MATERIAL CHANGE IN MATERIAL ADVERSE CHANGE CLAUSES: THE CASE FOR GREATER PRECISION IN CONTRACT DRAFTING TO ACHIEVE A MORE EQUITABLE BALANCE OF RISK BETWEEN MERGING PARTIES

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ABSTRACT

Material adverse change (or material adverse effect) (hereinafter "MAC") clauses are important provisions in merger and acquisition contracts that allow a buyer to exit a merger deal when certain conditions are met. The purpose of the MAC clause is to allocate risks between the buyer and seller in case some event materially alters the selling company, and consequently, the deal. Over the course of the last 23 years, a number of large cases have been heard in the Delaware Chancery where an acquiror attempts to exercise the termination right of the MAC clause. Thus far, only one decision has allowed for the termination of the merger agreement. The consistent seller-friendly decisions in Delaware Chancery MAC jurisprudence demonstrates the asymmetry in risk allocation between parties and leads to questions regarding the efficacy of MAC clauses in protecting an acquiring party. This paper will suggest alterations to MAC drafting practices that could result in a more equitable balance of risk for both parties and will allow for the exercise of the termination right when proper.

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INTRODUCTION: WHAT IS A MATERIAL ADVERSE CHANGE CLAUSE?

Material adverse change (or material adverse effect) (hereinafter "MAC") clauses are important provisions in merger and acquisition contracts that allow a buyer to terminate a deal when certain conditions are met.[1] The purpose of the MAC clause is to allocate risks between the buyer and seller in case some event materially alters the selling company, and consequently, the deal.[2] Because MAC clauses provide means to exit multi-billion-dollar transactions, the drafting and risk allocation between the parties is both highly consequential and intensely negotiated.[3] MAC clauses are meant to protect buyers, but in practice these clauses rarely excuse performance of the contemplated merger.[4] Although MAC clauses had existed for decades, former Vice Chancellor Strine's decision in *IBP* created

[1] David M. Clar & Kelly S. Foss, *Shedding Light on the Elusive and Mysterious "Material Adverse Effect" Clause*, HARRIS BEACH PLLC 3, https://www.harrisbeach.com/wp-content/uploads/2022/04/Harris-Beach-Law-Firm-Material-Adverse-Effect-Clause-White-Paper.pdf [https://perma.cc/RTR9-J7W6].
[2] Adam. O. Emmerich & Trevor S. Norwitz, *The MAC is Back: Material Adverse Change Provisions After Akorn*, THE INT'L COMPAR. LEGAL GUIDE TO: MERGERS & ACQUISITIONS 6 (2019), https://www.wlrk.com/wp-content/uploads/2019/03/MA19_Chapter-2_Wachtell-Lipton-Rosen-Katz.pdf [https://perma.cc/2YZA-LSWF].
[3] Andrew Schwartz, *A "Standard Clause Analysis" of the Frustration Doctrine and the Material Adverse Change Clause*, 57 UCLA L. REV. 789, 824 (2009); *see also* Peter S. Golden et al., *Negotiated Cash Acquisitions of Public Companies in Uncertain Times*, 13 The M&A Law. 1, 7 (2009).
[4] *See infra* Section II.

the analytical framework for MAC adopted in the Delaware Chancery Court (hereinafter "Chancery"), and led to 17 years of seller-friendly decisions finding no MAC.[5] Finally, in 2018, confronted by a particularly compelling set of facts, Vice Chancellor Laster found the first instance of MAC in *Akorn v. Fresenius*, and held that Fresenius' termination of the merger was legally permissible under the circumstances.[6]

Following the *Akorn* decision there was speculation as to whether the MAC doctrine had changed, and if the Chancery would be more inclined to find a MAC.[7] A crop of new litigation emerged, particularly after COVID-19, where buyers attempted to exit transactions by invoking the MAC termination right, however, the court has remained steadfast that the bar to find MAC should be almost impossibly high.[8] The consistent seller-friendly decisions in Delaware MAC jurisprudence demonstrates the asymmetry in risk allocation between parties, and leads to questions regarding the efficacy of MAC clauses in protecting an acquiring party. This paper will suggest alterations to MAC drafting practices that could result in a more equitable balance of risk for both parties and will enable the exercise of the termination right when proper. Section I of this paper will lay out the standard drafting practices for MAC clauses and explain their utility as risk allocation devices. Then, section II will focus on the development of the MAC analytical framework, and the seller-friendly perspective pervasive throughout Delaware jurisprudence. In section III, this paper will contemplate drafting strategies that will improve the efficacy of MAC clauses.

I. STANDARD DRAFTING PRACTICES FOR A MAC CLAUSE AND ITS UTILITY AS A RISK ALLOCATION DEVICE

The purpose of a MAC clause is to allocate risk between parties, with the goal of striking the perfect balance of exposure for the buyer and seller.[9] There are four key types of risk at play in the drafting of MAC clauses: systematic, indicator, agreement, and business risks.[10] Systematic risks are risks that are not controlled by the parties and generally impact more than just the parties or transaction at issue.[11] Examples of systematic risks include industry or economic changes, war, force majeure events, and changes in law.[12] Indicator risks, on the other hand, serve as potential evidence that MAC has occurred, but are not the adverse change in itself.[13] These includes a drop in credit ratings, trading volume, or stock price.[14] Agreement risks

[5] Peter D. Lyons et al., *Akorn v. Fresenius: Has a Material Change in Delaware M&A Jurisprudence Occurred?,* 22 No. 10 M & A Law. NL 1, (2018).
[6] *Id.*
[7] *See id*. at 1–2.
[8] *See* Randi C. Lesnick et al., *COVID-19 and Merger Litigation After Two Years*, JONES DAY (March 23, 2022), https://www.jonesday.com/en/insights/2022/03/covid19-and-merger-litigation-takeaways-after-two-years [https://perma.cc/TNV8-VEXZ].
[9] *See* Andrew M. Herman & Bernardo L. Piereck, *Revisiting the MAC Clause in Transaction What Can Counsel Learn from the Credit Crisis*, BUSINESS LAW TODAY (2010).
[10] *See* Emmerich & Norwitz, *supra* note 2.
[11] *See id.*
[12] *See id.*
[13] *See id.*
[14] *See id.*

stem from the public announcement of the merger agreement, including those associated with execution and any acts taken in performance of the merger.[15] Finally, there are business risks, which arise from the ordinary operation of the entity where the entity has control.[16] Generally, systematic, indicator and agreement risks are borne by the buyer, although there are specific exclusions that reallocate certain parts of those risks to the seller.[17] The business risk will be allocated to the seller, since the seller is best equipped to deal with any issues that emerge with its ordinary operations.[18] With this risk framework in mind, the next step in this inquiry is to examine the drafting of a typical MAC clause.

A. Step One: Defining Material Adverse Change

A typical MAC clause will begin with a general definition of what a material adverse change is. The definition, however, is usually not very instructive,[19] considering that a "Material Adverse Change" is often defined as a Material Adverse Change.[20] Usually, the MAC definition will include language that does not require a MAC to have happened, but rather that a MAC needs to be reasonably likely to occur.[21] Furthermore, "material" is almost always left without qualification.[22] The logic posited on this front is that a broad definition will allow for more room to renegotiation in the future.[23] Sometimes, parties will include a specific quantitative threshold for when a MAC has occurred; however, it is far more common to include a series of carve-outs, which shield the seller from the risk of MAC by not permitting the buyer to terminate, and then creating exclusions to those carve-outs.[24]

B. Step Two: Carve-Outs

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[15] *See id.*
[16] *See id.*
[17] For example, MAC clauses will often include an exclusion to a carve-out that preclude protection for the seller against systematic risks which have a "disproportionate impact" on the seller. *See* Bardy Diagnostics, Inc. v. Hill-Rom, Inc., No. 2021-0175-JRS, 2021 WL 2886188, at *21 (Del. Ch. July 9, 2021); *see also* Snow Phipps Grp., LLC v. KCAKE Acquisition, Inc., No. 2020-0282-KSJM, 2021 WL 1714202, at *29 (Del. Ch. Apr. 30, 2021).
[18] *See* Emmerich & Norwitz, *supra* note 2.
[19] *See* Frontier Oil Corp. v. Holly Corp., No. 20502, 2005 WL 1039027, at *33 (Del. Ch. Apr. 29, 2005) ("defining a 'Material Adverse Effect' as a 'material adverse effect' is not especially helpful").
[20] For example, the definition of material adverse effect in the merger agreement between IBP and Tyson was defined as, "any event, occurrence or development of a state of circumstances or facts which has had or reasonably could be expected to have a Material Adverse Effect." *See In re* IBP, Inc. S'holders Litig., 789 A.2d 14, 65 (Del. Ch. 2001).
[21] *See In re IBP*, 789 A.2d at 65.
[22] *See* Akorn, Inc. v. Fresenius Kabi AG, No. CV 2018-0300-JTL, 2018 WL 4719347, at *48 (Del. Ch. Oct. 1, 2018).
[23] Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 880 (2010).
[24] *See Akorn,* 2018 WL 4719347, at *49.

