i, above).[82] In that case, the Court of Appeal clarified the scope of an express duty of good faith in shareholder agreements in the context of an unfair prejudice petition. The Court of Appeal found that there were no minimum standards that would apply to all good faith obligations but rather the clause should be interpreted in light of the contract and commercial context as a whole. The decision, which is being appealed to the Supreme Court, emphasises the importance of clearly defined good faith obligations in contracts, if such obligations are intended to apply to the relationship (this is perhaps particularly important under English law, which does not imply a general duty of good faith in contracts).

One important Supreme Court decision was handed down in the past year that may have an impact on shareholder disputes as well as M&A litigation more broadly. In *BTI v. Sequana*[83] (discussed in Section III.i, above), the Supreme Court considered for the first time whether directors' duties to the company extended also to protect creditors, holding that it would in certain circumstances of actual or impending insolvency.

Although ESG issues are yet to yield significant M&A disputes, the increasing regulatory and public focus on these issues across jurisdictions continues to bring them into relief for investors. In the United Kingdom, for example, recent years have yielded a string of court decisions allowing claims against parent companies for alleged ESG failures at foreign subsidiaries to proceed on the basis that the parent had, arguably, assumed a duty of care in respect of its subsidiaries' activities.[84] There are also some signs of the courts being reluctant to extend too far into the role of ESG enforcement, including the recent decision preventing

81 [2023] EWHC 1559 (Comm).

82 [2022] EWCA Civ 1371.

83 *BTI 2014 LLC v. Sequana SA and Others* [2022] UKSC 25.

84 *Okpabi v. Royal Dutch Shell* [2021] UKSC 3; *Vedanta Resources v. Lungowe* [2019] UKSC 20.

the continuation of derivative claims against Shell's directors. However, notwithstanding that decision, we consider that risks surrounding liability for ESG issues in a corporate group are likely to continue their development in the M&A sphere.

The EU Foreign Subsidies Regulation,[85] which applied from 12 July 2023, establishes a mandatory prior notification and authorisation regime for some EU M&A transactions involving parties that have received financial contributions from non-EU countries. Those transactions must be cleared by the Commission before they are fully implemented. It is expected that these new EU regulatory requirements may well have an impact on the timing of M&A transactions that also have an EU nexus, and any such delays may well give rise to disputes.

VII OUTLOOK AND CONCLUSIONS

The choice of English law as the governing law of an M&A transaction is popular, even with parties who have no other nexus to the United Kingdom and whose businesses are located elsewhere. While in 2020 and 2021, there was a marked recovery in deal activity following the pandemic, that recovery period was short-lived. From 2022, deal activity cooled off, in part due to the Russian invasion of Ukraine, as well as political transition in UK government and resulting economic instability, and this trend has continued into 2023. We expect the macroeconomic environment to continue to contract into 2024, with factors such as rising interest rates, high inflation, energy insecurity and geopolitical uncertainties (including expansion of economic sanctions) all continuing to jeopardise financing opportunities. Downturns in the market are generally associated with more protracted deal lead times and increased levels of litigation as parties become focused on scrutinising the reasons for underperformance and parties' motivation to litigate generally increases. If the current economic environment persists or worsens, we would expect M&A litigation to increase.

Other areas of potential development include the increasing role of third-party litigation funders and the issues that come with their involvement in the parties' ability and willingness to bring claims, claims brought by large groups of claimants (another rapidly developing area of law and practice) and shareholder claims. The July 2023 UK Supreme Court decision regarding litigation funding agreements,[86] however, is expected to cause many litigation funders to alter their approach with existing claimants, including by amending or replacing existing funding arrangements, and to take a cautious approach going forward.

We also expect that coming years will continue to see issues relating to ESG risks, data protection (an increasingly regulated area with substantial risk and potential regulatory and private law liability) and liability for cyberattacks, ransomware and other data security risks becoming more prominent. Rapid technological and associated regulatory change in the artificial intelligence space, as well as in cryptocurrency, is also expected to prompt disputes as the regulatory sector adapts to those developments and as regulatory change affects M&A deals. Managing and litigating these risks may well take place in the M&A context as well as more generally. We also expect traditional M&A disputes over purchase price adjustments and W&I to continue and potentially to increase.

85 Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market.

86 *R (PACCAR Inc) v. Competition Appeal Tribunal* [2023] UKSC 28.

Chapter 5

GERMANY

Rüdiger Harms and Samira Meis[1]

I OVERVIEW

Although the number of cases in Germany concerning M&A disputes was fairly low in the 1990s, a steady increase in the number of cases can be observed over the past 20 years.[2] In Germany, the vast majority of M&A disputes are counterparty disputes; shareholder disputes are still rare in an M&A context. Furthermore, the characteristics of M&A disputes in Germany are strongly influenced by the fact that Germany is a civil law jurisdiction. As a result, judges in Germany take a much more active role in litigation – for instance, during the taking of evidence – compared with common law jurisdictions. Unless the parties agree on arbitration, M&A disputes are typically brought before the commercial chamber of a German regional court. Since German litigation practice in actuality does not feature pretrial discovery or disclosure, German litigation is often described as 'front-loaded'. This means that all relevant facts and evidence must be submitted together with the parties' initial pleadings, particularly with the statement of claim and the statement of defence, which are usually fully fledged submissions with which evidence is already presented or offered.

That said, the majority of German M&A disputes are resolved by means of arbitration proceedings.[3] According to the 2022 statistics of the leading German arbitration institution, the German Institute of Arbitration (DIS), the most popular seats of arbitration are Frankfurt (Main), Munich and Berlin.[4] At least in purely German domestic arbitration proceedings, arbitrators often take a similarly active role as judges would in German litigation. Although the pleading requirements in German civil litigation do not apply to commercial arbitration proceedings, which are usually subject to the chosen institutional rules, there is a tendency in arbitration proceedings with a strong German nexus for parties to file more robust initial pleadings than are strictly required under the applicable rules.

1 Rüdiger Harms is a counsel and Samira Meis is an associate at Cleary Gottlieb Steen & Hamilton LLP. The authors would like to acknowledge the assistance of Jakob Kühne and Frederic Giesen in the preparation of this chapter.

2 See *Ghassemi-Tabar/Wilk*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 1 Paragraph 1 et seq.; see also *Mehrbrey*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 1 Paragraph 1.

3 *Louven/Mehrbrey*: Bedeutung aktueller M&A-Streitigkeiten für die Gestaltungspraxis, NZG 2014, 1321.

4 https://www.disarb.org/en/about-us/our-work-in-numbers.

II LEGAL AND REGULATORY BACKGROUND

The procedural and substantive law that governs M&A disputes regularly follows from choice of law and dispute resolution clauses in the purchase agreement since it is best practice in German M&A transactions to include such clauses. Absent a clause concerning jurisdiction or arbitration, the German Code of Civil Procedure provides for rules to determine jurisdiction. In cross-border disputes, international jurisdiction and thus the applicable procedural law are often determined pursuant to the provisions of the Brussels Ia Regulation or the Lugano Convention.[5] The applicable domestic substantive law in cross-border disputes is determined in accordance with the Rome I Regulation (contractual claims) and Rome II Regulation (non-contractual claims) and – outside the scope of these regulations – the Introductory Act to the German Civil Code. The most important German substantive laws with regard to M&A disputes are the German Civil Code, the German Commercial Code, the Limited Liability Companies Act, the German Stock Corporation Act, the Transformation Act, the Securities Trading Act and the Securities Acquisition and Takeover Act. In Germany, unlike, for instance, in the United States, all laws that are material for an M&A dispute are federal laws. Thus, a conflict of laws analysis concerning cross-border disputes with a connection to Germany needs to consider only whether German domestic law governs and needs not distinguish between various German state laws.

In the context of M&A transactions, three regulatory bodies are of particular importance. First, the German Federal Financial Supervisory Authority (BaFin) is the authority responsible for supervision of takeovers of domestic companies listed on a stock exchange in Germany. BaFin monitors, among other things, the following transaction-related procedures: acquisition offers; takeover bids; mandatory offers; and delisting offers.[6] BaFin has the right to issue orders, including an order prohibiting an offer. Orders of BaFin are subject to an objection procedure administered by BaFin and can be appealed in a proceeding before the Higher Regional Court of Frankfurt.[7]

Second, mergers between companies that fulfil certain thresholds set out in the Act against Restraints of Competition must be notified and are subject to merger control assessment by the German Federal Cartel Office (BKartA). The BKartA has extensive powers to request information and data for the merger control assessment. Parties to a merger subject to notification are prohibited from proceeding with the merger before the transaction has received clearance from the BKartA (gun-jumping). Larger mergers that have cross-border implications within the European Union are also subject to review by the European Commission.

Third, the Federal Ministry of Economic Affairs and Climate Action (BMWK) has the authority under the Foreign Trade and Payments Act and the Foreign Trade and Payments Ordinance to review and restrict or prohibit certain acquisitions of German companies by foreign investors from outside the European Union, but in exceptional cases also from within

5 Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters; Lugano Convention of 30 October 2007 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

6 https://www.bafin.de/EN/Aufsicht/BoersenMaerkte/Transparenz/Unternehmensuebernahmen/unternehmensuebernahmen_node_en.html.

7 Sections 41 and 48 of the German Securities Acquisition and Takeover Act (WpÜG).

the European Union.[8] The scope of investigation and the BMWK's means of control depend on how sensitive the area in which the target company operates is considered to be, as well as on the amount of shares to be acquired. A prohibition or restriction by the BMWK can be challenged before an administrative court with an action for annulment by the buyer or the seller, but not by the target.[9]

III SHAREHOLDER CLAIMS

M&A-related disputes between shareholders and the company or its directors and officers are generally rare in Germany compared with M&A disputes against the counterparty to the transaction. This section outlines the substantive law and procedural aspects to be considered with regard to shareholder claims.

i Common claims and procedure

Common shareholder claims are related to either a breach of duties by directors and officers or exploitation of influence on a company to the detriment of the shareholders by any person. Furthermore, shareholders may claim damages against the company due to a failure to provide information or the provision of false information either under the Securities Trading Act (WpHG) or based on tort law. Tort claims may also be directed against directors and officers. Following a transaction, minority shareholders may claim monetary compensation if they have to transfer their shares to majority shareholders (squeeze-out).

In managing the affairs of the company, members of the management board in particular have to comply with their duty of care and their duty of loyalty. The duty of care requires the board member to exercise the due care of a prudent manager, faithfully complying with their duties. With regard to the duty of loyalty, the board member, as a fiduciary, is obliged to prioritise the company's interests over their own personal interests or the interests of third parties and to safeguard the company's interests. In the event of a breach of those duties, the board member is liable to the company for the damage caused. Correspondingly, claims against board members are usually pursued by the company, not by the shareholders. In pursuing such claims, the company is generally represented by the supervisory board. However, by resolution at the general meeting, the shareholders may appoint a special representative to pursue claims against a board member. Furthermore, shareholders owning, on aggregate, at least 1 per cent of the share capital or a proportionate amount of the share capital of €100,000 may seek permission from a court to pursue the claims in their own name on behalf of the company. The court will permit such legal action only if certain statutory preconditions are met, including that the shareholders provide proof that they unsuccessfully requested the company to pursue the claims within a reasonable notice period. Otherwise, and in contrast to other jurisdictions, German law does not provide for a derivative suit of individual shareholders to assert rights of the company.

In addition to the members of the management board, the members of a supervisory board may also be liable to the company for a breach of their duty. The supervisory board, which exists either pursuant to a statutory requirement or, in many German companies, based

8 Sections 6 and 13 Paragraphs 1 and 2 No. 2 of the Foreign Trade and Payments Act in conjunction with Chapter 6 Division 2 of the Foreign Trade and Payments Ordinance.

9 *Flaßhoff/Glasmacher*, Wankende Verwaltungsakte im Außenwirtschaftsrecht bei Unternehmenskäufen, NZG 2017, 489 (493).

on an agreement in the articles of association, has the duty to supervise the management. The supervisory board may, if necessary, withhold its consent to certain transactions so that the management may not carry out the transaction unless a majority of shareholders grants approval at the general meeting. Members of the supervisory board who are in breach of these duties are liable to the company.[10]

Any person who exploits their influence on the company to intentionally cause a member of the management board or of the supervisory board to act to the detriment of the company or its shareholders is liable to compensate the company for the damage suffered by the company as a result. Such influence can be based, for instance, on a business relationship, personal relationships with directors and officers of the company, or share ownership.[11] The management board generally pursues the claims on behalf of the company. If the management board is not prepared to do so, shareholders may seek to pursue the claims subject to judicial approval under the above-mentioned prerequisites. Shareholders also may hold and pursue a claim of their own against the person who exercised undue influence. However, such shareholder claims require that the shareholder suffers direct damage separate from the indirect damage suffered as a result of their holding a share in the company. The line between indirect and direct damages may be difficult to draw. Generally, a decrease in share value as a result of damage inflicted against the company would be considered mere indirect damage. In contrast, if a third party exploited their influence to cause the company to publish false information and the shareholder sold shares as a result, the (former) shareholder may have a personal claim for compensation.[12] Members of the management board and the supervisory board may also be liable in addition to the person exerting undue influence if they are found to have neglected their duties.[13]

The Securities Trading Act and the EU Market Abuse Regulation,[14] which is directly applicable in Germany,[15] set forth statutory claims resulting from the failure of a company to disclose information that is relevant with regard to the development of its future share price (insider information). In this regard, a takeover offer and the conclusion of a share purchase agreement both qualify as circumstances requiring ad hoc disclosure for the companies involved.[16] If such a violation of the obligation to disclose information can be established, a shareholder who purchased shares after the failure to disclose the information and before it became public, and who still holds the shares, may claim rescission of the share purchase or

10 *Habersack*, in MünchKomm-AktG, Vol. 2, 6th Ed. (2023), AktG Section 116 Paragraph 71; Koch, AktG, 17th Ed. (2023), AktG Section 116 Paragraph 13.

11 Koch, AktG, 17th Ed. (2023), AktG Section 117 Paragraph 3; *Spindler*, in MünchKomm-AktG, Vol. 2, 6th Ed. (2023), AktG Section 117 Paragraph 16 et seq.; *Leuering/Goertz*, in Hölters/Weber, AktG, 4th Ed. (2022), AktG Section 117 Paragraph 3.

12 *Spindler*, in MünchKomm-AktG, Vol. 2, 6th Ed. (2023), AktG Section 117 Paragraph 53 et. seq.

13 *Spindler*, in MünchKomm-AktG, Vol. 2, 6th Ed. (2023), AktG Section 117 Paragraph 58; Koch, AktG, 16th Ed. (2022), AktG Section 117 Paragraph 10.

14 Regulation (EU) No. 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC (L 173/1).

15 *Kumpan*, in Hopt, HGB, 42nd Ed. (2023), Vorb. MAR Paragraph 1; *Kumpan/Grütze*, in Schwark/Zimmer, Kapitalmarktrecht-Kommentar, 5th Ed. (2020), MAR Article 17 Paragraph 7.

16 *Kumpan*, in Hopt, HGB, 42nd Ed. (2023), MAR Article 7 Paragraph 16; *Kumpan/Grütze*, in Schwark/Zimmer, Kapitalmarktrecht-Kommentar, 5th Ed. (2020), MAR Article 17 Paragraph 92.

compensation for the difference in share price.[17] A party who already owned the shares before the event giving rise to the insider information and sold them after the company's failure to disclose may also claim such compensation.

In addition, shareholders can assert tort claims against the company as well as against its directors and officers, including a tort claim for causing intentional damage *contra bonos mores* based on a failure to disclose information or providing false information outside of the scope of the Securities Trading Act.[18] This is the case, for instance, when the management board directly harms shareholders or investors intentionally and unfairly by way of issuing grossly incorrect ad hoc disclosures in the course of an M&A transaction.[19] In addition, shareholders can even assert claims in tort based on misleading statements made during press conferences or in private discussions with investors.[20] However, compared with the ad hoc disclosure obligations under the Securities Trading Act, the applicable requirements are less strict regarding the truth and completeness of such informal information.[21]

Following an M&A transaction, majority shareholders of a stock corporation holding 95 per cent or more of the shares in the company may resolve the transfer of shares from the remaining minority shareholders (squeeze-out). In return, those minority shareholders can claim an appropriate cash settlement. Disputes arising over the adequacy of such settlement must be litigated before the commercial chamber of a regional court by means of an award proceeding.[22] This proceeding, which bears some similarity to a judicial appraisal under US law, enables shareholders to independently ascertain the fair value of their shares.

ii Remedies

The remedies available to shareholders are generally determined by the underlying claim and its objective. In addition, German corporate law provides for various specific remedies for shareholders.

Shareholders are most likely to assert claims for payment of damages. Such claims include, among others, monetary compensation by way of restitution in kind, or resulting from the rescission of a share purchase where the company failed to make an ad hoc disclosure of inside information under the Securities Trading Act.[23]

Additionally, a shareholder can challenge a shareholders' resolution and seek to have a court declare it null and void by way of an action for avoidance. A successful challenge requires that the resolution violates German substantive law or the articles of association of the corporation (e.g., when the shareholder was not duly informed in advance about the

17 Judgment of the Federal Court of Justice dated 13 December 2011, NZG 2012, 263 (268 et seq.); *Kumpan*, in Hopt, HGB, 42nd Ed. (2023), WpHG Section 97 Paragraph 6.

