Manufacturing M&A Minute

March 2025

Quick Links

Quick Numbers

1,172 deals reported as completed in the US in January and February of 2025 by Dealogic, an approximately 1/3 decrease from the same period in 2024 (Dealogic)

2003 the last year the number of deals completed in January and February was as low as the start to 2025 (Dealogic)

$67.89 billion global private equity investment value in January and February of 2025, down 20% from 2024 (MarketWatch)

33 months since the cost of supplies has been as high as in February 2025 based on the Institute for Supply Management February survey

10.3% of the US economy attributable to manufacturing (Institute for Supply Management)

2024 Delaware Earnout Decisions

By Corinne Davis

The Delaware Court of Chancery ruled on four key cases involving earnout provisions in acquisition agreements in 2024. For parties involved in, or considering, transactions in 2025 (and beyond!) that include earnouts, the rulings emphasize the limited post-closing obligations that buyers have to work toward the achievement of an earnout unless specific provisions are included in acquisition agreements to require additional obligations. A key takeaway for legal practitioners and M&A professionals from the 2024 earnout cases is the importance of carefully aligning earnout provisions with the buyer's strategic goals for the target business to avoid disappointment for sellers and prevent post-closing disputes. Parties who utilize earnouts as part of their M&A strategy and those considering entry into an acquisition agreement with an earnout should familiarize themselves with these cases to ensure their agreement accurately reflects the parties' intent. Below we have provided a brief summary of each of the cases along with practical takeaways for dealmakers to consider as they negotiate transactions involving earnouts.

2024 Cases

1. *Fortis Advisors, LLC v. Johnson & Johnson, Ethicon Inc.*, No. CV 2020-0881-LWW, 2024 WL 4048060 (Del. Ch. Sept. 4, 2024)

In *Fortis Advisors, LLC*, the Delaware Court of Chancery found for the sellers in one of the largest awards in Court of Chancery history. Here, the court found that the purchaser, a subsidiary of Johnson & Johnson (J&J), violated the earnout provision in the acquisition agreement requiring that J&J devote commercially reasonable efforts to achieving the milestones necessary to trigger earnout payments.

Leading up to the subject acquisition, J&J had incurred substantial expense to develop a surgical robot (referred to as "Verb") without much success. Subsequently, J&J acquired Auris Health, a startup company that had successfully developed advanced surgical robots, called "Monarch" and "iPlatform" for $3.4 billion in closing consideration and another $2.35 billion upon achievement of two commercial and eight regulatory milestones outlined in the acquisition agreement relating to the Auris robots.[1] The earnout provision at issue specifically included an "efforts" clause, requiring J&J to use commercially reasonable efforts suitable for developing a "priority medical device" to achieve the milestones that would trigger payment of the earnout.[2]

Shortly after closing the Auris acquisition, J&J launched an internal competition pitting Auris's robots against J&J's pre-existing Verb robots

[1] *Fortis Advisors LLC*, 2024 WL 4048060 at *1
[2] *Id.*

to determine which robot J&J would focus on moving forward. In internal testing, iPlatform emerged as a more suitable medical robot than Verb. However, the structure of the internal competition forced J&J's development teams to delay pursuit of the regulatory milestones tied to the earnout, as well as to devote development resources to Verb that would have otherwise benefited iPlatform. J&J ultimately chose to merge iPlatform with Verb. The result was that iPlatform became a glorified "parts shop" for Verb rather than J&J's flagship medical robot.[3]

Upon J&J's refusal to pay the earnout due to failure to meet the earnout milestones, sellers brought suit alleging a breach of the commercially reasonable efforts clause in the earnout provision. The Court found for sellers, concluding J&J's internal competitions were a breach of their commitment to commercially reasonable efforts befitting a "priority device." The Court found that in combining Verb and iPlatform, J&J had drained iPlatform's "system, technology, and team to fix another device's problems."[4] The Court also found J&J had intentionally structured the competition to delay the regulatory approvals in order to avoid the earnout payments. Based on these findings, the Court determined that J&J's breaches of the "efforts" provision contributed to the failure of six of the ten earnout milestones and ultimately, awarded Auris over $1 billion in damages.