The next step in drafting a MAC clause typically includes creating exceptions to the MAC.[25] These exceptions, often referred to as "carve-outs" enumerate categories of events that narrow the scope of MAC clauses, and disallows the buyer from exiting a transaction.[26] These exceptions promote fairness for the seller, and implicitly acknowledge that there are circumstances unforeseeable or so out of the seller's control that it should not create an out for the buyer. Thus, the carve-outs function as an allocation of risk to the buyer if any of the listed events transpire. The typical set of carve-outs in MAC clauses include among other things: general economic conditions; industry conditions; the announcement/execution of the transaction; delivery and performance of the acquisition agreement; changes in law or government regulations; terrorist acts; and force majeure situations, such as natural disasters, pandemics, or calamities.[27] Additionally, a seller will usually include exceptions for changes caused by conditions that were disclosed to the acquiror before entering into the merger agreement.[28] To rely on these carve-outs in the course of litigation, the burden is on the seller to show that the material change at issue is encompassed in one of the categories enumerated.[29] These exceptions have proven to be of paramount importance for sellers, especially in the wake of COVID-19 and the manifold attempts to exit transactions on the part of buyers.[30]

C. Step Three: Exclusions to the Carve-Outs

The final component of a typical MAC clause is exclusions to the carve-outs.[31] These exclusions reallocate risk back to the seller when the seller is uniquely affected by industry or market risks.[32] If a carved-out event had a "materially disproportionate impact"[33] on the selling company as compared

[25] Jonathon M. Grech, "*Opting Out": Defining the Material Adverse Clause in A Volatile Economy*, 52 EMORY L.J. 1483, 1488 (2003). Note, however, that not all MAC clauses will contain carve-outs. As an example, the MAC clause in *IBP*, did not include these carve-outs. *See In re IBP*., 789 A.2d at 65–66.
[26] *See* Grech, *supra* note 25, at 1490.
[27] Lou R. Kling & Eileen T. Nugent, *Negotiated Acquisitions of Companies, Subsidiaries and Divisions* § 11.04 at 24 (2018 ed.).
[28] *See* Grech, *supra* note 25, at 1488–89.
[29] *See* Kling & Nugent, *supra* note 27, at 26.
[30] *See* AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC, No. CV 2020-0310-JTL, 2020 WL 7024929, at *57 (Del. Ch. Nov. 30, 2020) (holding that the buyer could *not* walk away from its acquisition of AB Stable's interest in Strategic Hotels & Resorts *on grounds that a material adverse change had occurred* because the change in AB Stable's financial situation stemmed from the COVID-19 pandemic, which fit squarely within the "natural disasters and calamities" carve-out); *see also Snow Phipps*, 2021 WL 1714202, at *34 (finding that the buyer could not properly exit the deal because, inter alia, the financial downturn experienced by the selling party was caused by the various government issued orders related to COVID-19, and thus fell under the MAC agreement's carve-out for changes "arising from or related to . . . changes in any Laws, rules, regulations, orders, enforcement policies or other binding directives issued by any government entity.").
[31] *See Akorn*, 2018 WL 4719347, at *49.
[32] *See id.*
[33] *Bardy*, 2021 WL 2886188, at *34.

to similarly situated companies, then the MAC termination right is reinstated.[34]

Even with the materially disproportionate impact exclusions, a majority of the risks that could cause MAC are directed to the acquiring party.[35] This risk imbalance inherent in the agreement, coupled with the long record of Delaware jurisprudence upholding merger agreements in these scenarios, makes it practically impossible to use the MAC termination right. The next section of this paper will examine the development of the seller-friendly MAC doctrine in Delaware through its leading case law, and whether *Akorn* lowered the burden on acquiring parties to prove MAC.

II. DEVELOPMENT OF THE DELAWARE MAC DOCTRINE AND THE CHANCERY'S SELLER-FRIENDLY PERSPECTIVE

A. IBP *and the Establishment of the Modern MAC Doctrine*

Although the Chancery had dealt with cases involving MACs in the past, the court had not established a solid analytical framework for them until *IBP.*[36] In *IBP*, the court was asked to determine whether Tyson's termination of the merger agreement with IBP was proper.[37] After participating in a bidding war that caused Tyson to pay a premium for the acquisition, IBP experienced a precipitous drop in earnings over two quarters while Tyson's earnings also suffered.[38] The financial troubles coupled with IBP's issues with certain financial statements reported to the Securities and Exchange Commission ("SEC"), led Tyson to exercise its powers under the MAC clause to exit the merger agreement.[39] In examining whether a MAC had occurred, former Vice Chancellor Strine developed a framework to analyze the factual background of MAC clause disputes which became the standard in the Chancery going forward.[40]

There are several key principles highlighted in *IBP* that have become the touchstones for analyzing whether a MAC has occurred or is reasonably likely to occur. First, the court introduced a reasonable acquiror standard, which recognizes that a fact would likely be considered material if it were consequential to the decision making of a reasonable buyer.[41] This is judged by considering the information and warranties provided by the selling party

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[34] *See id.* at *34–*40 (holding that Bardy "disproportionately impacted" exclusion to the change in law carve-out of the MAC clause did not apply because Bardy's only comparable company, iRhythm, also had significant downturn).

[35] *See Akorn,* 2018 WL 4719347 at *50 (noting that the seller takes on the business risk, whereas the buyer takes on the remaining risk, including systematic, indicator, and agreement risk).

[36] *See* Raskin v. Birmingham Steel Corp., Civ. A. No. 11365, 1990 WL 193326, at *5 (Del. Ch. Dec. 4, 1990) (court reviewed the settlement agreement between parties that had agreed that Birmingham Steel Corp. likely experienced a MAC, and thus the merger was fine for Raskin to exit); *see also In re IBP*, 789 A.2d at 52 (noting that the contract is governed by New York Law). Despite applying New York Law in the decision, the analytical framework is adopted in Delaware in later cases.

[37] *See In re IBP*, 789 A.2d at 21.

[38] *See id.* at 22.

[39] *See id.*

[40] *See* Lyons et al., *supra* note 5, at 1–2.

[41] *See In re IBP,* 789 A.2d at 68.

before the merger agreement was signed.[42] If the acquiror was apprised of the circumstances that had led to a decline in performance, the court will be unlikely to find MAC.[43] Next, the court determined that to constitute as MAC, the event "must substantially threaten the overall earning potential of the target in a *durationally-significant manner*."[44] As the court instructs, this must be "viewed from the longer-term perspective of a reasonable acquiror"[45] and the consequence to the company's earning potential must be "measured in years rather than months."[46] Moreover, the court concluded that there is a heavy burden to prove a MAC had or was reasonably likely to occur, that first falls on the buyer.[47]

With this framework established, the court examined the relevant facts regarding IBP's financial performance, and found that it had not amounted to a MAC.[48] Under the reasonable acquiror standard the poor financial performance in the last quarter of 2000 and first quarter of 2001 would likely have been considered material had it continued for the rest of the year.[49] In the first quarter of 2001, IBP's earnings dropped 64% as compared to the same period in the year prior.[50] Additionally, the impairment charge incurred by an IBP subsidiary of $60.4 million, which Tyson argued was in itself a MAC, was worth $.50 and $.60 cents per IBP share.[51] As a result of the two events taken together, some analysts had adjusted their FY 2001 earnings estimates down from $2.38 to $1.44 a share.[52] Despite the significant drop in performance, it was compelling to the court that Tyson had been aware of the IBP subsidiary's issues prior to the signing of the merger, and further that IBP and other companies in the meat industry were often subject to swings in performance.[53] In this instance, the swing was caused by the severe winter, which led livestock to be held back from the market, drastically increasing the purchase price of cattle.[54]

Furthermore, Tyson had failed to meet its heavy burden in proving durational significance that would indicate a MAC had occurred.[55] Notwithstanding the two quarters of poor performance, IBP's earnings began to improve in the two weeks leading up to the termination of the merger.[56]

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[42] *See* William Savitt & Noah Yavitz, *Material Adverse Change and "Busted Deal" Litigation—Practical Considerations and Case Law*, 4D N.Y.PRAC., COM. LITIGATION IN NEW YORK STATE COURTS § 110:33, 1(4th ed. 2023).
[43] *See In re IBP*, 789 A.2d at 70–71 (explaining that Tyson was aware of the issues with DFG, a subsidiary of IBP that incurred an impairment charge of $60.4 million, as well as the cyclical nature of the meat industry which causes IBP's financial performance was subject to swings).
[44] *See id.* at 68 (emphasis added).
[45] *Id.*
[46] *See Id.*
[47] *See id.*
[48] *See id.*
[49] *See id.*
[50] *See id.*
[51] *See id.*
[52] *See id.* at 70.
[53] *See id.*
[54] *See id.*
[55] *See id.*
[56] *See id.* at 71.