18 See *Spindler*, in MünchKomm-AktG, Vol. 2, 6th Ed. (2023), AktG Section 117 Paragraph 53 et seq.

19 *Wagner*, in MünchKomm-BGB, Vol. 7, 8th Ed. (2020), Section 826 Paragraph 116 et seq.; *Ritter*, in Schüppen/Schaub, Münchener Anwaltshandbuch Aktienrecht, 3rd Ed. (2018), Section 24 Paragraph 67 et seq.; *Staudinger*, in Schulze, BGB, 11th Ed. (2022), Section 826 Paragraph 16.

20 See *Oechsler*, in Staudinger, BGB (2021), Section 826 Paragraph 531 et seq.

21 Judgment of the Higher Regional Court of Stuttgart dated 26 March 2015, ZIP 2015, 781 (783, 785); Judgment of the Higher Regional Court of Braunschweig dated 12 January 2016, ZIP 2016, 414 (416 et seq.).

22 *Grunewald*, in MünchKomm-AktG, Vol. 5, 5th Ed. (2020), AktG Section 327f Paragraph 2; Koch, AktG, 17th Ed. (2023), AktG Section 327f Paragraph 1; see *Müller-Michaels*, in Hölters/Weber, AktG, 4th Ed. (2022), AktG Section 327f Paragraph 13.

23 See Section 97 of the Securities Trading Act.

shareholders' meeting or the resolution). The shareholder must file the action for avoidance against the company in court within one month of the resolution being passed. Moreover, shareholders can apply for injunctive relief to prevent the implementation of a passed shareholder resolution by the company. However, the pre-emptive prevention of the passage of resolutions is generally inadmissible as it constitutes an undue anticipation of the decision on the merits.[24] In the context of an M&A transaction, a shareholder might seek injunctive relief in connection with a resolution of the general meeting of shareholders that approves of going forward with the transaction.

Shareholders may use an award proceeding as a special procedure for disputes concerning valuation-dependent compensation (e.g., regarding a squeeze-out).[25] It is for the court to choose the most appropriate method of valuation in accordance with the law. The decisive factor is that the respective method is recognised in the fields of economics or business administration and is customary in practice.[26] However, it is not uncommon for award proceedings to end in a settlement due to the long duration of the proceedings.[27]

iii Defences

As is the case in the United States, claims that are made against directors and officers are subject to high discretion regarding entrepreneurial decisions. Thus, if a member of the management board can demonstrate that they had sufficient information and could reasonably assume that the decision made was in the interest of the company, no conduct in breach of duty is assumed (business judgement rule). According to case law, directors and officers are consequently liable only in the event of unjustifiable conduct that significantly exceeds limits in relation to the company's well-being or constitutes an irresponsible assumption of risk.[28] However, a board member may invoke the business judgement rule only if they acted unrestrained by a conflict of interest.[29] The question of whether and to what extent a conflict of one board member affects the discretionary scope of the rest of the board members remains controversial under German law. A distinction is made based on whether the conflicted board member disclosed the conflict of interest to the board.[30] If they did so disclose, the business judgement rule is considered applicable to the other board members, provided that the conflicted board member did not participate in the preparation of the decision or in the passing of the resolution.[31]

Similarly, directors and officers can defend themselves against tort claims based on a violation of *bonos mores* if they were not aware of the occurrence of damage, the causality

24 See *Schäfer*, in MünchKomm-AktG, Vol. 4, 5th Ed. (2021), AktG Section 243 Paragraph 153 et seq.

25 Koch, AktG, 17th Ed. (2023), SpruchG Section 1 Paragraph 2; *Simons*, in Hölters/Weber, AktG, 4th Ed. (2022), SpruchG Section 1 Paragraph 1.

26 *Müller-Michaels*, in Hölters/Weber, AktG, 4th Ed. (2022), AktG Section 327f Paragraph 14.

27 *Kubis*, in MünchKomm-AktG, Vol. 5, 5th Ed. (2020), SpruchG Vorb. Paragraph 7.

28 *Koch*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 30 Paragraph 10 et seq.; Judgment of the Federal Court of Justice dated 21 April 1997, NJW 1997, 1926; Koch, AktG, 17th Ed. (2023), AktG Section 93 Paragraph 26.

29 *Spindler*, in MünchKomm-AktG, Vol. 2, 6th Ed. (2023), Section 93 Paragraph 69 et seq.; *Fleischer*, in BeckOGK/AktG (2023), AktG Section 93 Paragraph 96.

30 *Fleischer*, in BeckOGK/AktG (2023), AktG Section 93 Paragraph 97; *Spindler*, in MünchKomm-AktG, Vol. 2, 6th Ed. (2023), Section 93 Paragraph 72.

31 *Spindler*, in MünchKomm-AktG, Vol. 2, 6th Ed. (2023), Section 93 Paragraph 72.

of their own conduct or the circumstances justifying the alleged nature of their conduct.[32] Case law shows that the high threshold for a plaintiff to substantiate and prove a violation of *bonos mores* of an officer or director is difficult to satisfy. Even if directors and officers give misleading statements to investors in a situation characterised by intense speculation in the market, such conduct might not suffice to establish liability in tort if the corresponding questions by the investors could not be answered truthfully without disclosing the company's true intentions during that time.[33]

Under German law, the plaintiff generally bears the burden of substantiation and proof for all elements of the claim, including the damage suffered. Shareholders often face great difficulties when attempting to establish the occurrence of actual damage (e.g., damage based on the difference in share prices). This particular difficulty arises because – although it is possible to draw conclusions from the change in the share price immediately after insider information has become public – the influence of overall market movements also must be taken into account.[34] Demonstrating concrete damage becomes even more challenging where the insider information is gradually reflected in the stock market prices and not at a single moment in time.[35]

Furthermore, the company, along with its directors and officers, may invoke the statute of limitations as a defence against a claim. The limitation period for tort claims as well as claims under the Securities Trading Act is three years. This period commences at the end of the year in which the claim arose and the plaintiff obtained knowledge of the circumstances giving rise to the claim and of the identity of the defendant, or would have obtained such knowledge if they had not acted with gross negligence. Claims for damages based on the exploitation of influence on the company are time-barred after five years or, if the company is listed, after 10 years.

iv Advisers and third parties

Unless there is a contractual agreement or some other form of close connection between shareholders and M&A advisers or other third parties, which is rarely the case, there is usually no cognisable claim against such third parties under German law. However, a claim can be successful if the third party was substantially relied on by the shareholders and thereby significantly influenced their decision-making process. Case law shows that courts set a high threshold for establishing the existence of these conditions and additionally require that the third party must have personally warranted the reliability of its contractual counterparty as well as the eventual completion of the transaction.[36]

On the other hand, a claim may be based on a contract between the adviser and the company if it was deemed to provide protection also to the shareholders as third parties to

32 *Wagner*, in MünchKomm-BGB, Vol. 7, 8th Ed. (2020), Section 826 Paragraph 26.

33 A notable example is the case of *Porsche SE*. Investors claimed damages amounting to more than €1 billion based on a misleading press release in relation to the planned VW takeover. The court dismissed the action and ruled that in cases of informal communications to the capital market, stricter requirements must be set for establishing liability under claims in tort than in the case of false ad hoc disclosures (Judgment of the Higher Regional Court of Stuttgart dated 26 March 2015, ZIP 2015, 781 (784)).

34 See *Kumpan*, in Hopt, HGB, 42nd Ed. (2023), WpHG Section 97 Paragraph 6.

35 *Fleischer*, in Assmann/Schütze/Buck-Heeb, HdB-Kapitalanlagerecht, 5th Ed. (2020), Section 6 Paragraph 53.

36 Judgment of the Federal Court of Justice dated 12 December 2005, NJW-RR 2006, 993; see *Beisel*, in Beisel/Klumpp, Der Unternehmenskauf, 7th Ed. (2016), Section 17 Paragraph 17 et seq.

the contract. This requirement is fulfilled in cases in which the company has a particular interest in including the shareholders in the scope of protection of the contract, and the contract can be interpreted to the effect that the protection of the contract is to be extended to the shareholders. However, the adviser is liable only if they could recognise the inclusion of the shareholders in the scope of protection of the contract.[37] In addition, tort claims by shareholders against advisers also come into consideration, for instance, due to actions against *bonos mores*. This might be the case where advisers deliberately issue false reports regarding the target.[38]

v Class and collective actions

German law traditionally does not provide for class or collective actions. However, Germany has implemented two model case proceedings: the model case motion under the Capital Markets Model Case Act (KapMuG) and the model declaratory action (Section 606 et seq. of the German Code of Civil Procedure). Both proceedings aim to determine factual and legal issues that are equally relevant for a large number of individual proceedings by way of a model proceeding.[39] In addition, on 29 March 2023, the German government published its long-awaited draft bill on representative actions to transpose Directive (EU) 2020/1828 of 25 November 2020 on representative actions for the protection of the collective interests of consumers, repealing Directive 2009/22/EC.[40]

Under the KapMuG, a shareholder can file a model case motion that seeks the determination of factual or legal issues in relation to claims for damages due to incorrect public capital market information or claims for consideration in the context of takeover bids.[41] If at least 10 admissible and similarly directed model case motions are filed, the court of first instance issues an order for referral to the higher regional court and publishes this order. Upon publication of the order for referral, all courts of first instance must suspend proceedings in which the resolution depends on issues that will be determined in the model case proceeding. The higher regional court then selects a model plaintiff, exercising its reasonable discretion, and the remaining plaintiffs become co-appointees. Subsequently, the higher regional court renders a uniform decision on these issues, which is binding for all courts of first instance when they resume the suspended proceedings.

The model declaratory action, on the other hand, allows for certain registered institutions, essentially consumer protection organisations, to file a request for the determination of declaratory relief regarding the existence of factual and legal requirements of claims or legal relationships between consumers and an enterprise. Since the scope of application of the model declaratory action is not limited with regard to the subject matter, shareholders can –

37 *Beisel*, in Beisel/Klumpp, Der Unternehmenskauf, 7th Ed. (2016), Section 17 Paragraph 18.

38 *Heun-Rehn/Hoffmann*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 18 Paragraph 44 et seq.

39 *Schmitt*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 43 Paragraph 86.

40 The draft bill was first introduced to Parliament on 24 April 2023, Entwurf eines Gesetzes zur Umsetzung der Richtlinie (EU) 2020/1828 über Verbandsklagen zum Schutz der Kollektivinteressen der Verbraucher und zur Aufhebung der Richtlinie 2009/22/EG (Verbandsklagenrichtlinienumsetzungsgesetz – VRUG); the complete draft is available at https://dserver.bundestag.de/btd/20/065/2006520.pdf.

41 *Schmitt*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 43 Paragraph 20; *Schneider*, Kollektivrechtsschutz durch Verbraucherschutzverbände statt Class Actions?, BB 2018, 1986 (1988).

in theory – pursue a declaratory judgment through an institution.[42] However, it may often be doubtful whether the shareholders actually qualify as consumers within the meaning of the law, which is a key prerequisite for a plaintiff to be eligible to participate in a model declaratory action.

The proposed transposition of Directive (EU) 2020/1828 on representative actions is intended to strengthen the collective relief available to consumers and small businesses[43] (affected parties) in German courts and to relieve German courts of mass litigations.[44] The draft bill for the first time provides for a collective action that enables a request for payment. This significantly expands the model declaratory action currently in place, which is limited to a declaratory award clarifying issues of fact and law. However, individual consumers or businesses are not entitled to bring such a collective action. Rather, as in the case of a model declaratory action, only qualified entities are eligible to bring representative actions. They are required to show that there are (similar) claims by a large number of affected parties against a company, in which context it remains unclear whether shareholders qualify as consumers.

vi Insurance and indemnification

Companies regularly obtain directors' and officers' liability insurance (D&O insurance), which insures directors and officers as well as, in some cases, the company itself against liability incurred by the directors' and officers' actions. The insurance coverage includes claims for damage suffered by third parties outside of the corporate structure but also internally within the corporate structure. Therefore, the coverage includes claims both by the company itself and also by third parties against directors and officers.[45] Pursuant to statutory provisions, D&O insurance does not cover intentional misconduct of directors and officers. Instead, absent an express agreement extending coverage, insurance coverage is limited to lesser forms of fault, for example in cases in which a director considered it merely possible that their conduct might be unlawful and trusted that it was not, as opposed to having positive knowledge of the unlawfulness.[46] However, it is not uncommon and is legally feasible for the parties to an insurance contract to expressly deviate from statutory law to extend insurance coverage to intentional misconduct.[47] Statutory law requires that D&O insurance coverage for members of the management board must not amount to more than 90 per cent of the damage, and has to provide that a management board member is subject to an excess of at least 10 per cent.[48]

42 *Schneider*, Kollektivrechtsschutz durch Verbraucherschutzverbände statt Class Actions?, BB 2018, 1986 (1989).

43 Small businesses (i.e., those with fewer than 50 employees and an annual turnover or a balance sheet of no more than €10 million) shall be deemed to be consumers. This opens the door for representative actions in a business-to-business context.

44 For example, in the cases relating to nitrogen oxides emissions, tens of thousands of separate lawsuits were brought by customers against vehicle manufacturers, particularly Volkswagen.

45 *Armbrüster*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 108 Paragraph 1.

46 See *Seitz*, Vorsatzausschluss in der D&O-Versicherung - endlich Licht im Dunkeln!, VersR 2007, 1476.

47 *Heun-Rehn/Hoffmann*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 18 Paragraph 13.

48 See Section 93 Paragraph 2 Sentence 3 of the Stock Corporation Act.

vii Settlement

With regard to individual settlements, there are no particular procedural aspects to consider that are specific to shareholder claims. The Capital Markets Model Case Act does not offer any particular possibility of settlement either. The Code of Civil Procedure contains statutory provisions for the settlement of a model declaratory action between an institution and the defendant. However, practice shows that the parties use other means to settle disputes connected to a model declaratory action. For instance, in *Federation of German Consumer Organisations v. Volkswagen AG*, the largest model declaratory action in Germany to date (though not an M&A dispute), Volkswagen AG concluded individual settlements with consumers instead of concluding a settlement with the institution in accordance with statutory provisions. Subsequently, the institution withdrew its action.[49]

IV COUNTERPARTY CLAIMS

Claims between the parties to a transaction are the most common form of dispute that arises in the context of an M&A transaction either before or after closing. This section outlines substantive law and procedural aspects to be considered with regard to this category of claims.

i Common claims and procedure

Common counterparty claims are contractual claims based on breaches of representations and warranties or guarantees, statutory warranty claims and statutory liability claims.[50] The latter category also includes pre-contractual liability claims and claims under tort law.[51] Furthermore, a party may exercise a right to rescind a contractual declaration when the – rather strict – statutory prerequisites are met, including, in particular, on the ground of deceit or duress.

Disputes arising before the signing of the purchase agreement predominantly involve pre-contractual liability claims (*culpa in contrahendo*).[52] Three different scenarios are generally recognised as potentially constituting a breach of a pre-contractual duty by a party that may give rise to liability.[53] In the first scenario, a party only pretends to be interested in concluding a contract with the counterparty, and the counterparty incurs costs by relying on this false representation (e.g., costs for its advisers).[54] In the second scenario, the parties have already commenced contract negotiations, but subsequently one party abandons these negotiations without cause. In the third scenario, a counterparty violates its duty of disclosure by providing

49 See *Gurkmann/Jahn*, Außergerichtlicher Vergleich im Rahmen einer Musterfeststellungsklage, VuR 2020, 243.

50 *Becker/Mallmann*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 134 Paragraph 1.

51 *Becker/Mallmann*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 134 Paragraph 95.

52 *Elsing/Kramer, Post M&A Disputes under German Law in Festschrift für R. Geimer, Fairness Justice Equity*, 2017, p. 70.

53 *Becker/Mallmann*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 134 Paragraph 113 et seq.

54 *Mehrbrey/Jaeger*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 3 Paragraph 4.

incorrect information or omitting information.[55] In this regard, the broad assumption of a pre-contractual duty of disclosure in the case law of the German Federal Court of Justice (FCJ) as well as related considerations of attribution of knowledge must be observed.[56] Even in contract negotiations in which the parties pursue opposing interests, a party may be obligated to inform its counterparty of such circumstances that are, for example, likely to frustrate the purpose of the agreement pursued by the counterparty if it does not or cannot know these circumstances.[57] For example, in a decision applying the FCJ's case law, the Higher Regional Court of Munich considered the scope of pre-contractual disclosure obligations and the consequences of breaching such obligations.[58] The Court held that the seller of a company is generally obliged to inform the purchaser, even without a specific enquiry by the purchaser, of specific events that constitute significant indications of an ongoing crisis of the company. In that case, the contractually agreed exclusion of liability for the purchaser's rights and claims based on defects did not apply since such exclusion did not encompass culpable breaches of pre-contractual disclosure obligations. This decision illustrates the importance of a properly conducted due diligence and the risk that the contractual liability regime might be undermined by the mandatory statutory liability regime.

Since the different claim scenarios of pre-contractual liability claims essentially have the same basis in law, the prerequisites to mount a successful claim in each scenario are to establish:

a that a breach of duty has occurred;
b that the counterparty is at fault for this breach of duty;
c that this breach of duty has caused damage to the plaintiff; and
d the amount of damage incurred by the plaintiff.[59]

In addition to pre-contractual liability claims, a party's alleged misconduct in relation to contract negotiations may also give rise to tort claims.[60]

Other pre-closing disputes can arise out of various agreements concluded before and after the signing of the purchase agreement, including non-disclosure agreements, exclusivity agreements and break-up fee arrangements.[61]

In some cases, the parties may also dispute whether a valid purchase agreement has been concluded and therefore whether either party may be compelled to close the transaction.

55 *Becker/Mallmann*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 134 Paragraph 114.