2. *Shareholder Representative Services, LLC v. Alexion Pharmaceuticals, Inc.*, No. 2020-1069-MTZ, 2024 WL 4052343 (Del. Ch. Sept. 5, 2024)

In *Johnson & Johnson*, the parties had agreed to an "inward-facing" efforts provision, requiring that the buyer use efforts to develop the robot comparable to the efforts it expended for the buyer's other "priority medical products."[5] At issue in *Alexion* was an $800 million earn-out payment coupled with an "outward-facing" efforts provision. The outward-facing provision here applied to Alexion's post-closing development of a cutting-edge monoclonal antibody that was in the process of being developed by a pharmaceutical company Alexion acquired.[6] Alexion was required to use "efforts and resources typically used by biopharmaceutical companies similar in size and scope to [Alexion] for the development and commercialization of similar products at similar developmental stages" in order to achieve the earnout milestones which were tied to further development of the monoclonal antibody.[7]

After closing, the product's development was stalled due to a potential safety issue, and ultimately, terminated following Alexion's subsequent acquisition by AstraZeneca leading to this lawsuit.

The Delaware Court of Chancery found for the sellers, ruling that Alexion had breached its duties under the outward-facing efforts clause. Under an outward-facing efforts standard, the Court declared the buyer's efforts should be measured against an objective standard, rather than the buyer's past practice and conduct, and without taking into consideration the parties' subjective intentions. Since there were no companies comparable to Alexion in the space, the Court measured Alexion's actions against a hypothetical company using a number of factors such as "efficacy" and "likelihood of regulatory approval" to find Alexion breached their duties to work toward the earnout milestones.[8] For example, the Court found that the hypothetical company's response to the potential safety issue that led to the termination of the project would be to gather more data, rather than terminate development altogether. Importantly, the Court also found that Alexion's decision to end the development of the monoclonal antibody was largely driven by synergies in the merger with AstraZeneca, and not strictly as a response to the safety issue. The secondary acquisition of Alexion by AstraZeneca adds an intriguing wrinkle to this case but the ruling on Alexion's breach of their outward-facing efforts clause creates a fact pattern that practitioners will need to weigh when including such outward-facing provisions in their earnout provisions.[9]

3. *Fortis Advisors LLC v. Medtronic Minimed, Inc.*, No. 2023-1055-MAA, 2024 WL 3580827 (Del. Ch. July 29, 2024)

By contrast to *Johnson & Johnson* and *Alexion*, the Delaware Court of Chancery in *Medtronic* quickly dismissed a claim by the sellers seeking to enforce an earnout provision and provided a judgment that reinforced a buyer's limited duties to try to achieve an earnout beyond the express language of the agreement. The *Medtronic* case revolved around a $100 million earnout as part of the consideration for Medtronic's acquisition of Companion Medical. The earnout would be payable if Companion's "smart insulin pens" hit certain sales targets post-closing. Unlike in J&J, however, the earnout clause gave Medtronic "sole and absolute" discretion over how it sold and developed the pens, stating that any decisions Medtronic made would be based on

[3] *Id.* at *2.
[4] *Id.* at *29.
[5] *Fortis Advisors, LLC*, 2024 WL 4048060 at *14
[6] *Fortis Advisors, LLC*, 2024 WL 4048060 at *23.
[7] *Shareholder Representative Services*, 2024 WL 4052343 at *14.
[8] *Id.* at *41
[9] *Id.* at *39.

its own "business judgment." The provision also included a clause freeing Medtronic from liability for whether or not the earnout was paid, as long as Medtronic didn't take any actions "intended for the primary purpose of frustrating payment of [the earnout]."[10] The sellers argued that Medtronic deliberately sabotaged the earnout by failing to motivate sales teams and delaying marketing efforts.

The Court dismissed the claim, concluding that the seller did not meet the "unusually heavy burden" created by the buyer-friendly provision.[11] The Court found that it was not sufficient for sellers to allege that Medtronic took steps that were in part aimed at avoidance of the earnout payment. Seller's burden was much higher according to the Court. In order to prevail, Companion was required to plead facts indicating that the *primary purpose* of those affirmative actions was to avoid the earnout payment. Moreover, the Court held that the requirement to "not take any action" prohibited only *affirmative* steps to defeat the earnout and did not restrict Medtronic from merely failing to act in furtherance of the earnout milestones.[12]