Because of the upward trend in earnings, analysts had forecast that IBP's performance would return to normal by 2002, and that the 2001 earnings dip would not be severe.[57] Even Tyson's own investment bankers believed that the transaction was still beneficial to the company from a long-term perspective.[58]

With much doubt about its decision, the court concluded that there had been no MAC, and that IBP was entitled to specific performance of the merger.[59] In spite of the doubt expressed by the court, the IBP decision set the stage for 17 years of seller-friendly decisions, giving little hope to a buyer attempting to exercise its termination right.[60]

B. Frontier *and* Hexion*: Adopting the Seller Friendly Framework for MAC*

Following the IBP decision, the Chancery largely adopted the IBP framework for evaluating MAC in *Frontier* and *Hexion*.[61] First, in 2005 the court heard a dispute regarding Holly Corporation's attempt to exit its acquisition of Frontier, another petroleum refiner.[62] During the parties' merger negotiations, rumors that Erin Brockovich was pursuing a toxic tort litigation against a wholly owned subsidiary of Frontier began to circulate.[63] Despite knowing of the potential litigation and the huge costs associated with this type of case, the Holly Corporation board nonetheless approved a revised merger agreement containing warranties that no potential actions against Frontier existed that would "have or reasonably be expected to have" a MAC.[64] After closing, however, the litigation against Frontier's subsidiary went forward, and it became clear that a corporate separateness defense would not insulate Frontier from liability.[65] Holly Corporation was also advised by Lehman Brothers' that it had undervalued certain assets, making the merger a much better deal on Frontier's end.[66] For these reasons, Holly sought to exit the merger.[67]

In its ruling, the court adopted the framework set out in IBP to analyze whether a MAC had occurred. First, the court agreed that the burden of proof initially falls on the party invoking the MAC – usually the acquiring party – and that it must be proven by a preponderance of the evidence.[68] Next, the court adopted the objective reasonableness standard set out in IBP, asking

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[57] *See id.* at 70.
[58] *See id.* at 71.
[59] *See id.* at 71, 84 (Former Vice Chancellor Strine explained that he was "confessedly torn about the correct outcome," because under the new analytical framework it was a close call as to whether a MAC had occurred).
[60] *See* Lyons et al., *supra* note 6, at 1–2.
[61] *See* Frontier Oil Corp. v. Holly Corp., No. Civ.A. 20502, 2005 WL 1039027, at *34 (Del. Ch. Apr. 29, 2005); *see also* Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 739 (Del. Ch. 2008).
[62] *See Frontier*, 2005 WL 1039027, at *1.
[63] *See id.* at *2.
[64] *See id.* at *3,*10.
[65] *See id.* at *3.
[66] *See id.* at *11.
[67] *See id.* at *17.
[68] *See id.* at *35.

whether a MAC would or would reasonably be expected to occur.[69] Further, it was confirmed that to constitute MAC the event must cause or reasonably be expected to cause a durationally significant interference with the business.[70]

In its evaluation, the court found that there was no evidence presented that demonstrated Frontier was at risk of losing the toxic tort litigation.[71] Without this evidence the court could not conclude that a MAC was reasonably likely due to the potential payout costs if Frontier had lost.[72] Moreover, the estimated litigation cost was not a MAC in itself.[73] The court estimated that a fair price for Frontier's legal defense cost was around $15-20 million, which when viewed from a long-term perspective was a price that Frontier could have easily absorbed.[74] Thus, the court concluded that there was no MAC that could properly excuse performance of the merger.[75]

The importance of *Frontier* to the MAC doctrine was that it largely affirmed IBP's analytical framework, as well as exemplified the seller-friendly perspective of the Delaware Chancery. The case also introduced a new, but inconsistently applied, step in the MAC framework, which requires courts to examine the quantitative and qualitative aspects of the problem event.[76] In *Frontier,* Former Vice Chancellor Noble did not actually engage in a qualitative analysis, concluding based on the quantitative aspects alone that no MAC had occurred or was reasonably likely to occur.[77] As a result, there has been confusion as to what precisely is a MAC qualitatively.[78] Nonetheless, the quantitative/qualitative inquiry was adopted in *Akorn*, and then used or referenced in other subsequent MAC litigations in the Chancery.[79] Additionally, *Frontier* left open the possibility that large-scale litigations with high defense costs and substantial pay-outs could constitute MAC.

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[69] *See id.* at *33.
[70] *See id.* at *34.
[71] *See id.* at *36.
[72] *See id.* at *37.
[73] *See id*.
[74] *See id.* at *36–*37.
[75] *See id.* at *37.
[76] *See, e.g*., Robert T. Miller, *A New Theory of Material Adverse Effect*, 76 BUS. LAW. 749, 784 (2021) (explaining that Hexion made no mention of a quantitative/qualitative analysis); Agspring Holdco, LLC v NGP X US Holdings, L.P., No. CV 2019-0567-AGB, 2020 WL 4355555, at *16–*17 (Del. Ch. July 30, 2020); *AB Stable,* 2020 WL 7024929, at *53–*55, *judgment entered*, (Del. Ch. 2021), and *aff'd*, 268 A.3d 198 (Del. 2021); *Bardy*, 2021 WL 2886188, at *23–*25, *judgment entered*, (Del. Ch. 2021). Neither *Agspring* nor *Bardy* mentioned the quantitative/qualitative analysis, indicating that it has not been fully accepted into the MAC doctrine. AB Stable also did not acknowledge the quantitative/qualitative aspects, however, it likely was because the event at issue, COVID-19, so clearly fell within the "natural disasters and calamities" exception in the MAC clause that there was no need to reach that step.
[77] *See* Robert T. Miller, *A New Theory of Material Adverse Effect*, 76 BUS. LAW. 749, 784 (2021); s*ee also Frontier*, 2005 WL 1039027 at *37.
[78] *See* Robert T. Miller, *A New Theory of Material Adverse Effect*, 76 BUS. LAW. 749, 784 (2021)
[79] *See id* (the quantitative/qualitative analysis was used in *Akorn* and *Channel Medsystems*); *see also Snow Phipps*, 2021 WL 1714202, at *30 (noting that the quantitative/qualitative aspects are a part of the MAC inquiry without actually engaging in the analysis).

Three years after *Frontier* was decided, the Chancery heard *Hexion v. Huntsman*, and again ruled for the seller in a case where the acquiror was attempting to invoke the MAC termination right.[80] In *Hexion*, two large chemical companies entered into a merger agreement where Hexion would pay $28 per share in a leveraged cash buyout of Huntsman stock, with a deal value of $10.6 billion.[81] Because of a competitive bidding situation, Hexion agreed to pay a premium to acquire Huntsman's stock, but, after a series of disappointing earnings results in 2007 and early 2008, Hexion decided not to close.[82] To support its decision, Hexion argued that a MAC had occurred because 1) Huntsman's first two quarter 2008 EBITDA[83] was down by 19.9% from the first half of 2007, and that the expected future performance was to be much less than projected, 2) there was an expansion of Huntsman's net debt by $265 million when, prior to the merger closing, the company was projected to pay off billions of dollars in 2007, and 3) severe underperformance from one of Huntsman's line of businesses.[84]

The court assessed the MAC claim by reverting back to the framework outlined in *IBP*, without the additional quantitative/qualitative inquiry included in *Frontier*. Looking at all three events separately and in the aggregate, the court found that no MAC had occurred.[85] Regarding the decline in performance, a 19.9% drop in earnings was not significant enough to constitute MAC, and the missed earnings projections could not serve as the basis for a finding of MAC because Huntsman's earning projection warranties were specifically disclaimed in the agreement.[86] Regarding the debt issue, Huntsman's debt only increased between 5-6%, which the court found was not significant enough to constitute MAC.[87] Finally, the impairment of two lines of business could have potentially been a MAC had the businesses stood alone, but when considered against the earnings of the full company it was clear that the downturn in performance was not sufficient

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[80] *See Hexion*, 965 A.2d at 715.
[81] *See id.* at 723.
[82] *See id.* at 721–22.
[83] *See* Investopedia, *EBITDA: Definition, Calculation Formulas, History, and Criticisms*, https://www.investopedia.com/terms/e/ebitda.asp#:~:text=EBITDA%2C%20or%20earnings%20before%20interest,generated%20by%20the%20company's%20operations [https://perma.cc/45HE-TSWD] (Jan. 28, 2024) ("EBITDA, or earnings before interest, taxes, depreciation, and amortization, is an alternate measure of profitability to net income. By including depreciation and amortization as well as taxes and debt payment costs, EBITDA attempts to represent the cash profit generated by the company's operations.").
[84] *See Hexion,* 965 A.2d at 742–46.
[85] *See id.* at 739.
[86] *Id.* at 740–41 (former Vice Chancellor Lamb explains that "If Hexion wanted the short-term forecasts of Huntsman warranted by Huntsman, it could have negotiated for that . . . Creative investment bankers and deal lawyers could have structured, at the agreement of the parties, any number of potential terms to shift to Huntsman some or all of the risk that Huntsman would fail to hit its forecast targets."). Vice Chancellor Lamb's point indicates that greater specificity and contracting can be beneficial in the risk allocation of merger agreements, and that if the parties bargain for a specific provision, that it will be respected.
[87] *Id.* at 744.