56 *Risse*, Wissenszurechnung beim Unternehmenskauf: Notwendigkeit einer Neuorientierung, NZG 2020, 856 (856 et seq.).

57 Judgment of the Federal Court of Justice dated 25 July 2006, NJW 2006, 3139 Paragraph 18.

58 Judgment of the Higher Regional Court of Munich dated 3 December 2020, NZG 2021, 423.

59 *Mehrbrey/Hofmeister*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 4 Paragraph 2.

60 *Mehrbrey/Hofmeister*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 4 Paragraph 13.

61 *Mehrbrey/Jaeger*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 3 Paragraph 5; *Wächter*, in M&A Litigation, M&A Recht im Streit, 4th Ed. (2022), Chapter 1, Part IV.

Such scenarios commonly arise in relation to the exercise of call options for buyers and put options for sellers. In both cases, the contract is concluded by exercising the option in favour of the respective party.[62]

In the time period between signing and closing, the buyer may exercise the right to reform or exit the purchase agreement due to a material change in circumstances based on either a contractual clause concerning material adverse change (MAC) or material adverse events (MAE), or based on statutory provisions. MAC and MAE clauses are designed to protect the buyer from significant deterioration of the target between signing and closing. The absence of a MAC is usually agreed on as a closing condition.[63] In the event that a significant deterioration occurs, the buyer is not obliged to close the transaction since the closing condition is not fulfilled. The seller then has the opportunity to remedy the deterioration until an agreed long-stop date. If the situation is not remedied within the agreed time frame, the buyer is entitled to withdraw from the transaction. Absent an agreement on a MAC or MAE clause, a party may alternatively invoke frustration of the basis of the transaction pursuant to statutory law in order to seek a revision of contract provisions or to revoke the contract as a whole.[64] The law distinguishes between two scenarios. In the first scenario, the basis of the transaction is frustrated due to a change in circumstances after the conclusion of the contract. In the second scenario, material assumptions of the parties that have become the basis of the transaction are found to be incorrect.[65] However, parties can contractually agree to limit or waive this statutory right, instead replacing it with a contractual regime of MAC and MAE provisions.[66]

Post-closing claims are predominantly contractual claims based on alleged breaches of guarantees and warranties or indemnification clauses. Consequently, such clauses are regularly negotiated and formulated with great specificity. Notably, on the other hand, all statutory provisions and statutory claims that can be waived are usually waived in purchase agreements, thereby replacing the statutory regime of claims with the negotiated contractual regime of claims. However, certain statutory provisions and case law of the FCJ prevent the waiver of statutory claims arising from intentional conduct of a counterparty as well as rights of a party in cases of fraud.[67] As a result, there is a risk that the contractually agreed liability regime might be undermined by the mandatory application of statutory law, including due to the far-reaching case law concerning the attribution of knowledge in companies.[68] Parties also often agree on caps and *de minimis* provisions that might limit or exclude contractual claims based on warranties.[69]

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62 *Mehrbrey/Jaeger*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 3 Paragraph 7.

63 *Kästle/Haller*, Schieds- oder Schiedsgutachterverfahren zur Feststellung eines Material Adverse Change (MAC) beim Unternehmenskauf, NZG 2016, 926.

64 *Finkenauer*, in MünchKomm-BGB, Vol. 3, 9th Ed. (2022), Section 313 Paragraph 81.

65 *Finkenauer*, in MünchKomm-BGB, Vol. 3, 9th Ed. (2022), Section 313 Paragraph 54.

66 *Finkenauer*, in MünchKomm-BGB, Vol. 3, 9th Ed. (2022), Section 313 Paragraph 51.

67 *Becker/Mallmann*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 134 Paragraph 95; *Elsing/Kramer, Post M&A Disputes under German Law in Festschrift für R. Geimer, Fairness Justice Equity*, 2017, p. 72.

68 See *Risse*, Wissenszurechnung beim Unternehmenskauf: Notwendigkeit einer Neuorientierung, NZG 2020, 856; *Schudlo/Kersten*, Kenntnis im Haftungssystem des Unternehmenskaufs, BB 2021, 1154 (1157 et seq.).

69 *Elsing/Kramer, Post M&A Disputes under German Law in Festschrift für R. Geimer, Fairness Justice Equity*, 2017, p. 72.

A buyer may also raise claims for indemnification in the event that a previously identified (usually in the due diligence process) risk that was included in an indemnity clause materialises.[70] With regard to these often extensively negotiated warranty and indemnity clauses, warranty and indemnity insurance (W&I insurance) has become increasingly popular and thus provides a new avenue for counterparties to seek compensation.[71] With the help of such W&I insurance, the seller's liability for breaches of warranty is excluded to a certain extent. Instead, the buyer may have recourse to the insurer in the case of an insured event, and therefore is not exposed to the insolvency risk of the seller. Consequently, the policies are almost always held by the buyers.[72] Moreover, purchase price adjustment mechanisms, for example, by means of closing date accounts, may also give rise to claims between the parties for positive or negative adjustment amounts.[73]

With regard to the burden of substantiation and proof, a party generally must present and prove in a substantiated manner the facts on which it relies and which are favourable for its claim or defence. However, as pretrial discovery (or disclosure) is not a feature of German litigation practice, the German Civil Code partially provides rules for presumptions of fact with regard to individual elements of a claim. A prominent example is the presumption of the counterparty's fault for a breach of contract if the plaintiff succeeds in establishing factually and legally that the defendant committed a breach. German case law provides for additional rules to be considered, such as a secondary burden of substantiation and proof of the counterparty as well as the recognition of prima facie evidence. In the likely event that the parties have opted for arbitration, the arbitration proceedings may include a document production phase.[74]

ii Remedies

The appropriate and available remedies against counterparties depend on the underlying claim and its objective. If one party seeks to compel the closing of the transaction, for instance after exercising a call option, it can pursue such claim with a suit for performance. However, in most cases, a plaintiff will seek monetary compensation from its counterparty by way of a claim for payment.[75] Depending on the damage suffered and on the type of claim, this compensation may aim at restoring the status quo ante or even to recover lost profits. Although German civil law allows agreements of contractual penalties and liquidated damages, it does not provide for punitive damages.

Furthermore, a plaintiff can also seek a judgment ordering the defendant to indemnify the plaintiff from certain liabilities. In addition, a plaintiff can seek declaratory relief to the extent that damages cannot be fully assessed at the time of the decision, or if the declaration sought is prejudicial to further litigation. For example, a party may seek a declaratory judgment that the purchase agreement was not effectively concluded or that the counterparty

70 *Becker/Mallmann*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 134 Paragraph 42.

71 See *Hoger/Baumann*, Der M&A-Vertrag bei Abschluss einer W&I-Versicherung, NZG 2017, 811.

72 See *Hoger/Baumann*, Der M&A-Vertrag bei Abschluss einer W&I-Versicherung, NZG 2017, 811.

73 *Elsing*, in Salger/Trittmann, Internationale Schiedsverfahren, 1st Ed. (2019), Section 28 Paragraph 58.

74 *Becker/Mallmann*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 134 Paragraph 213.

75 See *Mehrbrey*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 2 Paragraph 37.

does not hold particular claims against the party. A plaintiff also has the option to bring a multi-tiered claim that, as a first step, asserts a right of disclosure against the defendant and, as a second step, seeks further relief (e.g., payment of a purchase price adjustment amount or damages on the basis of the disclosed information). In such multi-tiered proceedings, the plaintiff's entitlement to disclosure is based on a substantive claim to receive information against the defendant, rather than disclosure being a procedural feature of the proceeding.

In urgent cases, a party can apply for a preliminary injunction, in particular for the purpose of securing a certain status quo, for instance to prevent shares or assets from being sold to third parties.[76]

iii Defences

To the extent that the statute of limitations pursuant to the German Civil Code applies, a party can invoke as a defence that the claim is time-barred. The regular statutory limitation period in most cases is three years, but only two years for common statutory warranty claims. However, it is common practice in German purchase agreements to waive the statutory limitation periods and negotiate limitation periods that are tailored to the needs of the parties and the transaction. For particular guarantees such as a warranty of title, an agreement on longer limitation periods of up to 15 years is not unusual.[77] In the context of indemnification claims, there is a specific risk that the right to indemnification could become time-barred before the event for which indemnification can be sought occur (e.g., a third-party claim). Therefore, the statute of limitations deserves particular attention when drafting an indemnification clause but also in M&A disputes concerning indemnification more generally.[78]

German procedural law also provides for the possibility to involve a third party in a pending lawsuit by way of a third-party notice. A party typically employs this procedural mechanism if there is a risk of an adverse decision, as a result of which the party would be able to assert a warranty or compensation claim in subsequent litigation against the third party. As a result of the third-party notice, the court in such subsequent litigation is bound by the reasoning of the decision from the preceding litigation to the benefit of the plaintiff. Absent a third-party notice, the third party otherwise would not be bound by any *res judicata* effect of the preceding litigation.

iv Arbitration

M&A disputes in Germany are predominantly adjudicated by arbitral tribunals in private commercial arbitration proceedings. In most German M&A transactions, and especially in transactions involving foreign parties, the parties include an arbitration clause in the purchase agreement or enter into a separate arbitration agreement.[79]

76 See *Mehrbrey*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 2 Paragraph 58.

77 *Bisle*, Gewährleistungs- und Garantieklauseln in Unternehmenskaufverträgen, DStR 2013, 364 (366).

78 *Becker/Mallmann*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 134 Paragraph 51 et seq.

79 See *Elsing/Kramer, Post M&A Disputes under German Law in Festschrift für R. Geimer, Fairness Justice Equity*, 2017, p. 69; *Becker/Mallmann*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 134 Paragraph 192; *Mehrbrey/Pörnbacher/Baur*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 2 Paragraph 60 et seq.

The key reasons for selecting arbitration include, among others, the ability to nominate arbitrators with regard to their qualifications, experience and suitability for a particular dispute; greater flexibility and influence on how to conduct the proceedings; and the (potential) higher level of confidentiality in arbitration compared with litigation, which involves public court hearings.[80] Moreover, the parties may agree that the proceedings shall be conducted in English and that English language documents may be introduced into the proceedings without a German translation, which saves translation costs and also makes it easier for foreign parties to manage the proceedings.[81] Particularly in transactions involving parties outside the European Union, arbitration is also attractive due to the relative ease of international enforcement of arbitral awards, especially under the New York Convention.[82]

Parties may also agree on an expert proceeding to render a final and binding determination of individual issues (e.g., the determination of a purchase price in the context of a purchase price adjustment mechanism in the purchase agreement).[83] Especially in disputes concerning questions of accounting or valuation only, an expert determination potentially offers a quicker solution.[84] Generally, however, parties tend to agree on a comprehensive arbitration agreement that comprises all disputes arising out of or in connection with the transaction.[85] In contrast, a two-tier dispute resolution mechanism (e.g., tier one mediation, tier two arbitration) is uncommon in German M&A disputes.[86]

The leading institution in Germany for the administration of arbitrations is the DIS. The latest version of the DIS institutional rules was published in 2018.[87] The DIS also offers special rules, among others, for corporate law disputes and for expert determination. Alternatively, an arbitration proceeding administered by the International Chamber of Commerce and pursuant to its Arbitration Rules also represents a popular choice for dispute resolution in M&A transactions with a German nexus.

v Other issues

As mentioned above, most German M&A disputes are decided by private arbitral tribunals. As a flipside of this preference for arbitration, domestic courts are rarely called on to address and render opinions on key issues in M&A disputes. As a result of this lack of court involvement, and since most arbitral awards are not made public, little German case law is

80 *Elsing*, in Salger/Trittmann, Internationale Schiedsverfahren, 1st Ed. (2019), Section 28 Paragraph 3.

81 *Elsing/Kramer, Post M&A Disputes under German Law in Festschrift für R. Geimer, Fairness Justice Equity*, 2017, p. 76.

82 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958); see *Mehrbrey/Pörnbacher/Baur*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 2 Paragraph 64.

83 *Pörnbacher/Baur*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 2 Paragraph 70.

84 *Pörnbacher/Baur*, in Mehrbrey, Handbuch Streitigkeiten beim Unternehmenskauf, 2nd Ed. (2022), Section 2 Paragraph 69.

85 *Elsing/Kramer, Post M&A Disputes under German Law in Festschrift für R. Geimer, Fairness Justice Equity*, 2017, p. 75.

86 See *Elsing/Kramer, Post M&A Disputes under German Law in Festschrift für R. Geimer, Fairness Justice Equity*, 2017, p. 75.

87 https://www.disarb.org/en/tools-for-dis-proceedings/dis-rules.

available to provide guidance on common key issues in (large and complex) M&A disputes.[88] It is therefore all the more important that the personal knowledge and experience of legal counsel and arbitrators regarding M&A disputes are taken into account.[89]

Irrespective of the civil law aspects, a party, usually on the purchaser side, sometimes files charges of criminal fraud with the public prosecutor's office in order to increase the pressure on the other party in a post-M&A dispute and to influence the other party's willingness to settle. However, in addition to the risk of loss of reputation for both sides, such an action – once initiated – is outside the parties' control, since the public prosecutor's office decides autonomously on the proceedings.[90]

V CROSS-BORDER ISSUES

The frequent adoption of arbitration agreements by parties to German M&A transactions helps avoid some of the common complications that arise in litigation involving parties from different countries (e.g., in relation to international services of notice and briefs, the language of the proceedings, the taking of evidence and the enforcement of the decision).

Absent a specific dispute resolution clause, the court's jurisdiction will need to be determined pursuant to the Brussels Ia Regulation or the Lugano Convention, respectively, in conjunction with the German Code of Civil Procedure. The case will typically be heard before a chamber of commerce at a regional court. Several regional courts, including the Regional Courts of Frankfurt (Main),[91] Hamburg[92] and Stuttgart,[93] have established special chambers to adjudicate international commercial disputes. At the Regional Court of Düsseldorf, specialised chambers were recently created with exclusive jurisdiction over certain M&A disputes in the state (e.g., those that exceed a certain threshold value in dispute), while a special chamber was also established at the Higher Regional Court of Düsseldorf to adjudicate such cases on the appellate level.[94] These chambers are composed of highly skilled judges who possess strong knowledge in the field of M&A transactions and who can develop even more profound expertise through the chambers' exclusive work on transactional cases.

Stuttgart's and Mannheim's 'commercial courts', which were established in 2020, have since adjudicated around 400 cases, while around 200 cases are still pending before the courts. The value in dispute in these 600 proceedings amounts to a total of about €500 million. On average, it took the commercial courts around six months to render a

88 See *Louven/Mehrbrey*, Bedeutung aktueller M&A-Streitigkeiten für die Gestaltungspraxis, NZG 2014, 1321.

89 *Becker/Mallmann*, in Born/Ghassemi-Tabar/Gehle, MHdBGesR, Vol. 7, 6th Ed. (2020), Section 134 Paragraph 1.

90 *Reichling/Corsten/Borgel*, M&A-Transaktionen und das Straf- und Ordnungswidrigkeitsrecht (Teil I): Risiken für die Verkäuferseite, BB 2021, 1545.

91 See, for instance, Chamber for International Commercial Disputes at the Regional Court of Frankfurt (Main): https://ordentliche-gerichtsbarkeit.hessen.de/landgerichtsbezirk-frankfurt-am-main/landgericht-frankfurt-am-main/chamber-for-international-commercial-disputes.

92 See https://justiz.hamburg.de/pressemitteilungen/10983386/pressemitteilung-2018-04-30-olg-01/.

93 See the Stuttgart Commercial Court, https://www.commercial-court.de/en/commercial-court.

94 On these special chambers, see https://www.lg-duesseldorf.nrw.de/aufgaben/qualitylaw/mergers/index.php.

decision.[95] These statistics show that, in light of Germany's efforts to bundle relevant expertise in special chambers, parties to M&A transactions are gradually becoming more comfortable with submitting potential disputes to domestic courts.

In a dispute involving a German party before a US court, the German party might seek to avert discovery by asserting that the production of documents would violate German and European data privacy law. However, US courts have ruled against the German party in cases where the documents to be produced were subject to a protective order and the interest of the party seeking the discovery outweighed the interest of the German party.[96] Additionally, a recent legislative change[97] has significantly expanded the ability of US courts to successfully seek German courts' assistance in pretrial discovery: under the new law and assuming that certain prerequisites are met, the competent authority in Germany (usually a regional court or higher regional court) is required to grant a US court's application to provide documents located in Germany that the US court seeks as part of its pretrial discovery.

Although pretrial discovery is not generally available in German proceedings, a party to an M&A dispute may, in principle, seek the aid of US courts to order discovery by means of an application pursuant to 28 USC Section 1782.[98] The scope of this instrument will, however, likely decrease in M&A disputes in view of the recent US Supreme Court decision in which the Court held that Section 1782 is not applicable to international arbitration proceedings.[99] Nevertheless, Section 1782 remains applicable to court proceedings before domestic courts in Germany.

VI YEAR IN REVIEW

In the past year, Germany has intensified its efforts to incentivise parties to M&A transactions to resolve potential disputes in domestic courts rather than subject themselves to arbitration. On the federal level, the German legislator is still debating a legislative draft bill[100] that would allow federal states to establish special chambers at higher regional courts. The commercial courts would have first instance jurisdiction over certain M&A disputes, provided that the amount in dispute equals or is greater than €1 million and the parties have agreed on this

95 See press release of Baden-Württemberg dated 9 May 2023, Commercial Courts ziehen eindrucksvolle Bilanz: https://www.baden-wuerttemberg.de/de/service/presse/pressemitteilung/pid/commercial-courts-ziehen-eindrucksvolle-bilanz.