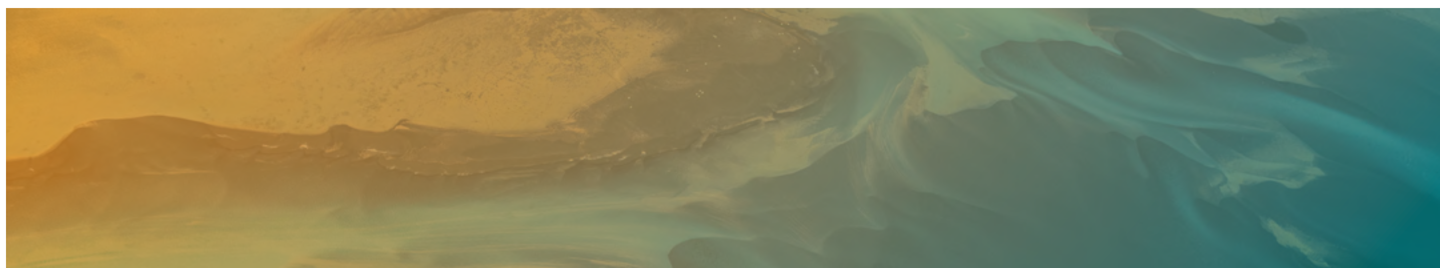
4. *Himawan v. Cephalon, Inc.*, No. 2018-0075-SG, 2024 WL 1885560 (Del. Ch. Apr. 30, 2024)

In *Himawan*, as in *Alexion*, the Court applied an "outward-facing" efforts standard to the earnout provision in the parties' merger agreement. The relevant provision gave buyers "complete discretion with respect to . . . the development [of the product]", and further stated that the buyer would have "no obligation to… take any action to protect, attain or maximize any [earnout] payment"[13]—provided that Cephalon must use "commercially reasonable efforts" to achieve the milestones, defined as "the exercise of such efforts and commitment of such resources by a company with substantially the same resources and expertise as [the buyer], with due regard to the nature of efforts and cost required for the undertaking at stake."[14]

Cephalon acquired Ception Therapeutics for its antibody RSZ, which showed promise for treating both eosinophilic asthma (EA) and eosinophilic esophagitis (EoE). The deal included milestone payments of up to $200 million for FDA approval relating to each malady (EA and EoE). After closing, Cephalon pursued FDA approval for both EA and EoE uses but ultimately prioritized obtaining approval for EA use.[15] Ultimately, Cephalon abandoned its pursuit of approval for use in treating EoE when use of the antibody for treatment of EA produced better results. Cephalon paid the $200 million earnout payment relating to FDA approval of use of RSZ for EA but the EoE FDA approval milestone was never accomplished and thus the related earnout payment never was triggered.[16] The selling stockholders claimed Cephalon failed to use commercially reasonable efforts to achieve the EoE milestone by focusing on FDA approval for EA treatment.

As in *Alexion*, the Court assessed this particular "outward facing" efforts standard by measuring the defendant's conduct against a hypothetical company in the same circumstances. Of critical importance to the Court's ruling was the fact that the buyers had negotiated a provision permitting buyers to give "due regard" for the "efforts and costs" of pursuing the milestones.[17] The Court ruled that these carveouts meant buyers could fail to pursue the development milestone where the "circumstances reasonably indicate, as a business decision, that they not go forward."[18] The Court stated that these business circumstances "includes all the costs and risks involved, *including* the milestone payments and the opportunity costs."[19] With this language included, the Court concluded that the buyers could consider the cost of the earnout payment in assessing whether to pursue further development. The Court noted that this was an buyer-friendly decision and provided little protections for sellers, but the Court felt bound by what the parties had negotiated in the efforts provision.

[10] *Fortis Advisors LLC*, 2024 WL 3580827 at *3.
[11] *Id.* at *6.
[12] *Id.* at *3.
[13] *Id.* at *7.
[14] *Id.* at *11.
[15] *Id.* at *14.
[16] *Id.* at *1.
[17] *Id.* at *11.
[18] *Id.*
[19] *Id.*



Key Practice Points

Likelihood of Dispute. All of these recent cases serve as a reminder that earnout features increase the likelihood of an unhappy buyer or seller and can give rise to disputes. This propensity should not be overlooked and weighed against the benefits that earnouts provide in bridging valuation gaps. Moreover, while the outcome of certain of these cases is more favorable to sellers than typically found in Delaware case law, the "split," and fact-specific, nature of the outcomes show that it would be a mistake to assume that earnout provisions will be interpreted as seller-friendly moving forward in Delaware. The highly context-specific nature of the rulings, along with the unusually specific seller-friendly language of the provisions in question were unique to the cases. Instead of drawing broad conclusions about Delaware court interpretation of earnouts, deal makers should use all four of these deals as a roadmap to inform their drafting of earnout provisions.