to constitute a MAC.[88] The court concluded that the combined impact of the three events did not meet the quantitative threshold to be considered MAC.[89]

Hexion, like *Frontier*, largely confirmed the analytical framework set out in IBP, with only one modification. Instead of using earnings-per-share[90] as the benchmark to measure the quantitative effects of MAC like in IBP, the court adopted EBITDA as its bar, comparing each quarter with the same period from other years.[91] This metric has been used in successive MAC cases, in conjunction with other financial measures.[92] Additionally, the *Hexion* decision cemented that Delaware required a heavy burden of proof to show a MAC, and created doubt regarding the efficacy of the MAC clause as a means to excuse performance of a merger.[93]

C. Akorn v. Fresenius*: Only MAC Found and a Potential Shift Away from the Seller-Friendly Perspective*

Following 17 years of seller-friendly decisions denying the invocation of the MAC termination right, the Chancery finally ruled that a MAC clause excused performance in *Akorn v. Fresenius*.[94] In 2017, pharmaceutical companies Akorn and Fresenius solidified their merger agreement, where Akorn was set to be acquired by Fresenius so long as Akorn did not suffer a MAC.[95] After signing the merger agreement, Akorn soon released its second quarter 2017 earnings results, which to the dismay of Fresenius, showed a precipitous drop in performance on a year-over-year basis.[96] Not only did the poor performance continue as time went on, but an anonymous whistleblower also revealed an emerging scandal related to pervasive Food and Drug Administration ("FDA") regulatory compliance issues.[97] Citing

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[88] *See id.* at 745.
[89] As compared with other arguments, such as in IBP, where there was a heavier focus on the durational significance of the downturn in economic performance of IBP. *See In re IBP*, 789 A.2d at 48.
[90] Jason Fernando, *Earnings Per Share (EPS): What It Means and How to Calculate It*, INVESTOPEDIA, https://www.investopedia.com/terms/e/eps.asp [https://perma.cc/QUA8-WNJP] (Sept. 18, 2024) ("EPS is a financial metric used to measure a company's profitability on a per-share basis. It is calculated by dividing the company's net income (after taxes and preferred dividends) by the number of outstanding shares of common stock.").
[91] *Hexion*, 956 A.2d at 740, 742 (Former Vice Chancellor Lamb's rationale for this change was because in the context of cash acquisitions, the capital structure of the seller is largely irrelevant to the post-merger corporation. Rather, the primary concern is the operational results of the business. "Because EBITDA is independent of capital structure, it is a better measure of the operational results of the business").
[92] Miller, *supra* note 78, at 765 (pointing out that in *Akorn*, although multiple financial measures were considered when determining MAC, including "changes in revenues, operating income, and earnings-per-share, it seemed to place the greatest weight on EBITDA.").
[93] Lyons, et al., *supra* note 5, at 5–6.
[94] *See Akorn*, 2018 WL 4719347, at *3 (Del. Ch. Oct. 1, 2018).
[95] *See id.* at *1.
[96] *Id* ("Akorn's business performance fell off a cliff").
[97] *See id.* at *1–*3, *9 (The Whistleblower sent two letters that contained allegations that the senior manager of quality compliance was aware of serious data-integrity issues that could put the company out of compliance with FDA regulations, and an earlier employee survey response stated he had in fact "provided misleading information to regulatory bodies." Moreover, instead of working to fix the quality systems, "he actively worked to prevent collaboration and transparency.").

these failures, Fresenius terminated the merger, leading Akorn to file an action in Delaware to compel specific performance.[98]

In an expansive 246-page memorandum opinion, Vice Chancellor Laster thoroughly detailed his reasoning for why it was proper for Fresenius to terminate the merger.[99] To find that there was a MAC sufficient to excuse performance of the merger, there were several contractual conditions that could be met. First, there was the General MAC condition, which commanded that "Akorn must not have suffered a Material Adverse [Change]," and would only give Fresenius the right to refuse to close, rather than to fully terminate.[100] Then, there was the "Bring-Down Condition" which required Akorn's representations to be true and correct as of the closing date, and the "Covenant Compliance Condition" which required performance of all obligations "prior to the Effective Time."[101] The failure of either these conditions would give Fresenius a right to terminate so long as Akorn's breach could not be cured and Fresenius itself was not in material breach of any part of the agreement.[102] Vice Chancellor Laster analyzed these three conditions separately, concluding that all three conditions were breached, while Fresenius only had a non-material breach of the agreement's "Hell-or-High-Water Covenant."[103] The following subsections will discuss the court's analysis for the General and Bring Down Condition MACs, and then move into *Akorn*'s lasting impact on the MAC doctrine.

1. *General MAC Found and a Right to Refuse to Close Conferred*

Beginning with the analysis of the General MAC, the court used the framework from *IBP*, recognized the heavy burden of proof, and emphasized both the reasonable purchaser standard and that the earning potential must be impaired in a durationally significant manner.[104] The court also imported *Hexion*'s use of quarterly results as the proper metric for determining the effect of a MAC, since it "minimizes the effect of seasonal fluctuation."[105] Looking at the available quarterly results regarding revenue, operating income, and earnings-per-share from Q2 2017 to Q1 2018, there were dramatic declines in all three categories, but particularly in operating income and earnings-per-share during Q4 2017.[106] The court then noted Akorn's 55% drop in EBITDA during 2017, which was not akin to any decline previously experienced by Akorn.[107] Regarding durational significance, the

[98] *See id.* at *3.
[99] *See id.*
[100] *Id.* at *45.
[101] *Id.* at *44–*45. This paper will not examine the analysis related to the Covenant Compliance Condition. A finding that the Bring Down Condition was breached was enough to exercise its right to terminate. *See id.* at *82.
[102] *See id*. at *45.
[103] *See id.* at *47.
[104] *See id.* at *52–*53.
[105] *See id.* at *53, *55 (note, however, that because Akorn did not report EBITDA on a quarterly basis, the court looked at the full year 2017 EBITDA in comparison with full year 2016 EBITDA).
[106] *See* id. at *54 (the operating income and EPS decline in Q4 2017 were 292% and 300%, respectively).
[107] *See id.* at *55.

court referred to analyst's estimates for 2018-2020 EBITDA, which "were lower than their estimates at signing by 62.6%, 63.9%, and 66.9% respectively."[108] As compared with its competitors over the same time period, Akorn's decline was more severe, indicating both durational significance and that the diminution was specific to Akorn, rather than being the product of industry or general economic issues.[109] Because of the decline in profitability, coupled with the durational significance of the impairment of Akorn's profits, the court found that the company had suffered a General MAC.[110]

The analysis of Akorn's General MAC did not end with the court's conclusions regarding materiality and duration. Rather, Vice Chancellor Laster then considered two additional questions: 1) whether the event deemed a MAC fell within one of the bargained for carve-outs, and 2) whether Fresenius had knowledge of and accepted the risks that led to MAC.[111] If either question could be answered in the affirmative, then even if MAC had occurred, it would not excuse Fresenius from closing the merger.

Regarding the first question, the court found that Akorn's poor business performance was not encompassed in one of the exceptions listed in the MAC clause.[112] Despite Akorn's attempt to attribute the poor business performance to general changes in the industry, which would have fallen into the systematic risks exception, the court instead found that the risk was borne to Akorn because of the clause's disproportionate effects exclusion.[113] As mentioned in Section I, there are often three layers to a MAC clause: the general MAC definition, a series of carve-outs that limit a party's ability to excuse performance of the merger if the event falls within one of the bargained for categories, and the exclusions to the carve-outs that return the risk back to the seller.[114] In this instance, the MAC clause had a disproportionate effects exclusion to the systematic risk carve-out, meaning that if Akorn was disproportionately impacted by changes in the industry, then the risk is on the seller, and thus the buyer can exercise the powers afforded by the MAC clause.[115] The court again referred to Akorn's decline in EBITDA projected for 2018-2020, which showed a 60%+ drop for each year, compared with competitors in the industry, which on average dropped 11%, 15.3%, and 15% for the years in that time period.[116] It was evident that there had been a disproportionate impact on Akorn's business, which shifted the risk back to Akorn.