96 See *Brightedge v. Searchmetrics*, US District Court for the Northern District of California, Order of 8 November 2017 - 14-cv-01009-HSG (MEJ), BeckRS 2017, 132018.

97 See Section 14 (as amended on 24 June 2022) of the German Act implementing the Hague Convention of 15 November 1965 on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters and the Hague Convention of 18 March 1970 on the Taking of Evidence Abroad in Civil or Commercial Matters.

98 See *Kreindler/Nettlau*, in Salger/Trittmann, Internationale Schiedsverfahren, 1st Ed. (2019), Section 14, Paragraph 1 et seq.

99 *ZF Automotive US, Inc v. Luxshare, Ltd*, 596 U.S. __ (2022).

100 On 25 April 2023, the German Federal Ministry of Justice published a draft bill, Entwurf eines Gesetz zur Stärkung des Justizstandortes Deutschland durch die Einführung von Commercial Courts und der Gerichtssprache Englisch in der Zivilgerichtsbarkeit; the complete draft is available at https://www.bmj.de/SharedDocs/Downloads/DE/Gesetzgebung/RefE/RefE_Justizstandort_Staerkung.pdf?__blob=publicationFile&v=3.

proceeding.[101] This would allow for a more efficient adjudication of transactional disputes by reducing the court proceeding to two instances (usually, the higher regional courts' jurisdiction is limited to second instance proceedings and they would only adjudicate a case on appeal). Under the proposed framework, any decision by the higher regional court's special chamber could be appealed directly to Germany's highest civil court, the FCJ.

The draft bill provides for another significant novelty, as it authorises German federal states to issue regulations allowing for certain commercial disputes to be conducted exclusively in English.[102] Under the current legal framework, it is already possible for hearings to be conducted in English and for certain English documents to be introduced into a proceeding without providing a translation. However, due to the official court language being German, certain documents and briefs have thus far been required to be submitted in German, including, for example, the statement of claim itself. The new framework would allow for a proceeding that is conducted entirely in English, making it easier for international parties to a dispute to effectively pursue their interests. Notably, if a decision rendered in such a proceeding is appealed to the FCJ, the proposal stipulates that even the FCJ proceeding can be conducted in English.

Finally, in an effort to overcome another obstacle that repeatedly discourages parties to an M&A transaction from litigating their disputes in state courts, the draft bill creates procedural rules that are designed to improve the protection of business secrets in judicial proceedings.[103] Often, parties opt for arbitration because conducting a case before an arbitral tribunal is considered to provide a higher level of secrecy than state court litigation. The draft bill tries to ensure the same level of protection of business secrets by introducing a procedure by which parties can seek the acknowledgement of the court that certain information should be deemed confidential and thus should not be accessible to the public at any point during or after the dispute.

These legislative efforts on the federal level and the aforementioned increasing activity of special commercial chambers at various regional courts underline the ongoing endeavour to strengthen German civil courts' capacities to handle (large) international commercial disputes.

101 See draft bill, 25 April 2023, p. 5.

102 See draft bill, 25 April 2023, p. 6 et seq.

103 See draft bill, 25 April 2023, p. 8.

Chapter 7

ITALY

Giuseppe Scassellati-Sforzolini, Carlo Santoro, Paolo Rainelli and Davide Raul Gianni[1]

I OVERVIEW

M&A-related disputes in Italy traditionally are rather frequent. However, the number of new disputes appears to have decreased in the past two years, with most cases involving small and medium-sized M&A deals, probably because transaction documents in smaller deals may be less sophisticated. The overall decreasing trend in M&A-related disputes is, most importantly, due to the shrinking volume of M&A deals as a result of increasing interest rates, deteriorating market conditions and other contingent factors. Fewer transactions lead to fewer disputes.

Parties usually prefer arbitration, and frequent recourse to arbitration implies that important decisions may remain confidential and not publicly available. Rulings by arbitral tribunals are generally faster than decisions in ordinary litigation before Italian courts. The average duration of an arbitration proceeding before the Milan Chamber of Arbitration, for example, is 13 months.[2] By contrast, the average duration of litigation before Italian lower courts is around two years, with six or seven additional years in the aggregate in case of appeal before the Court of Appeal and then before the Supreme Court.[3] M&A disputes do not generally deviate from such an average.

Italian courts are generally competent and knowledgeable on corporate matters, particularly in Milan and Rome, with specific departments staffed by experienced judges. Additionally, the costs are significantly lower in litigation than in arbitration, with negligible court fees. As a result, particularly for small and medium-sized M&A deals, parties may be more inclined to opt for exclusive court jurisdiction clauses instead of arbitration clauses.

In 2023, a new civil procedure reform came into force with the aim of expediting litigations.[4] The reform also involves arbitration, providing that arbitral tribunals may now issue interim orders and provisional measures pending the arbitration proceedings. Most of the new provisions apply only to proceedings initiated in the course of 2023, and the actual impact of the reform may be properly assessed only in the coming years.

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2 Milan Chamber of Arbitration, Report Annuale – Arbitrato, 2023, p. 7, available at https://www.camera-arbitrale.it/upload/documenti/statistiche/2022/report%20arbitrato%20CAM%20dati%202022.pdf.

3 European Commission for the Efficiency of Justice, European judicial systems: CEPEJ Evaluation Report, 2022, p. 75, available at https://rm.coe.int/cepej-fiche-pays-2020-22-e-web/1680a86276.

4 Legislative Decree No. 149 of 10 October 2022.

II LEGAL AND REGULATORY BACKGROUND

Private M&A is primarily regulated by the Italian Civil Code, while public M&A is also governed by the Italian Consolidated Financial Act.[5]

M&A transactions must also comply with Italy's foreign direct investments regime when the companies involved operate in certain strategic sectors or hold certain strategic assets.[6]

Depending on the sectors involved in the proposed transaction, M&A deals may also be subject to review by independent authorities. M&A deals may be subject to antitrust clearance by the Italian Antitrust Authority or the European Commission, if a proposed transaction meets the relevant Italian or EU thresholds, as well as to scrutiny by the government authority of Italy responsible for regulating the Italian securities market, Consob (for public M&A); the Bank of Italy, the Institute for the Supervision of Insurance (IVASS) and the European Central Bank (for banks, insurance companies and other financial institutions); and the Communications Authority (for telecoms and media companies).

III SHAREHOLDER CLAIMS

i Common claims and procedure

In the context of M&A shareholder litigation, most claims are brought by investors against the target company or its directors, or both, claiming that they invested in the company on the basis of misleading or inaccurate information. Claims are often dismissed (with some exceptions) or settled before a decision on the merits is issued.

In a recent case brought before the Court of Milan,[7] a buyer sued the management of the target, claiming to have invested based on false financial statements and other misleading information. The buyer acquired a majority shareholding in a company that went bankrupt a year later. The Court of Milan, despite the obvious failure of the investment, rejected the claim. The buyer was indeed a company with professional investment expertise and with an experienced banker as director. Due to that, and considering that such director had a very close de facto relationship with the target, the Court held that the buyer already knew of the target's difficult situation and nevertheless decided to make a speculative and risky investment.

In another case, the Court of Milan agreed with the plaintiff investor,[8] who had invested in a company by subscribing to a share capital increase. Only one year after the investment, due to the effect of severe financial distress that had been concealed up to that moment, the company was forced to make a further massive share capital increase with severe dilutive effects on existing equity: the value of the investor's shareholding was reduced to less than 5 per cent of the initial investment. In this case, the Court found that the false information provided by the company was at the core of the decision to invest in the company in the first place. As a result, the company was ordered to indemnify the plaintiff for the entire payment made at the time of the subscription of the first capital increase minus the value of the shares at the time of the announcement of the new capital increase.

5 Legislative Decree No. 58 of 24 February 1998.

6 Decree-Law No. 21 of 15 March 2012.

7 Court of Milan, Judgment No. 6694 of 1 August 2022.

8 Court of Milan, Judgment No. 5894 of 24 May 2017.

Shareholder litigation cases also result from takeovers of listed companies, which is a highly regulated sector. Directors can be sued, for example, for providing misleading or false information to prevent the success of a hostile takeover.

In one case, a group of shareholders of a listed company brought a claim against the members of the board of directors in charge when the company was the target of a tender offer.[9] The announcement of the offer increased the share price on the market, but the directors issued the required public statement[10] expressing a negative view on the offer, which was ultimately unsuccessful. The company went bankrupt within two years of the bid failing. The shareholders claimed that the directors had issued a false statement that did not describe the critical condition of the company and sought indemnification for an amount equal to the share price they would have received by accepting the offer. The Court rejected the shareholders' claims. According to the Court, the statement issued by the directors of a company subject to a takeover bid is necessarily subjective in nature, and the directors are entitled to express their views on the offer, provided that such views do not misrepresent or omit to disclose information relevant to a fair evaluation of the offer or are otherwise inconsistent with the information on the offer.

ii Remedies

As discussed, shareholder claims are typically addressed against the directors of the target company or against the target company itself. The remedy typically sought is compensation of damages, and in cases of claims against the directors, their liability is joint and several.

The action against the directors is promoted following a resolution of the shareholders' meeting or the board of the statutory auditors.[11] A derivative action against directors may also be brought on the initiative of minority shareholders, provided that certain thresholds are met.[12]

Directors may also be liable towards individual shareholders or third parties (typically the company's creditors) where they have suffered direct damage to their assets (rather than to the assets of the company) as a result of the directors' negligent or fraudulent conduct.[13]

iii Defences

Business judgement rule

It is not common for directors to be found liable for their conduct in M&A transactions. Moreover, most cases are settled before a decision is reached.

Directors owe a general duty of due care and diligence based on the nature of their office and on their expertise. In general, non-executive directors carry no liability for damages following actions or omissions relating to the exercise of powers formally or de facto delegated to the executive committee or to one or more executive directors. However, whether executive or non-executive, directors must act in an informed manner and are jointly and severally liable if they fail to do what is in their power to avoid or reduce the harmful consequences of actions or omissions that they are aware could cause damage to the company.

9 Court of Brescia, judgment of 17 March 2020.

10 A board statement on the offer is required under Article 103 of the Italian Consolidated Financial Act.

11 Article 2393 of the Italian Civil Code.

12 Article 2393 *bis* of the Italian Civil Code.

13 Article 2395 of the Italian Civil Code.

The burden of proof and the evidence standards needed to establish directors' liability are high and difficult to meet. Even if a director's conduct results in negative results for the company, possibly detrimental to its assets, this is not sufficient to prove a breach of the duty of care, as it is necessary to establish that the director acted irrationally according to an *ex ante* assessment. This is a long-established principle in the Italian courts. For example, in a case decided by the Milan Court of Appeal, a company sued its managing director for having acquired a controlling interest in another company without being aware of the target's poor economic conditions. The Court held that the director had not breached his duty of care because (1) the acquisition of the target, although highly damaging to the purchaser, had been preceded by due diligence and by internal and external audits and (2) the transaction process was highly complex and well documented.[14]

A recent decision of the Venice Court of Appeal may provide some practical guidance as to when the duty of care may be deemed breached.[15] The Court found a director to have breached his duty of care as he entered into an asset purchase agreement carelessly without taking any appropriate precautions. After completing the acquisition of certain land for the installations of photovoltaic panels, the company found out that the panels could not be installed due to environmental restrictions that made it impossible to obtain the required construction permits. In this case, the director's lack of care was rather self-evident. Not only had the director failed to exercise any ordinary care in identifying the relevant building restrictions but also he had failed to include in the purchase agreement any form of protection in the event that the necessary administrative permits were not obtained.

Directors' dissent

Directors can prevent personal liability by expressing their dissent to board resolutions. Liability actions may not be brought against those directors who clearly express their dissent with respect to a prejudicial action, request such dissent to be recorded in the minutes of the board meeting and give prompt written notice to the chair of the board of statutory auditors.[16]

Waivers

In the case of directors of target companies, their liability for breach of their duty of care is rarely established because, when an acquisition takes place, buyers and sellers often agree to a waiver of liability with regard to the target's directors for their actions and conduct prior to the acquisition.

Liability waivers for a director's conduct may also be granted prior to a potentially prejudicial conduct. However, unlike subsequent waivers,[17] advance waivers may not exonerate wilful misconduct or gross negligence.[18]

14 Milan Court of Appeal, judgment of 30 March 2001.

15 Venice Court of Appeal, Judgment No. 127 of 18 January 2023. The decision relates to an asset purchase and not a share deal between companies but is nonetheless indicative of the duties of a director also in the context of M&A deals.

16 Article 2392 of the Italian Civil Code.

17 Court of Milan, Judgment No. 2727 of 31 March 2021.

18 Article 1229 of the Italian Civil Code. Court of Milan, Judgment No. 7358 of 17 September 2021.

iv Advisers and third parties

Expert opinions

Shareholder claims in M&A disputes may also involve experts engaged in the context of the M&A deal, including, for example, to carry out due diligence or provide a fairness opinion.

Under Italian law, professionals cannot be held liable for failing to achieve the results expected by the client. Indeed, they may be liable to the client only if they have not acted according to the standards that may reasonably be expected in the performance of their specific duties.[19] In addition, when the professional's performance involves the solution of particularly complex problems, the professional is liable only in cases of wilful misconduct or gross negligence.[20] The complexity of the assignment may therefore limit the liability of experts for possible errors.

Also, the liability of experts is often subject to contractual restrictions and limitations. Letters of appointment may state that the information received from the client is assumed to be true and accurate and that the expert has no obligation to check its accuracy and reliability. Such a disclaimer was at the core of a decision by the Court of Milan on a fairness opinion rendered in a case involving major advisory firms and banks.[21] The client was the largest shareholder of an Italian bank, which, in order to finance the acquisition of a target bank, resolved to increase its share capital. Before subscribing to the share capital increase, the client requested the financial advisers to provide a fairness opinion on the acquisition price. The acquisition of the target bank turned out to be a bad deal, causing the share value of the acquiring bank to decrease significantly, and the client brought an action against its financial advisers. The Court of Milan dismissed the client's claim mostly as a result of the disclaimers contained in the letter of appointment regarding the documentation available to the advisers and because the opinion was found to be carefully provided based on the available information.

Auditors

Shareholders may also bring actions against auditors for errors in their auditing activities. This requires providing evidence of (1) a breach of the auditors' duties resulting from the violation of applicable technical rules and auditing standards (as well as the common rules of ordinary diligence) and (2) an economic loss that is an immediate and direct consequence of the breach.

In a recent case, the Court of Milan ruled on a claim brought by a minority shareholder in a private company against the company's auditor.[22] The shareholder claimed to have been misled by the report on the financial statements issued by the auditor because the report failed to disclose the company's actual situation of insolvency. The Court dismissed the claim, holding that there was no causal link between the economic loss suffered by the shareholder and the auditor's breach: at the time of the auditor's report, the company's shares were de facto already worthless, and considering that the company's shares were not listed, it would have been difficult for the shareholder to sell them and avoid the loss.

19 L Bragoli, *La due diligence legale e i suoi riflessi contrattuali*, in *Le acquisizioni societarie*, edited by M Irrera, Zanichelli, 2011, pp. 61 ff.

20 Article 2236 of the Italian Civil Code.

21 Court of Milan, Judgment No. 11801 of 23 November 2017.

22 Court of Milan, judgment of 19 February 2023.

v Class and collective actions

Class actions were first introduced in Italy in 2010[23] but until recently have been available only as a remedy to 'consumers', which limited the possibility to use them in the context of corporate disputes. As a result of this restriction, the Court of Milan recently dismissed a class action brought by a minority shareholder seeking damages for the alleged fraudulent determination of the price of a mandatory takeover bid.[24] The Court ruled that, inter alia, the relationship between the party launching the takeover bid and the tendering shareholders is not between a 'consumer' and an 'entrepreneur'; rather, it is the relationship between shareholders of a company.

The express limitation to consumers was removed in 2021.[25] Future court decisions will confirm whether such a change will make class actions available in the context of shareholders' claims.

vi Insurance and indemnification

Directors' and officers' (D&O) insurance is widespread in Italy. As with any insurance, D&O insurance coverage is based on the information provided when the insurance policy is signed. The information must be complete and accurate, and in cases of inaccuracies, the insurance coverage may be denied.

In a recent case, the Milan Court of Appeal held that the insurers were released from the obligation to hold a director harmless under his D&O insurance policy.[26] The policy had, in fact, been issued based on the group's consolidated financial statements, which were later found to be false. The Court held that the directors were presumably aware (or should have been aware) of the false information contained in the financial statements and therefore could not enjoy the insurance coverage.

vii Settlement

Liability actions against directors may be settled by the company or the shareholders, as the case may be.

The company can settle or waive its claim, subject to the approval by the shareholders' meeting and a veto right of shareholders holding a certain percentage.[27]

If the derivative action is brought by shareholders, the claim may be abandoned or settled, but any related indemnification or settlement amount should be agreed for the benefit of the company.[28]

23 As a result of Law No. 244 of 24 December 2007.

24 Court of Milan, judgment of 24 November 2022.

25 As a result of Law No. 31 of 12 April 2019.

26 Milan Court of Appeal, Judgment No. 475 of 9 February 2022.

27 Article 2393, Paragraph 6, of the Italian Civil Code.

28 Article 2393 *bis*, Paragraph 6, of the Italian Civil Code.

IV COUNTERPARTY CLAIMS

i Common claims and procedure

Pre-closing litigation

Under Italian law, the parties are required to conduct negotiations in good faith.[29] As a result, the parties cannot withdraw from the negotiations once they have reached an advanced stage if the other party has a legitimate expectation on their successful completion or if the withdrawal is unjustified or unreasonable under the circumstances.