Contextualized, Precise Provisions. One lesson that can be taken from this series of earnout-related decisions is that Delaware courts pay deference to the specific language used in earnout provisions. It is clear from these decisions that precision is key in capturing the parties' intent in an earnout. "Off-the-shelf" earnout provisions should be avoided in almost all cases given the clear focus on precise language. Earnout provisions should be tailored for the specific product, business, company, industry and situation, with input from both legal counsel and business professionals who have deep knowledge of the product or business. Buyers should be transparent with their counsel about internal or external challenges that may arise with respect to the achievement of the earnout. Counsel should consider carefully and address potential issues that could arise during the earnout process, gaming out possible outcomes with their clients to craft language that provides certainty and an appropriate amount of flexibility.

Inward Versus Outward Standard. Sellers and buyers should consider whether their negotiated earnout provision should be measured by a subjective, inward facing standard or by an outward-facing standard. If the parties settle upon an outward facing standard, they should consider whether to measure against a comparable, identifiable company (the "yardstick" approach) or a hypothetical, similarly situated company, but should avoid leaving the metric open to the discretion of the Court. Parties should be aware that oftentimes a court may find that there is not a comparable company, and thus the Court may apply the hypothetical approach, which leaves the buyer's business decisions open to interpretation by the Court. To avoid such an approach, parties may consider specifically identifying market peers or identifying in greater detail what underlies a given standard, including explicitly excluding hypothetical companies.

Q&A WITH

David M. Evatz

Managing Director,
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Q. You have a specific focus on plastics, and we have worked together on plastics deals in the past. Are you seeing supply chain issues create issues for sellers and buyers given the potential for tariffs or "trade wars" over the next 12 months?

A. There continues to be a significant amount of uncertainty as it relates to tariffs. The effects are likely to be widespread to almost all market participants (*i.e.*, it is unlikely that any plastic processors would have a fully domestic customer base and raw material sources). That said, manufacturers with facilities outside of the US and/or that source product from outside the US are evaluating all options at this point. Note that this is not the first time tariffs have surfaced/ been implemented. During Trump's first administration many companies reacted successfully to what was put in place. The other factor impacting the supply chain is the continued amount of excess inventory at the OEM level with many customers continuing to drive down inventory levels. This continues to impact many suppliers with lighter volumes and customer demand.

Q. Do you see any influence on deal making in the near-term from environmental sustainable plastics or materials along with increased regulatory scrutiny around single-use plastics?

A. Increased regulatory scrutiny may be muted in the near-term (*e.g.*, the recent executive order on plastic straws) but the reality is that it can't go away. One mini-trend that we are seeing is interest from certain plastic processors to acquire businesses that recycle raw material sources, particularly for processors that use a large amount of commodity resins (*e.g.*, polyethylene).

Q. What macroeconomic factors do you expect to play a role in deal activity in 2025, particularly in the manufacturing sectors?

A. Despite market uncertainty, the global economy has exhibited resilience, with many macroeconomic indicators stabilizing. The unemployment rate in 2024 has slightly risen YoY to 4.2 percent; however, overall job market conditions remain robust, sustaining downstream consumer demand. Real US GDP growth has dipped from Q2 2023, posting 3.1 percent and 2.7 percent in Q3 and Q4 2024, respectively. The outlook for 2025 is to see moderate growth in GDP. Inflation has shown signs of cooling, largely as a result of the Federal Reserve having kept interest rates at a high level through most of 2023 and 1H 2024, resulting in a federal funds rate of 5.3 percent at its peak this year—the highest seen in 15 years.

Q. What are some key factors you are seeing buyers use to distinguish themselves in competitive processes given the interest-rate environment?

A. First, most buyers now likely consider the current cost of capital as the new normal and have built that into their return models. We are currently seeing extended due diligence timelines with major focus on determining the sustainability of target company's financial performance. We saw major swings up and down in financial performance from companies over the past few years due to pandemic-related and other factors and it is important for a buyer to have conviction on what a normal and sustainable level of financial performance is for a target company. There are a number of ways a buyer can stand out in a process, including having no financing contingency, having a quick timeline to close, spending money/hiring third-party providers ahead of a LOI/Final Bid and finding creative ways to capture upside value (rollover, earnout, etc.).

Q. Are there any sectors that you think are poised for a jump in activity in 2025 or that seem likely to slow down?

A. Companies with a diversified end market base are going to remain highly attractive given downside protection from certain markets/ applications. Medical continues to be a coveted space for platform investment and add-ons, as existing buy and build platforms look to gain multiple expansions through additional end market exposure (accretive acquisition opportunities). Other niche applications continue to be desired—including data centers, renewable energy, etc. Automotive continues to struggle given ICE to EV transition timeline, tariffs and input costs, union risks, public comps and recent transactions mostly trading at historical low points.

Key Contact

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