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[108] *Id.* at *56.
[109] *See id.*
[110] *See id.* at *57.
[111] *See id.* at *58, *60.
[112] *See id* at *58.
[113] *See id.*
[114] *See* Herman & Piereck, *supra* note 9.
[115] *See Akorn,* 2018 WL 4719347, at *58. For an Akorn General MAC, it permits the Fresenius to refuse to close, whereas other contracts will allow for a party to fully terminate the merger; *See also In re IBP*, 789 A.2d at 51.
[116] *See Akorn,* 2018 WL 4719347, at *56, *58.

The court next turned to the question of whether Fresenius was on notice of the risks that caused the MAC, which per Akorn, would not excuse performance of the merger.[117] Vice Chancellor Laster expressly disagreed with the assumption of risk argument proffered by Akorn, but nonetheless walked through why the argument would fail even with such a reading.[118] Akorn centered its argument on then-Vice Chancellor Strine's comment in *IBP*, stating that MAC provisions are "best read as a backstop protecting the acquiror from the occurrence of *unknown events*."[119] In essence, Akorn interpreted "unknown events" to mean anything that was not learned by Fresenius through due diligence – which translates to a "tort-like concept of assumption of risk."[120] The problem with this reading, the court posited, was that it did not take into account that 1) Delaware gives maximum effect to contract language and that this would require the court's decision to turn on due diligence rather than the contract, 2) the reading would undermine the careful risk allocation bargained for between the parties in the three layers of the MAC clause, and 3) the language "is forward-looking and focuses on events," rather than risks.[121] Even if this were the proper reading, and Fresenius was aware and accepted the risk, the contract language of the MAC clause still returned the risk to Akorn through its disproportionate effects exclusion, so the result would not change.[122] Because the court concluded that a General MAC had occurred, it did not fall into a carve-out, and because the assumption of risk argument was irrelevant, Akorn's General MAC allowed Fresenius to not close.

2. *Bring-Down Condition MAC Found and a Termination Right Conferred*

Although the court already resolved that a General MAC had occurred, allowing Fresenius not to close, the court still had to establish whether there was a valid termination of the merger.[123] Per the parties' agreement, a breach of the Bring-Down Condition would permit Fresenius to terminate the merger if there were warranties made by Akorn that were not true at closing and would be reasonably expected to cause a MAC.[124] Additionally, to terminate, the breach of the Bring Down Condition must not be able to be cured by the "Outside Date."[125] Instead of applying the IBP framework used to analyze Akorn's General MAC, the court adopted Frontier's qualitative/quantitative analysis, because it was deciding whether the event *would reasonably be expected* to cause a MAC.[126] *Akorn* thus cemented that *Frontier's* framework should be used to analyze future MACs.

[117] *See id.* at *60.
[118] *See id.* at *60–*61.
[119] *See id.* at *60.
[120] *Id.*
[121] *See id.* at *60–*61.
[122] *See id.* at *62.
[123] *See id.*
[124] *See id.*
[125] *See id.* at *63.
[126] *See id.* at *65; *see also* Miller, *supra* note 78, at 784.

For the qualitative analysis, the court focused on Akorn's Regulatory Compliance Representations.[127] As a generic pharmaceutical company, Akorn's products were subject to various FDA regulations to be eligible to be sold on the market.[128] In particular, Akorn was responsible for providing true and correct data related to studies done on their generic drugs.[129] In 2016, Akorn engaged a consultant to investigate the company's data integrity systems, only to uncover that it was one of the top three worst systems out of the 120+ pharmaceutical companies reviewed by the consultant.[130] Even though Akorn received this report, and its internal quality experts confirmed the identified deficiencies, the company was slow to remedy its system.[131] Further, evidence suggested that Akorn's Executive Vice President of Global Quality Affairs approved the transmission of two fabricated data sets to the FDA, which compromised the integrity of all Akorn's representations to the agency.[132] Siding with Fresenius, Vice Chancellor Laster saw the pervasive data integrity issues and Akorn's culture of noncompliance as a danger to the merging company that could cause problems with future maintenance of FDA approval of its products.[133]

Turning to the quantitative analysis, the court again agreed with Fresenius that a MAC had occurred due to the data integrity problems.[134] After weighing projections from both parties, Vice Chancellor Laster picked the midpoint between the two, estimating that the decline in Akorn's standalone value was around $900 million.[135] The court reached this conclusion due to the huge amount of money needed to remedy the data integrity issues, and because of the likelihood that some of Akorn's products would be temporarily taken off or delayed from entering the market.[136] With Akorn's $4.3 billion implied value from the merger agreement, the $900 million decline represented a 21% diminution of value.[137] Although in past cases a 20% *drop in earnings* was not seen as sufficient to constitute MAC, in this case the court concluded a 20% *drop in overall value* of the company was enough to satisfy the MAC quantitative threshold.[138]

The inaccuracies of Akorn's Regulatory Compliance Representations were sufficiently impactful on the health of the business that the court determined it would be reasonably likely to cause a MAC.[139] Moreover, because Fresenius would not have been able to foresee the extent of the

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[127] *See Akorn,* 2018 WL 4719347, at *65.
[128] *See id.* at *66.
[129] *See id.* at *66, *67.
[130] *See id.* at *66.
[131] *Id.* at *67 (Akorn's internal quality experts "determined that Akorn ignored…[and] had not yet addressed the vast majority of deficiencies" identified by the consultant. Issues included data deletion and manipulation, unauthorized access by Akorn staff that allowed for them to make changes, and other quality problems.).
[132] *See id.* at *8, *67.
[133] *See id.*
[134] *See id.* at *74.
[135] *See id*.
[136] *See id.* at *73.
[137] *See id*.
[138] *See id,* at *73–*76.
[139] *See id.* at *76.

regulatory compliance issues, there was no possibility to cure by the Outside Date.[140] Further, the court found that Fresenius did not materially breach any of its covenants, so it was within the company's right to terminate the merger with Akorn.[141]

3. Akorn *did not Dramatically Alter the MAC Analysis nor the Seller-Friendly Outlook*

Akorn did not dramatically alter the MAC framework that was outlined in *IBP*. Rather, Vice Chancellor Laster strived to clarify some inconsistencies regarding the doctrine. First, *Akorn* confirmed that when analyzing a MAC, the company should be evaluated based on its own performance, not including the value added from synergies stemming from the merger deal.[142] Additionally, the analysis should only focus on the value of the seller instead of on profitability to the buyer.[143] Whether the acquiring company can still make a profit notwithstanding the financial hardships suffered by the seller is immaterial to determining MAC.[144] It also demonstrated that MAC language can appear in multiple places in a merger agreement, and thus there can be a finding of multiple MACs.

The *Akorn* decision added two new steps to the MAC analysis: considering 1) whether the MAC event falls into a carve-out or exclusion to the carve-out, and 2) whether the acquiring company accepted the risk.[145] The court also adopted the *Frontier* quantitative/qualitative analysis, but re-cast it as specifically for evaluating whether it was *reasonable to expect* a MAC to occur.[146] It is unclear how the quantitative/qualitative analysis operates differently from the IBP framework, and more so what indicates materiality qualitatively. Notably, durational significance is touched on in the quantitative analysis used in *Akorn* and *Frontier*, which leaves very little difference between that and the IBP framework.

Overall, the new additions to the MAC analysis do not amount to a change in the seller-friendly interpretation of Delaware. The quantitative drop in Akorn's business performance was far worse than any of the other cases the Chancery had seen, with a 55% decline in EBITDA in 2017 and a 20% drop in overall equity value of the company.[147] The exceedingly poor performance of Akorn was the reason for the court finding a MAC, rather than a shift in perspective about what constitutes a MAC. This is further confirmed by Chancery MAC opinions following *Akorn.*

*D. Post-*Akorn *and the Return to Seller-Friendly Decisions*

Following the *Akorn* decision, there was speculation that the Chancery had softened its position on the high burden to prove a MAC.[148] Before

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[140] *See id.* at *82.
[141] *See id.* at *76–*82.
[142] *See id.* at *56.
[143] *See id.* at *56.
[144] *See id.* at *57.
[145] *See id.* at *58, *60.
[146] *See id.* at *65.
[147] *See id.* at *47.
[148] *See* Lyons et al., *supra* note 5, at 4.

Akorn, it appeared to be nearly impossible for an acquiror to exercise the MAC termination right, but with the new ruling came hope that more buyers would be able to successfully invoke the clause.[149] After *Akorn*, a spate of new MAC cases emerged in Delaware, particularly after the COVID-19 crisis interrupted the ordinary course of business.[150] In the following subsections this paper will examine three cases decided post-*Akorn*, 1), *Channel Medsystems*, decided after *Akorn* and before COVID-19, and then 2) *AB Stable* and *Snow Phipps*, cases that emerged in response to COVID-19.[151] These decisions reveal that there has not been a shift in the view of the Chancery – the burden to prove MAC is still immense and thus the termination right is not easily accessible.