Withdrawal from negotiations is legitimate when the conduct of the other party shows no particular interest in the transaction. The Court of Bologna recently dismissed a claim as the plaintiff's own conduct showed a clear lack of interest in the transaction: the plaintiff was supposed to identify a third-party assignee of a minority shareholding but did so only after many months of unjustified silence.[30]

Pre-closing litigation in the context of M&A deals typically involves the liability resulting from interim arrangements such as a letter of intent, a memorandum of understanding or a term sheet. In general, the binding nature of such documents is assessed based on a fact-intensive analysis, and express statements regarding their non-binding nature are not determinative of the outcome of the case, to the extent that the parties had reached an advanced stage of the negotiations justifying pre-contractual liability,[31] or even contractual liability if the fundamental elements of the transaction had been agreed.[32]

Liability can be established for specific obligations that the parties agreed to assume, even in the context of interim arrangements. For example, the Milan Court of Appeal recently ruled on the effect of an exclusivity clause.[33] Two shareholders of two different companies signed a letter of intent with a fund willing to purchase their shareholdings simultaneously. The letter of intent had an exclusivity clause, preventing two sellers from selling their shares for a given time period. The shareholders then entered into two separate share purchase agreements with the fund, subject to certain conditions precedent. Following the fulfilment of the conditions precedent, one of the sellers informed the fund that he had already sold the shares to a third party, and the fund abandoned the deal. The Court ruled that the seller breached the exclusivity clause and was therefore required to compensate the other seller for the full amount he would have obtained from the sale to the fund.

Post-closing litigation

Post-closing disputes typically arise from (1) the breach of representations and warranties or (2) special indemnities granted by the seller to protect the buyer against certain well-defined events (e.g., sanctions issued by public authorities, tax liabilities or product liability). Breach of representations and warranties is by far the most frequent source of M&A litigation. Indemnification claims run the full gamut of business warranties (e.g., alleging inaccuracies in the financial statements or undisclosed litigation, non-compliance with laws, infringement of third-party intellectual property rights, labour, tax or environmental liabilities).

29 Article 1337 of the Italian Civil Code.

30 Court of Bologna, Judgment No. 2287 of 5 October 2021.

31 Court of Milan, Judgment No. 4927 of 4 May 2017.

32 Italian Supreme Court, Judgment No. 6871 of 7 April 2004.

33 Milan Court of Appeal, Judgment No. 2138 of 17 June 2022.

For example, if the buyer finds undisclosed contingent liabilities after the acquisition of the target company, it can seek indemnification equal to the contingent liability.[34] Nonetheless, even if the occurrence of a contingent liability and the breach of the relevant business warranty are clear, the dispute may be time-consuming on quantum, and if there is court litigation, Italian courts typically defer to the opinion of a court-appointed expert.

Another stream of disputes revolves around the purchase price, in particular (1) price adjustment mechanisms and (2) earn-out clauses.

The Italian Supreme Court recently ruled that a price adjustment clause is also valid if it does not provide that the determination shall be made by a third-party expert.[35] What matters, in fact, is that the criteria to determine the price adjustment are clearly set out. The relevant determination could then be deferred to an expert appointed by the court.

With respect to earn-out clauses linking the payment of part of the price to the achievement of certain financial results, the Court of Rome ruled that they are fully valid, even if the buyer may be deemed to have de facto control over the financial results of the target company following the acquisition. The Court noted that the financial statements are drafted not by the buyer but by the company's directors, who are ultimately third parties with regard to the buyer and responsible for the accuracy of the information in the financial statements.[36]

ii Remedies

Remedies typically include compensation or indemnification for damages and losses but may extend to (1) the annulment of the contract for fraud or gross negligence when granting the relevant representations and warranties or (2) contract termination for breach (although share purchase agreements typically contain a sole remedy clause excluding the latter).

Quantification of the damages and losses is an area of particular focus. One of the controversial issues may be when the damages and losses can actually be deemed to justify compensation and indemnification. For example, in a recent case where the contractual definition of damages included 'any loss or damage to the buyer or the company', the Court of Milan held that the buyer had no right to be indemnified absent documentary evidence showing the costs actually paid from the buyer or the target for asbestos removal work.[37]

iii Defences

The defence against claims for breach of representations and warranties or specific indemnification rights typically relates to (1) the existence of the breach (including on the basis of the disclosure provided at the time of the deal, through a data room or otherwise) or the indemnification right, (2) applicable time limitations for bringing the claim (based on the share purchase agreement or general rules of Italian law) and (3) quantum (including contractual limitations thereto).

In recent times, M&A litigation has also seen the impact of the covid-19 pandemic and the conflict between Russia and Ukraine (including the resulting EU sanctions regime), which provided specific (and rather novel) defences to parties deciding to abandon M&A deals or sellers sued by buyers whose investment expectations were frustrated.

34 Court of Florence, Judgment No. 425 of 13 February 2023.
35 Italian Supreme Court, Judgment No. 9347 of 5 April 2023.
36 Court of Rome, judgment of 30 October 2020.
37 Court of Milan, Judgment No. 2999 of 6 April 2022.

iv Arbitration

Many M&A disputes, especially high-value ones, are resolved through arbitration. Following a recent reform of the Italian rules of civil procedure, starting from March 2023, arbitrators are empowered to grant interim measures, if the parties granted them this power (including indirectly, by agreeing to the application of institutional arbitration rules contemplating this power).[38]

Interim measures ordered by arbitrators may be challenged before the Court of Appeal, but only on grounds similar to those available for the annulment of arbitral awards, or in cases where the relevant interim measures are contrary to public policy.[39]

v Other issues

A recent issue arising in the context of M&A disputes concerning the breach of representations and warranties is the possible impact of warranty and indemnity (W&I) insurance.

W&I insurance with the typical features of the common law systems is increasingly considered in the context of M&A deals in Italy, without much thought being given to its compatibility with Italian mandatory law provisions. A problematic example is the clause providing for termination of the policy if the declarations made by the policyholder are inaccurate, irrespective of their relevance for the correct assessment of the risk and without differentiating the remedy based on the degree of fault of the policyholder. According to Italian mandatory law provisions, termination may be sought only in cases of wilful misconduct or gross negligence.[40]

V CROSS-BORDER ISSUES

As a general rule, the parties are free to determine the law governing an M&A deal, including the share purchase agreement. However, under the EU Regulation on the law applicable to contractual obligations,[41] the choice of a law different from domestic law cannot lead to avoidance of the application of mandatory provisions of law if the transaction is purely domestic.

The issue may become relevant in connection with certain specific Italian rules providing particularly severe time restrictions for claims relating to sales contracts, which, particularly in the past, were deemed to limit the parties' ability to agree on more generous time limits for bringing claims.[42]

38 Article 818 of the Italian Code of Civil Procedure.

39 Article 818 *bis* of the Italian Code of Civil Procedure.

40 P Rainelli, *Le polizze assicurative 'Warranty and Indemnity' nelle compravendite di partecipazioni societarie*, in *Governance e mercati. Studi in onore di Paolo Montalenti*, edited by M Callegari, S Cerrato and E Desana, Giappichelli, 2022, pp. 2242 ff.

41 Regulation (EC) No. 593/2008.

42 M Speranzin, *Una criticabile sentenza della Cassazione in materia di garanzie legali e convenzionali nel caso di trasferimento di partecipazioni sociali*, in *Il Corriere Giuridico*, 2020, Issue 4, pp. 510 ff.

VI YEAR IN REVIEW

Large M&A deals are rare, and resulting disputes are even more infrequent. However, when a dispute does arise out of a large deal, the visibility of the case is high, especially when one of the parties is a public entity.

The most recent example is the challenge announced by the Region of Sardinia to the merger of two airport management companies. The Region, holding a minority shareholding in both companies, claims that the merger may impair its current governance rights.[43]

Other notable examples include the dispute brought by Mediaset (the Italian media company founded by Mr Silvio Berlusconi) and its parent company Fininvest against the French media company Vivendi, and the dispute between Blackstone and RCS (a major Italian publishing company) following Blackstone's purchase of the historic headquarters of the *Corriere della Sera* newspaper in Milan.

The first dispute related to a share exchange agreement under which Vivendi would be acquiring Mediaset Premium, Mediaset's pay TV business. After post-signing due diligence, Vivendi refused to close the deal, claiming a misrepresentation of Mediaset Premium's clients and revenues. Fininvest and Mediaset filed multiple claims before the Court of Milan, seeking, inter alia, specific performance and multibillion-euro compensation of damages.[44] The Court found that Vivendi was not entitled to refuse to close the deal, although it could seek indemnification for breach of representations and warranties according to the applicable contractual terms, but nonetheless rejected Mediaset's claims.[45] The dispute was eventually settled.[46]

The second dispute was relating to an asset sale, but nonetheless raised issues similar to those of M&A litigation. RCS started an arbitration against Blackstone claiming that it was forced to sell the asset at a low price because it was facing severe financial problems and sought annulment of the contract and compensation of damages. The arbitral tribunal dismissed the claim,[47] and the Milan Court of Appeal recently upheld its two awards,[48] noting that the negotiations and the sale process had been conducted fairly by two sophisticated parties. Again, the dispute was eventually settled.[49]

43 *Regione impugna ufficialmente la fusione scali nord Sardegna*, available at https://www.ansa.it/sardegna/notizie/2023/07/13/regione-impugna-ufficialmente-la-fusione-scali-nord-sardegna_692a83ec-7888-4f34-81d1-b69d6f9caf37.html.

44 'Italy court dismisses Mediaset's damage bid against Vivendi in pay TV case', available at https://www.reuters.com/business/media-telecom/italy-court-dismisses-mediasets-damage-bid-against-vivendi-pay-tv-case-2021-04-19/.

45 Court of Milan, Judgment No. 3227 of 19 April 2021.

46 'Mediaset, Vivendi sign deal to end years-long legal war', available at https://www.reuters.com/business/media-telecom/mediaset-vivendi-could-sign-deal-end-legal-battle-later-monday-sources-2021-05-03/.

47 Partial Award of 26 May 2020 and Final Award of 10 May 2021.

48 Milan Court of Appeal, Judgment No. 1978 of 8 June 2022.

49 'Italy's RCS reaches settlement with Blackstone over property dispute', available at https://www.reuters.com/business/media-telecom/italys-rcs-blackstone-reach-settlement-over-property-dispute-source-2022-07-15/.

VII OUTLOOK AND CONCLUSIONS

Industry reports show a reduction in the value and number of M&A deals in 2022 compared with 2021[50] and an additional considerable decline in the first half of 2023 compared with the first half of 2022.[51]

The increase of interest rates together with soaring inflation and other contingent market factors are playing a major role in this contraction. Buyers are used to financing acquisitions with debt, so higher borrowing costs have a direct impact on M&A activity. This scenario is likely to change only in the case of a pause in interest rate hikes by the European Central Bank.

In this context, we expect the current trend of small and medium-sized M&A litigation to continue, with fewer major cases involving large M&A deals. We also expect that most M&A litigation will continue to involve counterparty claims following the breach of representations and warranties, in line with past and current trends.

50 KPMG, *Nel 2022 operazioni M&A per 80 miliardi di euro. Gli esteri tornano ad investire in Italia*, 4 January 2023, available at https://kpmg.com/it/it/home/media/press-releases/2023/01/kpmg-mergers-acquisitions-2022.html.

51 KPMG, *Mercato M&A in forte calo nel primo semestre 2023*, 4 July 2023, available at https://kpmg.com/it/it/home/media/press-releases/2023/07/mercato-m-a-in-forte-calo-nel-primo-semestre-2023.html.

Chapter 11

UNITED STATES

Roger A Cooper and Mark E McDonald[1]

I OVERVIEW

Litigation in the United States relating to M&A transactions continues to be significant. From 2007 through 2018, the percentage of public company M&A transactions valued over US$100 million that were subject to shareholder litigation rose from approximately 44 per cent to 82 per cent.[2] At that time, most of those cases were filed in Delaware Chancery Court. Although some were actually litigated, a large majority were quickly settled by the target company agreeing to make additional disclosures, often of dubious value, and to pay plaintiffs' attorneys' fees, without any payment to the class, a resolution that many plaintiffs' lawyers were eager to accept. While commentators anticipated that this type of strike suit might come to an end following the Delaware Chancery Court's landmark ruling in *In re Trulia, Inc Stockholder Litigation* in 2016,[3] which signalled that Delaware courts would no longer approve settlements (and particularly attorneys' fees) in such cases, much of the litigation instead simply migrated to federal courts.

While the number of federal filings has remained high year over year, there has finally been a downward trend in filing volumes.[4] According to Cornerstone Research, in 2023, the level of these filings has remained far beneath the level of filing activity between 2015 and 2020.[5] Those federal cases tend to be brought by plaintiffs and firms that are amenable to quick settlements and ultimately present few risks for the transactions they challenge.

1 Roger A Cooper and Mark E McDonald are partners at Cleary Gottlieb Steen & Hamilton LLP.

2 See Cornerstone Research, Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2018 M&A Litigation, at 1 (2018), available at https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-of-Public-Companies-Review-of-2018-M-and-A-Litigation-pdf.

3 *In re Trulia, Inc S'holder Litig*, 129 A.3d 884, 898-99 (Del. Ch. 2016).

4 In 2015 – the year before *In re Trulia* – just 34 M&A-related cases were filed in federal courts. In 2016, that number more than doubled to 85; in 2017, it more than doubled again to 198; and in 2018 and 2019, it remained relatively high at 182 and 160, respectively. However, in 2020, the number of M&A-related cases decreased to 100. By 2021, M&A-related cases fell to the lowest level since 2014. See Cornerstone Research, Securities Class Action Filings: 2019 Year in Review, at 5 (2020), available at https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2019-Year-in-Review.pdf; Cornerstone Research, Securities Class Action Filings: 2020 Year in Review, at 5 (2021), available at https://www.cornerstone.com/wp-content/uploads/2021/12/Securities-Class-Action-Filings-2020-Year-in-Review.pdf; Cornerstone Research, Securities Class Action Filings: 2021 Year in Review, at 4 (2022).

5 See Cornerstone Research, Securities Class Actions Filings, 2023 Midyear Assessment, at 4 (2023), available at https://securities.stanford.edu/research-reports/1996-2023/Securities-Class-Action-Filings-2023-Midyear-Assessment.pdf.

Meanwhile, and in contrast, the lower number of cases that continue to be filed in Delaware Chancery Court (and less often in other state courts) are often brought by more motivated plaintiffs, tend to raise sometimes significant issues and more often involve attempts to enjoin a transaction or to seek substantial damages on a class-wide basis after a transaction has closed.

Public company shareholder litigation is only one part of the litigation landscape affecting M&A in the United States. Federal and state regulators also have the authority to bring litigation to enjoin transactions that would violate federal or state antitrust or securities laws, and the parties to a transaction themselves may end up litigating pre- or post-closing any number of issues arising out of the transaction agreement. While litigation between the parties has historically been less common than that brought by shareholders, several recent disputes between the parties are notable and have resulted in some significant decisions.

II LEGAL AND REGULATORY BACKGROUND

In the United States, M&A transactions are governed by both federal and state laws. The federal legal landscape comprises securities and antitrust laws under which both government regulators and agencies as well as private parties may bring claims. M&A transactions also implicate fiduciary duties owed by directors and officers to shareholders under state corporation laws (under the internal affairs doctrine, the law of the state where the company is incorporated will govern such issues regardless of where litigation is brought). The most common jurisdiction for incorporation of US companies is the state of Delaware (consequently, Delaware has traditionally been the site for the majority of shareholder lawsuits).

The Securities and Exchange Commission (SEC) is the regulatory agency responsible for enforcing US securities laws, including in the context of M&A transactions. The SEC has promulgated rules governing, among other things, disclosure requirements, solicitation of shareholders and registration requirements. The SEC may bring suits in federal district courts for violations of any of these laws or rules, and district court decisions can be appealed to the US court of appeals in the relevant jurisdiction.[6]

Shareholders of public companies may also bring suit for the violation of certain federal securities laws and SEC rules provided that, among other things, there is a private right of action to do so. In addition to these private claims under federal securities laws, shareholders also commonly assert claims under state corporate law in the M&A context.

Regarding antitrust law, Section 7A of the Clayton Act (also known as the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the HSR Act)) requires parties to a proposed M&A transaction to notify the Federal Trade Commission (FTC) if certain thresholds are met. The FTC and the Department of Justice (DoJ) are then the two agencies that have authority to review proposed M&A transactions under the HSR Act. The FTC or the DoJ may challenge a proposed M&A transaction, including through litigation, if it concludes that the transaction will substantially lessen competition in the relevant market.

6 See, e.g., in connection with Digital World Acquisition Corporation's merger with Trump Media and Technology Group. SEC release, 'SEC Charges Digital World SPAC for Material Misrepresentations to Investors' (20 July 2023), available at https://www.sec.gov/news/press-release/2023-135.

To block a transaction, the reviewing agency must file suit to enjoin the transaction. For example, the DoJ in November 2022 succeeded in a civil antitrust suit in blocking Penguin Random House's acquisition of its competitor Simon & Schuster.[7]

The DoJ may seek preliminary and permanent injunctive relief in a federal district court, and the DoJ or the parties to the merger can appeal the district court decision to the US court of appeals for the relevant jurisdiction. The FTC is also authorised to seek a preliminary injunction in federal district court, but more commonly will seek a permanent injunction in a trial-like proceeding before an administrative law judge (ALJ). The ALJ's decision can be appealed to a full panel of FTC commissioners. Their decision, in turn, can be appealed to a US court of appeals where the merging party resides or carries on business. Any US court of appeals decision can be appealed to the US Supreme Court, although the Court chooses to review only a limited number of cases each year.

State attorneys general may also bring suits to enforce federal antitrust laws. For example, multiple state attorneys general sued to block the T-Mobile and Sprint merger even after the merger had received clearance from the DoJ and the Federal Communications Commission. Such a lawsuit following federal clearance was unprecedented due to the size and national scope of the merger;[8] the relief sought was ultimately denied by the federal district court following a full trial on the merits.

III SHAREHOLDER CLAIMS

i Common claims and procedure

Common types of claims

Shareholders may bring claims under both federal and state law relating to M&A transactions. Shareholder claims are typically premised on the adequacy of the disclosures concerning the transaction, the process followed by the target company and its board in negotiating and approving the transaction, and the deal price.

Under federal law, shareholder litigation is typically brought under the Securities Exchange Act of 1934 (the Exchange Act), although a claim under the Securities Act of 1933 would also be available in connection with a transaction involving some new issuance of securities. Under the Exchange Act, shareholders frequently bring claims in connection with M&A transactions under Section 14(a) for inadequate disclosures in the proxy statement regarding the merger provided to shareholders of the company being acquired. To succeed in bringing such a claim, a shareholder must show that the proxy statement failed to disclose information required to be disclosed by SEC regulations, or made a materially false or misleading statement in the proxy statement.[9] Actions pursuant to Section 14 are generally brought before the close of the merger, and often seek injunctive relief (typically based on a claim that shareholders will be irreparably harmed if forced to decide whether or not to vote in favour of the merger in the absence of additional disclosures). Where the transaction is

7 Victoria Bisset, 'Judge Blocks Penguin Random House and Simon & Shuster Merger', *Washington Post*, available at https://www.washingtonpost.com/business/2022/11/01/penguin-random-house-simon-schuster-merger-blocked/.

8 Drew FitzGerald and Brent Kendall, 'T-Mobile, Sprint Head to Court to Defend Merger', *Wall St J* (9 December 2019), https://www.wsj.com/articles/t-mobile-sprint-head-to-court-to-defend-merger-11575820835.

9 *Resnik v. Swartz*, 303 F.3d 147, 151 (2d Cir. 2002).

structured as a tender offer, shareholders may also bring a claim under Section 14(e) of the Exchange Act. As with Section 14(a) claims, tender offer claims also typically focus on the adequacy of the disclosures in the target company's Schedule 14D-9 filing with the SEC, and also will ordinarily seek injunctive relief (and additional disclosures).

Under state law, shareholders can bring claims for breaches of the fiduciary duties of care or loyalty – duties that the company's officers and directors (and, in some circumstances, controlling stockholders) owe to the company and its stockholders. The duty of care requires the fiduciaries to inform themselves of and make use of all material information that is reasonably available to make an informed and deliberative decision regarding the merger. The separate duty of loyalty requires the fiduciaries to act based on a belief that the action is in the best interests of the company and its shareholders, and to refrain from taking action that harms the company or its shareholders.

To succeed on a claim for breach of the duty of care, a shareholder must show that a director was grossly negligent in failing to consider all relevant and material information in making a decision.[10] To succeed on a duty of loyalty claim requires a shareholder to show that the decision-making process for a transaction was improperly affected by a conflict of interest, such as in a transaction where a controlling stockholder improperly acted at the expense of the minority stockholders, or where a director acted in bad faith or with conscious disregard of their corporate responsibilities.[11] Where the transaction requires some shareholder action, the board also has a duty of disclosure. Delaware courts have recognised this not as a separate independent duty but as deriving from the duties of care and loyalty. A plaintiff alleging that the directors violated their disclosure duty must demonstrate that the directors omitted reasonably available and material information from the company's proxy materials. A fact is material if there is a substantial likelihood that a reasonable stockholder would consider it important in deciding how to vote on the proposed transaction.[12]

There are several different standards of review under Delaware law for evaluating whether a fiduciary has breached their duties. The applicable standard will also often determine whether a defendant is able to succeed on an early motion to dismiss.

Business judgement rule

The Delaware General Corporation Law (DGCL) Section 144(a) provides that the business and affairs of every Delaware corporation are managed by or under the direction of the corporation's board of directors. As long as a majority of the directors have no conflicting interest in a transaction, a Delaware court reviewing a shareholder challenge to that transaction will apply the permissive business judgement rule and generally will not second-guess the board's decision-making if it is undertaken with due care and in good faith. The business judgement rule applies even if the business decision later turns out to have been unwise. When the business judgement rule applies, the court will typically dismiss stockholder claims at the pleading stage unless the stockholder plaintiff pleads specific facts rebutting the presumption that the board reasonably exercised its business judgement in good faith.

10 *In re Walt Disney Co Derivative Litig*, 906 A.2d 27, 64-65 (Del. 2006).

11 *Andarko Petroleum Corp v. Panhandle E Corp*, 545 A.2d 1171, 1174 (Del. 1988).

12 *Loudon v. Archer-Daniels-Midland Co*, 700 A.2d 135, 143 (Del. 1997).

Enhanced scrutiny

In the event of a change of control transaction or where the company is for sale, the board of directors of a Delaware company owes a fiduciary duty to the shareholders to take reasonable efforts to sell for the highest price possible. These are *Revlon* duties. The purpose of this rule is to ensure that the board of directors maximises shareholder value in those specific circumstances.[13] To succeed on a *Revlon* claim, a shareholder must prove that the sale of the company was inevitable and that the directors failed to obtain the best price that was reasonably available.[14] Judicial review of the board's conduct in such circumstances applies an intermediate standard of enhanced scrutiny. It shifts the burden from the plaintiff – where it lies under the business judgement rule – to the board, and requires the board to prove that it acted with proper care under the circumstances to pursue a reasonable strategy to maximise price for the shareholders, including that it was able to obtain the best price available.[15] The same standard governs the actions of controlling stockholders in the event that they undertake the change of control transaction, provided that they do not receive any non-rateable benefit.[16] Nonetheless, as long as the board or controlling stockholders acted reasonably, the court will not second-guess their decision-making, even when reviewing a transaction under enhanced scrutiny.

Entire fairness

A Delaware court will review a transaction where a majority of the directors are interested or that involves a conflicted controlling shareholder under the strictest entire fairness standard. This standard shifts to the defendants the burden of proving that the transaction was fair in respect of both process and price.[17] As a practical matter, it decreases the likelihood that the complaint can be dismissed at the early stages of the case, and often means that the matter requires a full trial on the merits.

MFW exception for conflicted transactions

In a series of cases, the Delaware Supreme Court established an exception to the standard of review applicable to conflicted transactions involving a controlling stockholder where the transaction is conditioned *ab initio* on the approval of a special committee of independent directors and the majority approval of disinterested, uncoerced and fully informed shareholders.[18] For conflicted transactions that satisfy all those conditions, the Delaware court will treat the transaction as though it were at arm's length and apply the more deferential business judgement rule instead of entire fairness.

13 *Revlon, Inc v. MacAndrews & Forbes Holdings, Inc*, 506 A.2d 173, 182 (Del. 1986).

14 *Paramount Commc'ns Inc v. QVC Network Inc*, 637 A.2d 34, 48 (Del. 1994).

15 *Chen v. Howard-Anderson*, 87 A.3d 648, 672-73 (Del. Ch. 2014).

16 *Firefighters' Pensions Sys Of City of Kansas v. Presidio, Inc*, 251 A.3d 212, 266 (Del. Ch. 2021).

17 *Weinberger v. UOP, Inc*, 457 A.2d 701, 710-11 (Del. 1983).

18 *Kahn v. M&F Worldwide Corp*, 88 A.3d 635, 643 (Del. 2014); *Flood v. Synutra Int'l, Inc*, 195 A.3d 754, 756 (Del. 2018) (the Delaware Supreme Court explained that '*ab initio*' means before any 'economic horse trading' took place); *Olenik v. Lodzinski*, 208 A.3d 704, 717 (Del. 2019) (joint valuation exercise constituted substantive economic negotiation as opposed to preliminary discussions that can take place outside of *MFW* conditions); *In re Dell Techs Inc Class v. Stockholders Litig*, No. CV 2018-0816-JTL, 2020 WL 3096748, at *15 (Del. Ch. June 11, 2020) (at the pleading stage, plaintiffs established that the transaction did not meet *MFW* conditions where it excluded forced conversion from *MFW* conditions,

Appraisal

DGCL Section 262 gives shareholders the right to a judicial appraisal of the fair value of their shares in the context of certain acquisitions (e.g., where the shareholders receive cash for their shares). An appraisal action enables a shareholder to receive the fair value for its shares as at the merger date as opposed to the consideration provided in the merger. To bring an appraisal action, a shareholder must:

a deliver a written demand prior to the vote;
b not have voted in favour of the transaction;
c continuously hold the stock through closing; and
d perfect appraisal rights after closing.

In an appraisal action, following full discovery and a trial, the Delaware court will provide 'an independent judicial determination of the fair value of their shares'.[19] Recent appraisal decisions finding that the fair value was lower than the deal consideration (and awarding the appraisal petitioner the lower fair value) have made exercising this right increasingly less attractive for shareholders, particularly for public company mergers, and there has been a significant decline in the volume of appraisal petitions filed.[20] Moreover, in 2016, Delaware amended its appraisal statute to allow companies to prepay appraisal petitioners, thereby halting the accrual of interest. This amendment has made appraisal arbitrage less attractive to certain activist investors who had built a business model on the practice, and has thereby further contributed to the decline in appraisal petitions being filed. However, a company that prepays is not entitled to a refund if the court determines that the deal price exceeds fair value. Following these developments, the volume of appraisal litigation in Delaware has declined significantly.

Procedures for bringing claims

Actions are commenced by filing a complaint that must contain 'a short and plain statement of the claim showing that the pleader is entitled to relief' in Delaware state court,[21] or, in federal court, 'enough facts to state a claim to relief that is plausible on its face'.[22] Defendants often challenge the sufficiency of the complaint through a motion to dismiss, and discovery is typically stayed pending resolution of the motion to dismiss. If a plaintiff's case survives a motion to dismiss, then the case proceeds to fact discovery (which includes the exchange of documents, depositions of relevant fact witnesses, and exchange of expert reports and depositions of experts), and afterwards either party may move for summary judgment. A

and the company bypassed the special committee in certain negotiations); *Berteau v. Glazek*, No. CV 2020-0873, 2021 WL 2711678, at *14-15 (Del. Ch. June 30, 2021) (emphasising that '*MFW* was designed as a narrow safe harbor' and noting that providing 'business judgment review to a controlling stockholder transaction merely because it can be structured to avoid a statutory stockholder vote' would 'undermine the entire rationale for the doctrine').

19 *Dell, Inc v. Magnetar Glob Event Driven Master Fund Ltd*, 177 A.3d 1, 19 (Del. 2017). The court may consider all relevant factors to determine fair value. *Fir Tree Value Master Fund, LP v. Jarden Corp*, 236 A.3d 313, 325, 328 (Del. 2020) (rejecting the argument that *Dell*, among other cases, 'require[d] that the court give heavy weight to the deal price').

20 See Cornerstone Research, Appraisal Litigation in Delaware: Trends in Petitions and Opinions, at 1 (2019), available at https://www.cornerstone.com/publications/reports/appraisal-litigation-delaware-2006-2018.

21 Del. Ch. Ct. R. 8(a).

22 *Bell Atl Corp v. Twombly*, 550 U.S. 544, 569 (2007).

party moving for summary judgment must demonstrate that there are no genuine disputes of material fact requiring resolution at trial, and that it is therefore entitled to judgment as a matter of law. If summary judgment does not resolve the case, it then proceeds to trial for resolution of disputed factual issues. All trials in the Delaware Chancery Court are bench trials. The parties may choose to settle the case at any point, and, often, if a complaint survives a motion to dismiss, the parties will consider settlement before proceeding to discovery, because of the significant expense and time associated with the discovery process and the potentially significant risks of trial.

To aid shareholders in determining whether to bring a lawsuit and to help them better plead facts to make out a plausible claim (to the extent that such facts exist), DGCL Section 220 grants shareholders a qualified right to inspect a company's books and records, including to investigate whether there have been any breaches of fiduciary duties or a basis to challenge valuation in an appraisal action. Other states generally have their own book and record inspection statutes for companies incorporated in those states, which generally mirror the Delaware statute, or a right of inspection derived from the state's common law. A Section 220 request must first be made directly on the company and must be made for a proper purpose, including identifying a credible basis for any investigation of potential wrongdoing. Further, the scope of the request must be limited to information that is necessary and essential to accomplish the proper purpose.[23] If a stockholder believes that the company's response to its Section 220 request is inadequate, it may then bring a Section 220 action in the Delaware Chancery Court seeking an order requiring the production of all such documents by the company. Such matters are usually litigated on an expedited basis and culminate in a one-day trial. Recent developments in Delaware law have, in effect, expanded the scope of what shareholders can inspect under Section 220(c). Under more recent case law, shareholders may be able to inspect more than minutes and other formal board materials where those formal materials are insufficient to satisfy plaintiffs' proper inspection purpose. For example, if a corporation does not conduct corporate business exclusively through resolutions and board minutes (which is often the case), other informal electronic communications may become discoverable.[24] In a controversial 2020 decision, the Chancery Court held that the Section 220 plaintiffs were entitled to conduct a Rule 30(b)(6) deposition of the company to explore what relevant information existed to satisfy the Section 220 demand (and where the information is held), and that Section 220 plaintiffs are generally not required to identify an 'end' for their inspection request or to establish a basis for actionable wrongdoing.[25] The Delaware Supreme Court accepted interlocutory review of this decision and affirmed, explaining that 'when a Section 220 inspection demand states a proper investigatory purpose, it need not identify the particular course of action the stockholder will take if the books and records confirm the

23 *Saito v. McKesson HBOC, Inc*, 806 A.2d 113, 114-15 (Del. 2002).

24 *KT4 Partners LLC v. Palantir Techs Inc*, No. 281, 2018, 2019 WL 347934, at *2 (Del. Jan. 29, 2019).

25 *Lebanon Cty Employees' Ret Fund v. Amerisourcebergen Corp*, No. CV 2019-0527-JTL, 2020 WL 132752, at *14-19, 26-27 (Del. Ch. Jan. 13, 2020), aff'd, 243 A.3d 417 (Del. 2020).

stockholder's suspicion of wrongdoing'.[26] In another recent Section 220 action, the Chancery Court held that the court could shift fees if companies failed to reasonably comply with books and records demands by stockholders.[27]

ii Remedies

Shareholder plaintiffs typically seek injunctive relief after a merger agreement is signed (and announced) but before it is voted on by the shareholders and closes. For claims under Section 14 of the Exchange Act and state law fiduciary duty claims based on purported breaches of the duty of disclosure, plaintiffs will typically move to enjoin the shareholder vote on a transaction unless and until additional disclosures are made (and, if they are made, until the shareholders have adequate time to process the new information).[28] In a case for breach of the duty of loyalty, or where the complaint alleges that the board of directors failed to obtain the best possible price, plaintiffs may seek an injunction to prevent not only the vote but also the transaction from closing, and even to require the board to take certain actions to satisfy its obligations to take reasonable steps to obtain the best price available.[29] Once the transaction has closed, plaintiffs' only real remedy in deals involving a public target is to pursue monetary damages. Seeking to unwind such a transaction is virtually impossible. One form of monetary relief is rescissory damages, which may be available in circumstances involving breaches of loyalty, with the aim of restoring the plaintiffs to their financial position before the breach. Another more common form of remedy is quasi-appraisal, which aims to make the shareholders whole by providing them with the value of consideration they would have received had the defendants not breached their duties as alleged. As its name suggests, the quasi-appraisal remedy is similar to the statutory remedy in appraisal actions. Most post-closing damages cases, however, are litigated on a class-wide basis and therefore seek relief on behalf of all affected shareholders.[30]

iii Defences

As in any litigation, defences vary based on the claim asserted. The standard of review that the court applies will also shape the defences available, at least at different stages of the case. Some common defences (in addition to arguing that the plaintiffs have failed to satisfy the elements of their claim) are summarised below.

26 *AmerisourceBergen Corp v. Lebanon Cty Employees' Ret Fund*, 243 A.3d 417, 440 (Del. 2020). However, see *Gross v. Biogen, Inc*, No. CV-2020-0096, 2021 WL 1399282, at *1 (Del. Ch. Apr. 14, 2021) (granting the plaintiff stockholder access to books and records but limiting inspection in key respects).

27 *Seidman v. Blue Foundry Bancorp*, C.A. No. 2022-1155-MTZ at 17(Del. Ch. July 7, 2023) (shifting fees for 'glaringly egregious litigation conduct in defending against a books and records request').

28 *In re Lear Corp S'holder Litig*, 926 A.2d 94, 114-15 (Del. Ch. 2007); *Assad v. DigitalGlobe, Inc*, No. 17-CV-01097-PAB-NYW, 2017 WL 3129700, at *3 (D. Colo. July 21, 2017).

29 *In re Del Monte Foods Co S'holders Litig*, 25 A.3d 813, 818-19 (Del. Ch. 2011) (shareholders alleged that the board failed to reasonably pursue the best transaction available, and the court temporarily enjoined the transaction from proceeding and stayed certain non-solicitation clauses to allow for additional bids to be received).

30 *In re Orchard Enters, Inc S'holder Litig*, 88 A.3d 1, 50 (Del. Ch. 2014).