1. Channel Medsystems*: Introduction of a New Temporal Limit on Future MACs*

The next prominent MAC litigation heard in the Chancery post-*Akorn* was *Channel Medsystems v. Boston Science Corp*.[152] In *Channel Medsystems*, the Chancery again grappled with the fallout of a merger between two pharmaceutical companies, where Boston Science was set to acquire Channel.[153] The deal fell apart when it was revealed that Channel's Vice President of Quality stole from the company and had falsified expense reports and other documents that were submitted to the FDA in its pre-market approval package.[154] Fearing that the falsified documents could endanger the FDA approval of Channel's sole product, Cerene, Boston Science attempted to exit the merger.[155] Despite the issues with its submission, Channel did receive pre-market approval for Cerene on schedule.[156] Nonetheless, Boston Science pursued its MAC claim under a theory that Channel had made misrepresentations that would reasonably be expected to cause a MAC.[157] The Chancery disagreed, however, and found that no MAC had occurred or was reasonably likely to occur.[158]

To evaluate Boston Science's MAC claim, the court used the quantitative/qualitative framework outlined in *Frontier*, and then employed again in *Akorn*.[159] For the quantitative and qualitative analysis, Boston Science failed to carry its burden in proving that a MAC was reasonably likely to occur.[160] Quantitatively, Boston Science's expert tried to forecast

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[149] *See id.*
[150] *See* Lesnick et al., *supra* note 8.
[151] *See, e.g.,* Channel Medsystems, Inc. v. Boston Sci. Corp., No. 2018-0673-AGB, 2019 WL 6896462 (Del. Ch. Dec. 18, 2019); Snow Phipps Grp., LLC v. KCAKE Acquisition, Inc., No. CV 2020-0282-KSJM, 2021 WL 1714202 (Del. Ch. Apr. 30, 2021); AB Stable VIII, LLC v. Maps Hotels and Resorts One, LLC, No. CV 2020-0310-JTL, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020).
[152] *See* Miller, *supra* note 78, at 813.
[153] *See Channel Medsystems*, 2019 WL 6896462 at *1.
[154] *See id*.
[155] *See id*.
[156] *See id.*
[157] *See id.*
[158] *See id.*
[159] *See id.* at *29–*36.
[160] *See id.*

the potential impact that the scandal would have, but relied on the false premise that Channel would shelve Cerene for 1-2 years.[161] Further, the model created by the expert looked at changes in Channel's value including its merger synergies, rather than the standalone value of the company, which was deemed the proper measure for MAC in *Akorn*.[162] Boston Science's qualitative arguments were characterized by the court as mere speculation and thus fell short as well.[163]

Channel Medsystems affirmed that there is no more generous understanding of MAC in the Chancery and that a finding of MAC depends on an egregious set of facts. In addition, then-Chancellor Bouchard introduced a new limitation on MACs.[164] As seen in *Frontier* and *Channel Medsystems*, an acquiror can exercise the powers of the MAC clause if it could reasonably be expected that a MAC would occur.[165] Bouchard in his opinion held that in order to terminate based on MAC, one must prove that "it would reasonably be expected *as of the time of the anticipated closing*" rather than at some undefined point in the future.[166] This added limitation to finding MAC makes it even more difficult for acquirors to use the clause's termination right, because MACs that could happen soon after the anticipated closing would no longer count. This reading would foreclose the possibility of exercising a termination right from the start for cases like *Frontier*, where the threat of MAC from a toxic tort litigation was looming but *the effect* would not materialize before the closing date.[167] Thus, this reading is not only a drastic departure from the prior understanding of MACs reasonably expected to occur, but it also severely limits arguments for future MACs.[168]

2. *COVID-19 MAC Cases* AB Stable *and* Snow Phipps*: New Risk Exposure for the Seller in the Ordinary Course Covenant*

In 2020, a series of MAC cases arose because of the COVID-19 pandemic.[169] With the pandemic came a severe downturn in the economy and an interruption that halted business combination throughout the world.[170] Fearing the effects of COVID-19 on the economy and the welfare of their standalone businesses, many companies attempted to exercise the MAC

[161] *See id.* at *34–*36.
[162] *See id*. at *35; *see also Akorn*, 2018 WL 4719347, at *56.
[163] *See* Miller, *supra* note 78, at 785.
[164] *See Channel Medsystems*, 2019 WL 6896462, at *28; *see also* Miller, *supra* note 78, at 787.
[165] *See Channel Medsystems*, 2019 WL 6896462, at *28; *see also Frontier Oil*, 2005 WL 1039027, at *7.
[166] *Channel Medsystems*, 2019 WL 6896462 at *27.
[167] *See Frontier Oil*, 2005 WL 1039027, at *11–*12 (the Beverly Hills Litigation had commenced before the Closing Date of the merger agreement, however, the actual effect of the MAC would not come until later because the large litigation expenses would not kick in, and the potential liability would not be determined until the resolution of the case).
[168] For legibility, I will refer to MACs "reasonably expected to occur" as "future MACs."
[169] *See* Lesnick et al., *supra* note 8.
[170] *See* Richard Harroch, *The Impact of The Coronavirus Crisis on Mergers and Acquisitions*, FORBES, https://www.forbes.com/sites/allbusiness/2020/04/17/impact-of-coronavirus-crisis-on-mergers-and-acquisitions/?sh=2fdfeb96200a.

termination right to stop their mergers.[171] As these cases emerged, many in the legal community wondered whether the effects of COVID-19 could constitute MAC, or if the pandemic would fall into one of the bargained for carve-outs.[172] The Chancery answered clearly, finding that these predicate events fell into at least one of the carve-outs, thus not permitting acquiring parties to terminate.[173]

In *Snow Phipps*, for instance, the court held that no MAC had occurred because of a bargained for carve-out.[174] In that case, Kohlberg & Company, LLC (creator of KCAKE, an acquisition vehicle for the company) was set to acquire DecoPac (owned by Snow Phipps Group, LLC), a company that sells cake making technology for supermarket bakeries.[175] When DecoPac suffered a drastic drop in revenue because of the pandemic, the "buyer lost their appetite for the deal" and attempted to pull out of the merger.[176] Then-Vice Chancellor McCormick ruled that no MAC occurred, and even if it had, DecoPac was protected because the event fell into the "changes in law" carve-out, and did not have a "disproportionate effect" on the company.[177]

In its determination that no MAC had occurred or was reasonably likely to occur, the Chancery utilized the *IBP* framework, and found that a 5-week severe decline in revenue was not durationally significant enough to qualify.[178] Additionally, then-Vice Chancellor McCormick focused on the carve-out language of the MAC clause that covers changes "arising from or related to . . . changes in any Laws, rules, regulations, orders, enforcement policies or other binding directives issued by any Governmental Entity."[179] The court viewed the stay-at-home orders caused by the pandemic as a binding directive from the government, meaning that it would not provide the acquiror with a termination right.[180] Then, to complete the analysis the court had to consider the disproportionate effects exclusion.[181] Upon examination of similarly situated companies, it was clear that the decline in business was not unique to DecoPac but rather an industry wide issue.[182]

In a separate case, the Chancery found that COVID-19 fell into a different common MAC carve-out.[183] Vice Chancellor Laster again was tasked with answering whether a MAC had occurred, this time in a merger between AB Stable LLC and MAPs Hotels and Resorts One LLC.[184] The parties had a Sale and Purchase Agreement where AB Stable would sell all of its member interests in Strategic Hotels & Resorts LLC, a Delaware LLC,

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[171] *See* Lesnick et al., *supra* note 8.
[172] *See* Harroch, *supra* note 170.
[173] *See Snow Phipps*, 2021 WL 1714202, at *35; *see also AB Stable*, 2020 WL 7024929 at *55–*56, *aff'd*, 268 A.3d 198 (Del. 2021).
[174] *Snow Phipps,* 2021 WL 1714202, at *35.
[175] *See id.* at *1.
[176] *Id.* at *1, *9.
[177] *Id.* at *35–*37.
[178] *Id.* at *13, *34.
[179] *Id.* at *35.
[180] *See id.*
[181] *See id.* at *35–*36.
[182] *See id.*
[183] *See AB Stable*, 2020 WL 7024929, at *57.
[184] *See id.* at *1.

for $5.8 billion.[185] Then, when COVID-19 hit, MAPs decided to not close due to certain representations no longer being true and correct, which would reasonably be expected to cause a MAC.[186]

The court determined that no MAC had occurred per the sales agreement because COVID-19 fell squarely within the "natural disasters and calamities" carve-out.[187] Laster rebuffed MAP's argument that because there was no express usage of "pandemic" in any of the carve outs, that it could not be covered.[188] The Vice Chancellor also clarified that the effects of the pandemic fall within the plain meaning of calamity, and therefore is fully encompassed in the "natural disasters and calamity" exclusion.[189] These decisions served an important role in chilling MAC litigation arising out of COVID-19 because both the calamities and change in law carve-outs are found in most MAC clauses.[190] The Chancery 's holding forecloses MAC as an avenue for which an acquiror could potentially use to terminate a merger due to pandemics.