Where a transaction (that does not involve a conflicted controlling stockholder) is approved by the fully informed, uncoerced vote of disinterested stockholders, it is governed by an irrebuttable version of the business judgement rule, meaning that any stockholder challenge to such a transaction will be dismissed unless the stockholders can plead and prove that the transaction constituted corporate waste.[31] This is a powerful defence accepted by the Delaware courts in recent years, but it puts a premium on pre-closing disclosures by the board concerning the transaction.

Under DGCL Section 102(b)(7), a corporate charter may exculpate directors from personal liability for any violations of the duty of care, and most Delaware companies have adopted such exculpation provisions. In practice, this means that covered directors can be held personally liable only for breaches of the duty of loyalty; in the presence of an exculpation provision, claims that merely allege breaches of the duty of care must be dismissed.

Finally, in appraisal actions, in which Delaware courts take into account all relevant factors in determining value, companies often argue that the court should place considerable weight on the agreed deal price as evidencing the fair price of the company in the transaction.[32] The value of any synergies that would be realised from the transaction, however, is not to be included in measuring the fair value of the company, which is to be measured on a stand-alone basis.[33] This can create serious challenges for petitioners in certain circumstances to prove that the fair value exceeds the merger consideration.[34] In addition, overall, the default to deal price minus synergies makes it difficult for petitioners to prove a higher valuation if they intend to rely on an alternative expert valuation such as a discounted cash flow.[35] Petitioners also take the risk that the court will conclude that the fair value they are entitled to is actually less than the merger consideration.[36]

iv Advisers and third parties

It is somewhat common for shareholder plaintiffs to bring claims against advisers (particularly financial advisers) and other third parties for aiding and abetting a breach of fiduciary duty. To bring an aiding and abetting claim, plaintiffs must plead and prove:

a the existence of a fiduciary relationship;
b a breach of the fiduciary's duty; and
c the knowing participation of the non-fiduciary in the breach.[37]

Such aiding and abetting claims are often based on alleged conflicts of interest by a financial adviser, especially if that conflict was not fully disclosed to the board. However, advisers and

31 *Corwin v. KKR Fin Holdings*, 125 A.3d 304, 305-06 (Del. 2015).

32 *Fir Tree Value Master Fund*, 236 A.3d at 325.

33 Dell, 177 A.3d at 21 ('[T]he court should exclude "any synergies or other value expected from the merger giving rise to the appraisal proceeding itself"' (quoting *Global GT LP v. Golden Telecom Inc*, 993 A.2d 497, 507 (Del. Ch. 2010), aff'd, 11 A.3d 214 (Del. 2010))).

34 *ACP Master, Ltd v. Sprint Corp,* C.A. No. 8508-VCL, 2017 WL 3421142, at *30 (Del. Ch. July 21, 2017), aff'd, 184 A.3d 1291 (Del. 2018).

35 Dell, 177 A.3d at 6 (holding that the lower court failed to properly consider the deal price and overly relied on a discounted cash flow analysis in calculating the appraisal value).

36 *Fir Tree Value Master Fund*, 236 A.3d at 313 (the fair value of the company was the unaffected market price, which was less than the deal price agreed to).

37 *In re Santa Fe Pac Corp S'holder Litig*, 669 A.2d 59, 72 (Del. 1995).

other third parties are under no duty to prevent directors from breaching their duty of care.[38] The greatest risk for third parties alleged to have aided and abetted a board's breaches of its duties arises when the board itself is not liable on exculpation grounds, potentially leaving the third party alone in the case as the only defendant with potential liability.[39]

v Class and collective actions

In the United States, shareholder litigation can be brought as either a direct or a derivative claim. Direct actions are for harm directly suffered by the shareholder and can be brought either individually by one or more shareholders or on a class-wide basis. Derivative actions, in contrast, are for harm suffered by the corporation. They involve a stockholder suing on behalf of the corporation, for example against certain directors for losses they allegedly caused the company. Although the courts examine many issues when determining whether a suit is direct or derivative, the overall enquiry is whether the corporation itself, or the plaintiffs individually, suffered the alleged harm and would receive the benefit of any remedy.[40] Before a shareholder can bring a claim derivatively, they must have first made a demand of the board to pursue the litigation (in which case the shareholder will likely be stuck with the board's decision) or plead that the board was conflicted and, as such, a demand would have been futile. In the event that the shareholder tries to plead demand futility, the shareholder must satisfy the heightened pleading standard of Chancery Court Rule 23.1(a).[41]

Most M&A lawsuits brought by the shareholders (or, in the post-closing phase, former shareholders) of a selling company are brought as direct actions (often as class actions). Certain procedural requirements must be met for a class action to proceed in either state or federal court. Each state has its own requirements, but Rule 23 is generally stricter than state requirements, which tend to be modelled on the federal rule. Rule 23 requires:

a a proper class definition;
b an ascertainable class;
c a class sufficiently numerous;
d questions of law or fact common to the class;
e that the claims or defences of the representative parties be typical to the claims or defences of the class as a whole; and

38 *RBC Cap Mkts, LLC v. Jervis*, 129 A.3d 816, 865-66 (Del. 2015) (noting that 'the requirement that the aider and abettor act with scienter makes an aiding and abetting claim among the most difficult to prove').

39 id. at 873-74; *Presidio*, 251 A.3d, at 286 (noting that the 'Delaware Supreme Court has declined to extend exculpation to aiders and abettors, even when the aider and abettor facilitated otherwise exculpated breaches of duty by directors').

40 *Tooley v. Donaldson, Lufkin & Jenrette, Inc*, 845 A.2d 1031, 1033, 1035 (Del. 2004).

41 The Delaware Supreme Court recently adopted a new, three-part test for demand futility, which requires that the court assess, for each director '(i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand; (ii) whether the director faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; and (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand. If the answer to any of the questions is "yes" for at least half of the members of the demand board, then demand is excused as futile.' *United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, No. 404, 2020, 2021 WL 4344361, at *17 (Del. Sept. 23, 2021).

f that representative parties fairly and adequately represent the claims of the class and at least one of the following:
- that separate adjudication of the class claims would create the risk of decisions inconsistent with or dispositive of other class members' claims;
- that declaratory or injunctive relief would be appropriate to address the defendant's acts; or
- that common questions predominate over individual questions, and a class action is superior to individual actions.[42]

vi Insurance and indemnification

Delaware law codifies the permissible boundaries of indemnification of directors and officers, providing that the cost of any successful defence must be indemnified, and that directors who are found to have acted in bad faith cannot be indemnified.[43] Within these boundaries of success and bad faith, corporations may agree to indemnify directors as they wish.[44] Usually, a corporation's indemnification obligations are defined either in the corporation's governing documents or by contract. One notable exception to indemnification under Delaware law is that directors cannot be indemnified for payments made to the corporation in a derivative suit, as the indemnification would be circular, with the corporation essentially returning the payments it makes on the directors' behalf back to the corporation as nominal defendant.[45]

Insurance can fill gaps to protect corporate directors where they are not indemnified, as well as insure the company both for amounts it pays for indemnification and for the company's own costs and liability. Shareholder litigation arising from M&A transactions thus typically involves claims that fall within the scope of standard directors' and officers' (D&O) insurance, which usually covers claims brought for breaches of fiduciary duty as well as disclosure claims brought under federal law. Such insurance may also cover judgments or settlement payments for any alleged bad-faith conduct or derivative liability where Delaware law does not permit indemnification from the company.[46] Such coverage is typically subject to an initial retention to be paid by the company, and in recent years (with the high volume of such litigation), the sizes of the retention have increased. Appraisal actions are generally not covered by D&O insurance.[47] Similarly, while settlement of claims should be covered by insurance, provided that the insured gets the authorisation and consent to the settlement by the insurer, a settlement that effectively provides an increase in the deal consideration paid to the stockholders is typically excluded under the policy.[48] Section 220 books and records demands and related litigation typically are covered where the purpose is investigating potential wrongdoing by directors or officers.

42 Fed. R. Civ. P. 23.
43 8 Del. C. § 145(c).
44 *Hermelin v. K-V Pharm Co*, 54 A.3d 1093, 1094 (Del. Ch. 2012).
45 *Arnold v. Soc'y for Sav Bancorp*, 678 A.2d 533, 540 n.18 (Del. 1996) (citation omitted).
46 8 Del. C. § 145(g).
47 See *In re Solera Insurance Coverage Appeals*, C.A. No. N18C-08-315 (Del. 2020).
48 See, e.g., *Komatsu Mining Corp. v. Columbia Casualty Co.*, No. 21-2695 (7th Cir. Jan. 23, 2023); *Onyx Pharmaceuticals, Inc. v. Old Republic Insurance Co.*, Case No. CIV 538248 (Cal. Super. Ct. San Mateo Cty. Dec. 30, 2022).

vii Settlement

Settlement of both shareholder derivative and class action claims typically requires court approval. Generally, the shareholder plaintiff will file a motion seeking preliminary approval of the proposed settlement, which will include, among other items, the method for providing notice to other shareholders, the content of the notice and the deadline for any shareholder to object or opt out. Plaintiffs' attorneys will also seek payment of attorneys' fees through the settlement fund. At a final approval hearing, the court will determine whether the settlement is fair and reasonable or subject to any objections and will determine the amount of fees to be awarded to plaintiffs' counsel based on, among other things, the results they obtained for the class and the number of hours worked on the matter.

In the past, as noted above, shareholder claims were resolved with regularity through disclosure only settlements, whereby the company agreed to make additional disclosures prior to a vote or tender and to pay attorneys' fees. In exchange, it generally received a release of all class member claims (including those of absent class members who did not participate in the settlement) concerning the merger. Recently, US courts have become increasingly sceptical of such disclosure only settlements because shareholders receive little benefit from such agreements. Following the watershed *In re Trulia* decision in 2016, which allowed disclosure only settlements only where such disclosures were plainly material,[49] the practice largely stopped in Delaware Chancery Court but continues with disclosure-based claims now filed in federal court.

In nearly all federal cases today, however, the defendants do not receive a full class-wide release and instead settle only the individual named plaintiff's claim. This is because a class-wide release would require the court's approval of the settlements, which plaintiffs' counsel often have no interest in trying to secure (and it is doubtful that a federal court would approve them as fair and reasonable, for the same reasons the Delaware Chancery Court has identified).[50]

Further, these federal court settlements tend to come about early in a case (often before the shareholder vote): that is, before the court selects a lead plaintiff (as is required in federal securities class actions under the Private Securities Litigation Reform Act of 1995, which usually takes at least 90 days after the complaint is filed). It is therefore unclear whether the named plaintiff who filed the claim (but is not the lead plaintiff) would be able to obtain court approval to settle for the class at that early stage. Consequently, the court almost never gets involved in settlements of such federal actions, and the cases are voluntarily dismissed by the plaintiff.

A new trend may be under way, however. With federal M&A-related filings down, some defendants also now appear to be declining to settle cases early, and some plaintiffs appear to be just walking away from cases that they filed, voluntarily dismissing them without any settlement.

viii Other issues

Another significant recent development in M&A litigation relates to forum selection clauses in a corporation's by-laws. Corporations often choose Delaware as the forum for such disputes, and the Delaware Chancery Court generally enforces forum selection clauses to the

49 *In re Trulia*, 129 A.3d at 898-99.

50 *House v. Akorn, Inc*, 385 F. Supp. 3d 616, 622-23 (N.D. Ill. 2019).

extent that they cover the fiduciary duty and other claims concerning the internal affairs of a corporation.[51] Corporations have attempted to amend their by-laws to expand these forum selection clauses also to cover where federal securities claims may be brought, and in 2020 the Delaware Supreme Court held that such clauses are facially valid but may not be valid in every circumstance.[52] As more corporations have added federal forum selection clauses to their corporate charters or by-laws, the number of cases filed in state courts has been declining. Notably, in May 2022, the California Court of Appeal enforced a federal forum provision in *Wong v. Restoration Robotics, Inc*, becoming the first appellate court outside Delaware to do so.[53]

IV COUNTERPARTY CLAIMS

The other principal area in which disputes arise in connection with M&A transactions is in litigation between the parties themselves. This section sets forth the main types of such disputes and identifies the key issues and recent significant decisions.

i Common claims and procedures

Pre-closing, where the buyer terminates or refuses to close, the seller may seek to enforce the merger or sale agreement by requesting specific performance or damages. In contrast, buyers may seek a declaratory judgment permitting them to terminate or revise the merger or sale agreement on the basis of, among other things, alleged material adverse events or breaches of covenants by the seller.

Most agreements provide a cure period during which the breaching party may attempt to remedy any alleged breach of the agreement. However, a plaintiff need not wait until the cure period expires before bringing a claim if the breach is of the type that could not be cured or if the other party has stated unequivocally that it will not remedy the alleged breach.

Material adverse effects and material adverse changes

Most merger agreements include as a condition to closing that the target company has not suffered a material adverse effect (MAE) or material adverse change (MAC)[54] as at the closing date. An MAE is commonly defined as an effect, event, development or change that, individually or in the aggregate, has had or would reasonably be expected to have a material adverse effect on the business, operations, results of operations and financial condition of the target company and its subsidiaries, taken as a whole. The purpose of such clauses is to allocate between the buyer and seller the risks relating to the target business during the period between signing and closing. Thus, parties may choose to exclude certain specific events or developments from the definition of an MAE, thereby allocating the risk to the buyer. Exogenous business risks typically borne by the buyer include macro-changes affecting the target company that result from economic, financial or political conditions more generally, as well as changes affecting the target company's industry as a whole.

51 *Boilermakers Local 154 Ret Fund v. Chevron Corp*, 73 A.3d 934 (Del. Ch. 2013).

52 *Salzberg v. Sciabacucchi*, 227 A.3d 102, 137-38 (Del. 2020).

53 *Wong v. Restoration Robotics, Inc.*, 78 Cal. App. 5th (Cal. Ct. App. 2022).

54 For the purposes of this chapter, we will use MAE to refer to either an MAE or an MAC.

If an MAE has occurred before closing, the buyer typically has no obligation to close and may be able to terminate the agreement.

Whether an MAE clause is triggered depends on the language of the merger or sale agreement and the specific facts of the transaction. To successfully invoke an MAE, a buyer must typically show that the event had a durationally and economically significant impact on the target. A significant impact is not precisely defined under Delaware law. However, in general, courts have considered an event significant if it resulted in a dramatic loss of value that persists, or is expected to persist, for more than a year.[55] Events that generally affect the target's industry are insufficient unless the target company was disproportionally impacted by the event compared with other companies in its industry.

In a litigation arising from an alleged MAE, the burden to prove that an MAE has occurred will typically be on the buyer who seeks to avoid closing or has terminated. This is no easy burden to satisfy. At the time of writing, there has been only one case in Delaware in which the court concluded that an MAE had occurred, and that case involved extreme facts including 'overwhelming evidence of widespread regulatory violations and pervasive compliance problems', as well as the fact that the target's financial performance 'dropped off a cliff'.[56] In contrast, in *Snow Phipps v. KCAKE Acquisition*, the buyer refused to close, arguing that the covid-19 pandemic had resulted in an MAE and that the target had been disproportionally affected. The court, however, held that no MAE had occurred, because the seller's sales rebounded quickly and an exception for events 'related to government orders' applied.[57]

Interim operating covenants

Most merger or sale agreements include interim operating covenants that define the seller's responsibilities between signing and closing. Similar to MAE provisions, interim operating covenants are another tool for protecting the deal value during the period between signing and closing. Sellers typically covenant and agree to continue operating the business in the ordinary course and in compliance with applicable law. Such clauses may also expressly include specific limitations on what the seller may do, such as purchasing and selling assets, incurring new debt and capital expenditures, and restricting employee compensation. Depending on the agreement, the seller may be permitted to deviate from ordinary course practices only with the consent of the seller, which (typically) may not be unreasonably withheld. Compliance with covenants is usually a condition of closing, unless this is waived by the other party. Such condition is usually subject to a materiality qualifier.

55 See *Akorn, Inc v. Fresenius Kabi AG*, C.A. No. 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018) (finding that an MAE occurred where significant regulatory shortcomings came to light, 21 per cent of shareholder equity value was lost, earnings fell off a cliff and, as at trial, the situation showed no signs of improving); *In re IBP, Inc S'holders Litig*, 789 A.2d 14 (Del. Ch. 2001) (finding that no MAE occurred where there was a 'hiccup' in profitability and the buyer was aware of the cyclical nature of the target company's business); *Channel Medsystems, Inc v. Boston Scientific Corp*, No. 2018-0673-AGB (Del. Ch. Dec. 18, 2019) (finding that no MAE occurred where the buyer discovered Food and Drug Administration compliance issues between signing and closing, because the seller was successfully implementing a remediation plan without significant ongoing costs or other effects on the target).

56 *Akorn*, 2018 WL 4719347, at *55, 66.

57 *Snow Phipps v. KCAKE Acquisition*, C.A. No. 2020-0282, 2021 WL 1714202 (Del. Ch. Apr. 20, 2020).