Importantly, however, *AB Stable* shed light on a drafting issue that was ultimately consequential for the company. In the AB Stable merger agreement with MAPs, the MAC clause and ordinary course of business covenant were bifurcated.[191] Often the ordinary course covenant is either encompassed in the MAC clause or the separate covenant will import MAC language.[192] The AB Stable merger agreement did neither, and so despite a finding that the calamities carve-out applied, the protections from the carve-out did not extend to the ordinary course of business covenant.[193] Thus, even though the court found that no MAC had occurred, MAPs termination of the merger was deemed proper because AB Stable was found not to be operating in the ordinary course of business due to the pandemic.[194]

The *AB Stable* holding has the potential to substantially alter MAC clause negotiations because it has markedly increased the selling party's exposure to risk. Counsel for sellers must be careful to connect MAC language to the ordinary course covenant because it would otherwise undermine the efficacy of the carve-outs. Conversely, the *AB Stable* holding is immensely beneficial for the acquiring party. Because the seller must prioritize drafting the MAC clause and ordinary course covenant together, it

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[185] *Id.*
[186] *Id.*
[187] *Id.* at *2.
[188] *Id.* at *55–*56.
[189] *Id.* at *57–*58.
[190] *See* Lesnick et al., supra note 8*; see also* Miller, *supra* note 78*,* at 755–56 (table 1).
[191] *See AB Stable,* 2020 WL 7024929, at *73.
[192] *See* Kling & Nugent*, supra* note 27*,* at 21; *see also Akorn*, 2018 WL 4719347, at *46 ("[T]he Merger Agreement deploys the concept of a Material Adverse [Change] in multiple locations.").
[193] *AB Stable*, 2020 WL 7024929, at *73 ("The Ordinary Course Covenant in this case does not incorporate the concept of a Material Adverse Effect. The parties selected a different materiality standard, which requires compliance with the Ordinary Course Covenant 'in all material respects.' That standard does not require a showing equivalent to a Material Adverse Effect, nor a showing equivalent to the common law doctrine of material breach.").
[194] *Id.* at *2.

can give the acquiror more bargaining power to demand concessions in drafting that will equalize the risk exposure.

E. *MAC Clauses Continue to be Analyzed from a Seller-Friendly Perspective which Augments the Risk to the Acquiring Party*

The MAC analytical framework in Delaware has been shown to have certain idiosyncrasies per case, but the jurisprudence shares a set of core principles.[195] First, MAC is still viewed by the Chancery through a seller-friendly lens, with a heavy burden of proof required to indicate MAC.[196] Also, MAC is to be analyzed from a long-term perspective of a reasonable acquiror, which is an objective standard.[197] Next, although "material" in MAC clauses is left largely undefined, case law has demonstrated that acquirors must surpass a high quantitative threshold to prove MAC, and that the effect of the MAC must be durationally significant – meaning that it is measured in years rather than months.[198] Fourth, a MAC does not actually have to occur, rather the triggering event merely must be reasonably expected to result in a MAC.[199]

The result of these principles is a nearly insurmountable burden on the party attempting to invoke the MAC termination right. Despite the fact that *IBP* – the case that set the MAC framework – was arrived at "with less than the optimal amount of confidence," these principles have continued to be the basis for determining whether MAC has occurred.[200] As of now, the Chancery has only found MAC in one instance that allowed for an acquiror to exit the merger deal.[201] Even though cases such as *IBP* have noted large downturns in business performance, these claims have failed because the court either found a lack of durational significance, the poor performance did not meet an undefined quantitative threshold for materiality, or the predicate event fell into one of the bargained for carve-outs.[202]

The Chancery's seller-friendly perspective, in effect, augments the risk for the buyer, undermining the careful risk allocation bargained for by the parties. This erodes the efficacy of the MAC clause as a protective device for buyers, and advantages sellers in the event of litigation. Section III of this paper will explore changes in drafting practices that can be implemented to create a more equitable balance of risk and improve the function of the MAC clause so that it provides adequate protection to both merging parties.

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[195] *See generally In re IBP*, 789 A.2d 14; *Frontier Oil*, 2005 WL 1039027; *Hexion*, 965 A.2d; *Akorn*2018 WL 4719347; *Channel Medsystems*, 2019 WL 6896462; *Snow Phipps*, 2021 WL 1714202; *AB Stable*, 2020 WL 7024929.

[196]*See* Clar & Foss, *supra* note 1, at 4.

[197] *See Snow Phipps*, 2021 WL 1714202, at *20.

[198] *See id.* at *2, *24, *30, *37.

[199] *See Channel Medsystems*, 2019 WL 6896462, at *32 (Although former Chancellor Bouchard decided that MACs reasonably expected to occur must have that effect before the closing date of the merger.) It is unclear whether this perspective has been embraced or rejected, because the successive MAC cases in Delaware have been silent on the issue.

[200] *In re IBP*, 789 A.2d at 71.

[201] *See Akorn*, 2018 WL 4719347, at *14.

[202] *See In re IBP*, 789 A.2d at 69 (reporting a 64% in earnings compared to the prior year); *see also Hexion*, 965 A.2d at 742–46.

III. THE CASE FOR INCREASED PRECISION: DRAFTING MAC CLAUSES TO ACHIEVE A MORE EQUITABLE BALANCE OF RISK BETWEEN MERGING PARTIES

Counsel for merging parties should strive to draft MAC clauses that have a more equitable balance of risk allocated between parties. As section II discussed, the seller-friendly perspective of the Chancery disadvantages the buyer and makes it difficult to exercise the MAC termination right.[203] On the other hand, the *AB Stable* decision exposes the seller to risk through the ordinary course covenant if it is not adequately tied to MAC language.[204] With heightened risk exposure on both sides, the parties should attempt to control these risks as much as possible through greater specificity in contractual language.

Throughout Delaware MAC jurisprudence, Vice Chancellors have called for more specific contract terms so that the parties have superior control of the risk.[205] As Vice Chancellor Laster explained in *Akorn*, there is a "strong American tradition of freedom of contract…[that] is especially strong in [Delaware], which prides itself on having commercial laws that are efficient."[206] In *IBP*, former Vice Chancellor Strine reasoned that instead of waiting for the court to render a decision on the MAC clause, the party in question "should have bargained for it."[207] Similarly, in *Hexion*, former Vice Chancellor Lamb wrote that "[i]f Hexion wanted the short-term forecasts of Huntsman warranted by Huntsman, it could have negotiated for that."[208] Moreover, Vice Chancellor Laster further posited that "[i]t is not the court's role to rewrite the contract between sophisticated market participants, allocating the risk of an agreement after the fact, to suit the court's sense of equity or fairness."[209] The Vice Chancellors have in essence said that they would respect the terms bargained for in the contract, and that those terms would serve to guide the court's interpretation. If the contract language is specific enough such that it defines unclear terms including materiality and what is considered durationally significant to a party, then the court is forced to use the bargained for contractual definitions, rather than relying on the unfavorable precedent in Delaware jurisprudence.

Attorneys have already responded to the call from the Chancery to make contracts more specific, but there are additional steps that can be taken to control the court's interpretation of MAC.[210] Since *IBP*, where former Vice Chancellor Strine faulted the parties for not including carve-outs and exclusions to the carve-outs, most disputed MAC clauses before the

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[203] *See generally In re IBP*, 789 A.2d; *Frontier Oil*, 2005 WL 1039027; *Hexion*, 965 A.2d 715; *Akorn*, 2018 WL 4719347; *Channel Medsystems*, 2019 WL 6896462; *Snow Phipps*, 2021 WL 1714202; *AB Stable*, 2020 WL 7024929.
[204] *See AB Stable*, 2020 WL 7024929, at *73–*75.
[205] *See, e.g.*, *Akorn*, 2018 WL 4719347, at *60; *In re IBP*, 789 A.2d at 66; *Hexion*, 965 A.2d at 739.
[206] *Akorn*, 2018 WL 4719347, at *60 (alteration added) (footnote omitted).
[207] *In re* IBP, 789 A.2d at 66.
[208] *Hexion*, 965 A.2d at 743.
[209] *Akorn*, 2018 WL 4719347, at *60
[210] *See, e.g.,* Herman & Piereck, *supra* note 9.

Chancery have incorporated these features.[211] Nonetheless, although the exceptions and exclusions function to allocate risk, the risk generally still seems to fall on the acquiror.[212] Deal attorneys can go farther with the specificity of contractual terms, even if by consequence there is increased front-end negotiations.[213] In particular, this paper puts forward three recommendations: 1) that parties should bargain for a more precise definition of both materiality and durational significance, 2) the acquiring party should advocate for a temporal limit outside of the merger closing date for future MACs, and 3) the acquiring party should use the drafting of the ordinary course covenant to incentivize the selling party to accept a more precisely defined MAC with the temporal limit outside of the merger closing date.