If a seller has breached an interim operating covenant that is material and that has not or cannot be cured, the buyer generally has the right to terminate the agreement and refuse to close the transaction.[58]

To state a claim for breach of an interim operating covenant, however, it is insufficient to allege merely that the seller made business decisions that were different from what the buyer would have preferred. Rather, the buyer must show that the target's actions were inconsistent with ordinary course practices in the industry.[59]

In *AB Stable v. MAPS Hotels*, a seller sought to enforce the agreed sale of a portfolio of hotels in the Delaware Chancery Court.[60] The buyer refused to close, alleging that (among other things) the seller had failed to continue operating the hotels in the ordinary course because it 'allowed material business relationships to deteriorate' during government-mandated quarantine orders in connection with the covid-19 pandemic. While the Court ruled that the pandemic fell within the 'natural disasters and calamities' exception to the MAE, the buyer was not obligated to close, because the seller failed to comply with the ordinary course provision.[61] The Court rejected the seller's argument that it engaged in 'ordinary course of business based on what is ordinary during a pandemic', in part because the parties' contract required that the ordinary course be evaluated only with respect to the seller's own 'past practice' and not how other companies responded to the pandemic under similar circumstances.[62] The Court noted, however, that in the event of government-mandated shutdowns, a party's obligation to operate in the ordinary course 'would be discharged' because '[n]o one is required to comply with an illegal contract, and no one receives damages based on a breach of an unenforceable obligation.'[63] The Delaware Supreme Court subsequently affirmed the lower court's decision, agreeing that the ordinary course should be 'measured by its operating history, not that of the industry in which it operates'.[64]

Purchase price adjustment disputes

Post-closing purchase price adjustment provisions are common in M&A transactions. There are two main types of post-closing purchase price adjustments: closing balance sheet adjustments, which account for any changes in the value of the business being sold between the signing of the purchase agreement and closing, and earn-out adjustments, which require the buyer to compensate the seller if the acquired business meets certain specified targets.

58 See id. (finding that the ordinary course covenant requires a seller to use sufficient effort to remedy emerging issues that a reasonable company in the same industry would do under the circumstances).

59 See, e.g., *Cooper Tire & Rubber Co v. Apollo (Mauritius) Holdings Pvt Ltd*, No. 8980-VCG, WL 2013 5787958 (Del. Ch. Oct. 25, 2013) (finding that the buyer was entitled not to close where the minority owner of the target caused the target's union workers to go on strike).

60 *AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC*, No. CV 2020-0310-ITL, 2020 WL 7024929, at *1 (Del. Ch. Nov. 30, 2020).

61 id.

62 id., at *71.

63 id., at *80.

64 *AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC*, 268 A.3d 198, 212 (Del. 2021).

Closing balance sheet adjustment provisions typically compare a final closing balance sheet amount with a reference balance sheet amount and correct the purchase price accordingly. If the parties cannot agree on a final closing balance sheet, an independent expert is often retained to resolve the matter, based on the terms of the purchase agreement. The final closing balance sheet is then used to determine whether a post-closing purchase price adjustment is necessary.[65]

The most common post-closing purchase price adjustment disputes concern a party's choice of specific accounting principles and the application of those principles[66] and disagreements about whether claims arise under the purchase agreement's indemnification provision or are covered by the post-closing purchase price adjustment provision.[67] Such disputes are often resolved by confidential arbitration.

Other obligations and closing conditions

Other closing conditions may include making certain information available to the seller between signing and closing or permitting the buyer to inspect physical assets and real estate. If such information is not made available or if the buyer is not granted the access necessary to complete inspection, the buyer may be able to terminate the agreement.[68]

Disputes may also arise over compliance with a hell-or-high-water provision. Such a provision shifts the risk of a performance-preventing event to one of the parties to the contract, usually the buyer. A typical hell-or-high-water provision in a purchase agreement will assign the buyer an absolute and unconditional obligation to undertake any and all actions necessary to gain antitrust clearance. Courts have routinely found these types of provisions to be enforceable in contracts negotiated by sophisticated parties,[69] even when a party claims impossibility of performance or frustration of purpose.

Finally, a merger or sale agreement may include covenants regarding the mechanics of the closing and preparations for the integration of the target into the acquirer's business. These provisions can also be breached and lead to disputes and litigation between the parties.

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65 See *HDS Inv Holding, Inc v. Home Depot, Inc*, 2008 WL 4606262, at *2 (Del. Ch. Oct. 17, 2008) (describing the process for determining the closing adjustment).

66 Given that the generally accepted accounting principles (GAAP) are a set of principles rather than strict rules, the buyer's and seller's methodologies may be materially different. Courts therefore look to the language of the purchase agreement to resolve such disputes. See, e.g., *Chicago Bridge & Iron Co NV v. Westinghouse Elec Co LLC*, 166 A.3d 912 (Del. 2017) (finding that consistency with past practice was all that the language of the agreement required and prohibiting the buyer from asserting that the financial statements were not in compliance with the GAAP); *Alliant Techsystems, Inc v. MidOcean Bushnell Holdings, LP*, C.A. No. 9813–CB, 2015 WL 1897659, at *8 (Del. Ch. Apr. 24, 2015) (allowing claims of inconsistency with the GAAP because the agreement contained a net working capital definition that discussed consistency as well as compliance with the GAAP).

67 When financial statements underlying a purchase price adjustment are challenged and the purchase agreement contains representations about those financial statements, courts have found that the claim is for a breach of representation under the indemnification provision, rather than under the purchase price adjustment provision. See, e.g., *Chicago Bridge*, 166 A.3d 912 (Del. 2017) (preventing the buyer from recovering for a purchase price adjustment based on a net working capital calculation that did not comply with the GAAP).

68 See *Khan v. Cinemex Holdings USA, Inc*, No. 4:20-CV-1178, 2020 WL 2047645 (S.D. Tex. Apr. 27, 2020).

69 See, e.g., *Akorn*, 2018 WL 4719347 (finding that the buyer did not materially breach the agreement's hell-or-high-water provision and therefore did not forfeit its termination right, which it properly exercised in light of the seller's conduct).

General disputes about breaches of representations and warranties

In a typical M&A purchase agreement, each party makes certain representations and warranties concerning key issues affecting the deal. Typically, a seller makes representations and warranties to the buyer as to the business being acquired, its operations and its financial position. These representations and warranties allocate risk between the parties and provide a basis for post-closing indemnification obligations. To succeed on a claim for indemnity, the claimant will have to prove both that a representation or warranty was breached and that the breach caused damage.[70] Typically, the claimant has a right to indemnity only if the representations and warranties were untrue when they were made.[71] Further, some agreements may provide that the representations and warranties do not survive the closing, which precludes any claim for the breach post-closing.[72] Additionally, while public policy prohibits a party from contractually insulating itself from liability for deliberate inaccuracies in representations and warranties within the contract, provisions precluding fraud claims based on extra-contractual statements may be enforceable.[73]

ii Remedies

When buyers decline to close a transaction, sellers may seek specific performance. Specific performance is an equitable remedy whereby a court can order a recalcitrant party to perform the terms of a valid and binding agreement. To succeed in getting an order for specific performance, a party must demonstrate both that there is a valid agreement and that it is capable of being performed by the parties. Thus, one issue that may arise in the context of leveraged transactions is the closing condition that external financing remains available. Debt commitments by lenders have expiration dates, however, and if a court is unable to decide the matter before the commitment expires, the parties may not be able to perform under the contract, and equitable relief may no longer be available.[74]

Alternatively, either buyers or sellers may seek a declaration from the court that a sale or merger agreement either has or has not been validly terminated. Such declaratory relief may then provide a basis for a party to walk away from the transaction or to force the other party to perform and close. In the latter case, declaratory relief may be sought in conjunction with specific performance.

70 See, e.g., id. (finding that the seller's breach of its regulatory compliance representations gave rise to an MAE).

71 See, e.g., *Winshall v. Viacom Int'l, Inc*, C.A. No. 39, 2013 (Del. Oct 7, 2013) (finding that the buyer was not entitled to indemnity because the seller's intellectual property representations and warranties covered only infringement existing at the time of closing).

72 See *GRT, Inc v. Marathon GTF Tech, Ltd*, No. 5571–CS, 2011 WL 2682898, at *13 (Del. Ch. 2011) (explaining 'that there are at least four distinct possible ways to draft a contract addressing the life span of the contract's representations and warranties, with each possibility having the potential to affect the extent and nature of the representing and warranting party's post-closing liability for alleged misrepresentations').

73 See *Abry Partners V, LP v. F & W Acquisition*, LLC, 891 A.2d 1032 (Del. Ch. 2006).

74 See *Snow Phipps v. KCAKE Acquisition*, C.A. No. 2020-0282, 2021 WL 1714202 (Del. Ch. Apr. 20, 2020).

Finally, the parties may also seek damages, particularly if the dispute follows termination and is for breach of the agreement. One of the parties may also be entitled to a termination fee or liquidated damages under the agreement.[75] One issue that parties need to consider with respect to seeking damages, however, is that injunctive relief, as with specific performance, is available only where an adequate remedy at law is not, meaning that the plaintiff cannot be made whole with an award of money damages. The risk of seeking damages in an action for injunctive relief (even in the alternative) is that a court will conclude that the pleadings show that damages are adequate and deny the request for injunctive relief on that basis.

iii Defences

Contractual risk allocation

In a dispute between the parties, a defendant will look to argue that it has not breached the agreement and that the terms of the contract either expressly or implicitly allocated a certain risk to the other party. As discussed above, the specific terms and conditions circumscribing an MAE is one such example of the parties' allocation of risk.[76] Another such provision is a *force majeure* clause, which is also commonly included in merger agreements, and may provide defendants with a potential defence. Such a clause relieves a party from its contractual duties when its performance has been prevented by a force beyond its control and despite its best efforts. *Force majeure* clauses, however, are construed narrowly and are often limited to expressly identified events. Still, if a party successfully invokes a *force majeure* clause, the party's liability will be excused in accordance with the terms of the agreement.

Unclean hands (or the prevention doctrine)

A party generally cannot rely on failures of closing conditions or covenants to terminate an agreement where that party itself was responsible for causing the failure of that condition. In the M&A context, a defendant may argue that the other party should not be entitled to a remedy because it was responsible for causing the breach of the sale agreement in the first instance or has otherwise breached the agreement itself.[77] This doctrine, however, is narrow. Courts apply it only where the other party's inequitable act directly relates to the cause of action at issue: bad conduct that is unrelated to the matter in controversy will not be considered.

75 In some cases, neither party recovers. See *In re Anthem-Cigna Merger Litig*, No. CV 2017-0114-JTL, 2020 WL 5106556, at *6 (Del. Ch. Aug. 31, 2020), aff'd sub nom. *Cigna Corp v. Anthem, Inc*, 251 A.3d 1015 (Del. 2021) ('This outcome leaves the parties where they stand. Neither side can recover from the other. Each must deal independently with the consequences of their costly and ill-fated attempt to merge.').

76 See, e.g., *Snow Phipps*, 2021 WL 1714202, at *7 (where a 'draft purchase agreement contained an MAE provision that made no reference to pandemics or epidemics but included other broad carveouts for effects related to "general economic conditions," "terrorism or similar calamities," and "government orders"').

77 See *Keystone Driller Co v. Gen Excavator Co*, 290 U.S. 240, 244-45 (1933). More recently, the doctrine was invoked in *Realogy Holdings v. Sirva Worldwide* where the court held that the plaintiff was not entitled to specific performance because it had caused the termination of the financing by violating the terms of the financing agreement. C.A. No. 2020-0311, 2020 WL 4559519 (Del. Ch. Aug. 7, 2020); see *Realogy Holdings v. SIRVA Worldwide*, No. 2020-0311, 2020 WL 4057553 (Del. Ch. July 17, 2020); cf complaint, *Sycamore Partners III LP v. L Brands Inc*, No. 2020-0306 (Del. Ch. April 24, 2020) (alleging that the buyer caused equity financing to fail when it asserted claims against guarantors).

Impossibility

The doctrine of impossibility may excuse performance under a contract where performance is rendered objectively impossible either by operation of law or because the subject matter of the contract is destroyed.[78] The impossibility must be the result of an unanticipated event, and the party seeking to avoid performance must have made all reasonable efforts to overcome obstacles to performance. Though the specific terms of the contract and circumstances preventing performance will be key, events such as natural disasters, acts of God, war and government regulations may relieve a party of its duty to perform.[79] Circumstances that make performance merely unprofitable or inconvenient, however, are insufficient.

V CROSS-BORDER ISSUES

The percentage of M&As that are in some respect cross-border continues to increase. Litigation arising out of these cross-border transactions raises its own set of procedural issues. Two key threshold issues with respect to foreign defendants are service of process and personal jurisdiction. For disputes arising between the parties for breach of the merger agreement, the merger agreement may include provisions obligating foreign parties to accept service of any complaint to enforce the agreement and to submit to the jurisdiction of a US court. This is particularly true for agreements governed by the law of Delaware or another US state. Where the foreign defendant has not consented to either service or jurisdiction, the plaintiff will need to satisfy the applicable international service rules and bring the action in a court with jurisdiction over the foreign defendant. That may make expedited proceedings extremely difficult to pursue, and the parties will need to consider this as part of their respective litigation strategies.

The same issues arise in shareholder actions, but the recourse available is often different. First, directors of a Delaware company, regardless of where those individuals are physically located, by statute may be served through the registered Delaware agent for the company. Those directors are also deemed to have consented to the jurisdiction of the Delaware courts in cases concerning acts taken as directors.[80] Foreign buyers, too, may end up subjecting themselves to the jurisdiction of the Delaware courts if, for example, the transaction utilises a Delaware incorporated merger entity to facilitate the merger or acquisition.[81]

Other issues that may arise in litigations involving cross-border transactions include discovery challenges where the documents are located abroad and in a foreign language, navigating applicable data privacy issues and determining where depositions may legally take place – which is particularly challenging in the context of expedited proceedings – as well as considering the enforceability of a judgment abroad and the process and timing for litigating its enforcement, if that becomes necessary.

78 See Restatement (Second) of Contracts § 261 (1981).

79 See, e.g., *Khan*, 2020 WL 2047645, complaint (buyer alleging it could not close because it could not exercise its right to inspect the theatres due to government travel restrictions). The court has not ruled on this defence. The case was stayed when the buyer filed for bankruptcy.

80 See 10 Del. Code §3114; see also, Eric A Chiappinelli, *Jurisdiction Over Directors and Officers in Delaware*, Harvard Law School Forum on Corporate Governance (Dec. 13, 2016).

81 See 10 Del. Code §3104.

VI YEAR IN REVIEW

While the past year was marked by a significant decline in M&A transactions, that did not mean that M&A litigation died away. Significant cases continued to be filed arising from a number of different areas. The FTC brought antitrust challenges to a series of significant transactions, including Microsoft Corp's acquisition of Activision Blizzard, Inc.,[82] Meta's acquisition of Within Unlimited[83] and Lockheed Martin Corporation's acquisition of Aerojet Rocketdyne Holdings Inc.[84] And one of the key antitrust cases to follow in 2023 will be the lawsuit brought by the DoJ against JetBlue and Spirit Airlines, which is currently pending in federal court in Boston.

Major cases in Delaware Chancery Court largely reflected applications of doctrines and standards fairly well established under Delaware law. In particular, investor challenges to transactions involving controlling stockholders have continued. For example, in *In re Match Group Inc Derivative Litig*, the Court granted a motion to dismiss a challenge to a reverse spin-off where the Court concluded that the defendants satisfied the *MFW* requirements.[85] In contrast, in *Manti Holdings LLC v. The Carlyle Group Inc*, where *MFW* did not apply, a minority stockholder challenged a sale on the grounds that the company's controller had undue influence and acted in its own interest. The Court applied entire fairness and declined to dismiss the complaint on the pleadings.[86] Some other cases involving the entire fairness standard went to trial, and the Court found that defendants' conduct had satisfied the standard. For example, in *In re Tesla Motors Inc Stockholder Litig*, the Court found some issues with the fairness of process. It concluded that the price was fair and that overall the transaction satisfied the fairness standard.[87] The increasing size of settlements also reflects the significant risk defendants may face in certain cases. In *In re Dell Technologies Inc Class V Stockholders Litig*, a stockholder action arising out of a US$23.9 billion conversion of Dell stock, defendants agreed on the eve of trial to settle for US$1 billion, one of the largest settlements of such a claim ever.[88]

82 FTC Release, 'FTC Seeks to Block Microsoft Corp.'s Acquisition of Activision Blizzard, Inc.' (Dec. 8 2022), available at https://www.ftc.gov/news-events/news/press-releases/2022/12/ftc-seeks-block-microsoft-corps-acquisition-activision-blizzard-inc.

83 FTC Release, 'FTC Seeks to Block Virtual Reality Giant Meta's Acquisition of Popular App Creator Within' (July 27 2022), available at https://www.ftc.gov/news-events/news/press-releases/2022/07/ftc-seeks-block-virtual-reality-giant-metas-acquisition-popular-app-creator-within.

84 FTC Release, 'FTC Sues to Block Lockheed Martin Corporation's $4.4 Billion Vertical Acquisition of Aerojet Rocketdyne Holdings Inc.', (Jan. 25 2022), available at https://www.ftc.gov/news-events/news/press-releases/2022/01/ftc-sues-block-lockheed-martin-corporations-44-billion-vertical-acquisition-aerojet-rocketdyne.

85 C.A. No. 2020-0505-MTZ, 2022 WL 3970159 (Del. Ch. Sept. 1, 2022).

86 C.A. No. 2020-0657-SG, 2022 WL 1815759 (Del. Ch. June 3, 2022).

87 C.A. No. 12711, 2022 WL 1237185 (Del. Ch. Apr. 27, 2022).

88 No. 2018-0816-JTL (Del. Ch. July 31, 2023).

Finally, the expansion of economic sanctions resulting from Russia's invasion of Ukraine in 2022 has also led parties to terminate contracts or to restructure commercial operations so as to avoid the application of sanctions. This has, in turn, led to disputes in relation to, for example, parties' contractual termination rights and, in the case of companies with complex corporate structures, compliance with warranties. We expect these trends to continue as long as sanctions remain in place.

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