A. Parties Should Bargain for a More Precise Definition of Both Materiality and Durational Significance

One strategy that could help balance the risks of the merging parties would be to define "material" and what constitutes durational significance. Beginning with materiality, parties should attempt to arrive at a specific quantitative threshold for what would be considered a MAC. In the past, the quantitative threshold has been successfully employed by an acquiror to exercise its termination right in other jurisdictions.[214] For instance, in *Nip v. Checkpoint Systems,* a case arising in Texas, the parties had set a quantitative thresholder where a $50,000 decline in value would indicate MAC.[215] Because the value of the selling company indisputably fell more than $50,000, the court easily arrived at its decision to allow the buyer to terminate the transaction.[216] Although *Nip* is not perfectly apposite because it is in a separate jurisdiction, and the deal is worth substantially less than those litigated in Delaware, the case illustrates the control over risk by the parties and ease of decision making for the court.[217]

There are a few potential drawbacks to the quantitative threshold. First, commentators have posited that a quantitative threshold would likely be a "noisy proxy" meaning that it is "not perfectly correlate[d] with the true state of the world."[218] When a proxy is noisy in combination with narrowly defined terms, the court's discretion may be diminished and could lead to false positives or negatives in terms of litigation results.[219] Instead, high

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[211] Lyons et al., *supra* note 5.
[212] *See generally Hexion*, 965 A.2d 715; *Akorn*, 2018 WL 4719347.
[213] *See* Choi & Triantis, *supra* note 23, at 852.
[214] *See* Art. H. Rosenbloom & Jonathan Hermann, *Quantifying Material Adverse Changes for Liability and Damage Purposes*, 21 NO. 4 WESTLAW JOURNAL DERIVATIVES 1, 3-4 (2015).
[215] *See* Nip v. Checkpoint Sys., Inc., 154 S.W.3d 767, 769 (Tex. App. 2004).
[216] *See id.* at 770.
[217] The ease of decision making is evidenced by the length of the *Nip* memorandum opinion, which in total was 11 reporter pages. Compared to the *Akorn* memorandum opinion, which was 246 pages total, it shows that a judge can come to a conclusion without an exhaustive analysis. *See id*. at 769; *see also* Emmerich & Norwitz, supra note 2, at 4.
[218] *See* Choi & Triantis, supra note 23, at 852 ("[Q]uarterly accounting net income of a corporation is positively but not perfectly correlated with the long-term profitability of the corporation.").
[219] *See id.* at 889.

litigation costs theoretically act as a "screen" to litigation itself, and therefore the seller would only sue if it had a high probability of winning.[220] While a noisy proxy may not reflect real world conditions perfectly, an additional decade of case law has demonstrated that leaving discretion in the hands of the court would be against the interest of the buyer. With the seller-friendly perspective and high burden on the party exercising its termination right, a seller has the advantage if a dispute reaches the litigation stage. The litigation "screen", therefore, would likely not deter a selling party unless its drop in performance was commensurate or worse than that of Akorn's.

Notwithstanding the differences with *Nip*, and the potential drawbacks from being a "noisy proxy," a quantitative threshold could have considerable cost saving benefits for both parties.[221] Indeed, it may be difficult for parties to arrive at a specific quantitative threshold without prolonged negotiation which would drive up the front-end costs of the transaction. However, a specific threshold would simplify the task of identifying a MAC and likely save parties from exorbitant litigation costs.[222] On the other hand, if parties opt for vague terms and the dispute over MAC reaches the litigation stage, then it will result in a resource intensive investigation with staggering costs for both parties.[223] Twitter, for example, incurred at least $90 million in fees in connection with its enforcement of Elon Musk's acquisition of the company, despite his attempt to exercise his MAC termination right.[224] Because of the straightforward analysis stemming from the inclusion of a quantitative threshold, the litigation cost savings would likely outweigh any increased cost of negotiation.

With the benefits of a quantitative threshold established, arriving at this benchmark should be done on a case-by-case basis according to the value of the deal to the parties. Generally, an acquiring party should attempt to set the quantitative threshold at a level below what the Chancery has endorsed in the past as what could constitute a MAC. In *Akorn*, the court found a 55% drop in EBITDA and a 20% drop in equity value of the company to be a MAC.[225] Additionally, Vice Chancellors and many courts throughout the U.S. generally have found a 40% decrease in profits to count as MAC.[226] Counsel for the acquiror in conjunction with its investment bankers should confer to determine an appropriate level to set the threshold where the selling

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[220] *See id.*
[221] *Id.* at 854.
[222] *See* Kling & Nugent, *supra* note 27, at 9.
[223] Choi & Triantis, *supra* note 23 at 853 n.6 ("Litigation costs can arise either from the task of interpreting a vague provision or from the presentation and weighing of evidence proving whether a contingency occurred or a promisor performed as promised").
[224] Mike Scarcella, *Elon Musk's Twitter Fee Fight with Law Firm Wachtell Belongs in Arbitration, Judge Says*, REUTERS, https://www.reuters.com/legal/transactional/elon-musks-twitter-fee-fight-with-law-firm-wachtell-belongs-arbitration-judge-2023-10-17/ [https://perma.cc/PBG8-XFTH;]; *see also* Verified Complaint, *Twitter, Inc. v. Elon Musk et al.*, No. 2022-0613-KSJM (Del. Ch. Jun. 12, 2022) (Elon Musk attempted to exercise the termination right in connection with the merger agreement's MAC clause). The MAC clause present in the Twitter merger agreement included vague terms, and therefore required a fact intensive investigation.
[225] *Akorn*, 2018 WL 4719347, at *55, *74.
[226] Kling & Nugent, *supra* note 27, at 9.

party would be willing to negotiate, but there would still be an advantage conferred by including a specific threshold. Moreover, the quantitative threshold language can be drafted such that it is not the exclusive indicator of a MAC but that the court may find a MAC at a lower quantitative threshold or using a different metric.[227]

Next, the parties can include a definition of durational significance in the MAC clause. Durational significance is not usually contractually defined, but rather a part of the MAC analysis established in *IBP*.[228] By defining durational significance in the merger contract, the parties can exercise greater control over the MAC analysis by the courts. Moreover, it could be a way for either party to gain a significant advantage in litigation.

Delaware jurisprudence has indicated that a downturn of profits for one quarter is not sufficient to qualify as durationally significant.[229] Additionally, former Chancellor Allen and other jurisdictions have concluded that a more than 50% decline in earnings over two quarters would likely be considered a MAC.[230] If an acquiring party has significant leverage in the merger, it could attempt to define durational significance as a drop in earnings for only one quarter. Under this definition, the outcome of cases like *IBP* would be altered, where there was a 64% drop in earnings for only one of the quarters.[231] By setting the durational threshold as only one quarter, the acquiror would be better protected because it would have a much easier time exercising the termination right. Conversely, if the seller had greater leverage in the deal, then it could also attempt to set the durational threshold to three quarters or more, making it more difficult to find a MAC. In most instances, however, parties would be unlikely to agree to such a departure from the current view of a MAC. Therefore, under normal circumstances, parties should set the durational threshold for business performance as two quarters. Thus, if there is a decline that meets the quantitative threshold over two quarters, then a MAC has occurred.

B. The Acquiror Should Advocate for a Temporal Limit Outside of the Merger Closing Date for Future MACs

An acquiror should also seek to include MAC clause provisions that relate to the timeframe for future MACs. Prior to *Channel Medsystems*, there was no temporal limit established for when a MAC could occur.[232] Former Chancellor Bouchard held that to demonstrate a future MAC, one must prove that it "would reasonably be expected *as of the time of the anticipated closing*."[233] This interpretation is a departure from how MACs were previously understood by the Chancery. Had this been the proper reading, *Frontier*, where the potential MAC would not materialize until after the

[227] *Id.*
[228] *In re IBP*, 789 A.2d at 68.
[229] *Id.*
[230] *See Akorn*, 2018 WL 4719347, at *53 n.559–60.
[231] *See In re IBP*, 789 A.2d at 68.
[232] *See* Miller, *supra* note 78, at 753.
[233] *Channel Medsystems*, 2019 WL 6896462, at *27 (emphasis added).

closing date, would have never made it to trial.[234] Former Chancellor Bouchard's holding limits the potential future MACs that could be found, which disadvantages a buyer seeking to terminate because of a reasonable expectation that a MAC would occur. To remedy this, an acquiror's deal counsel should include language that sets a temporal limit some time past the anticipated closing date of the merger. Although it is unlikely for seller's counsel to agree to a time far in the future, the seller could be amenable to an extended timeframe if there are certain concessions made.

C. The Acquiror Should Leverage the Ordinary Course Covenant in Bargaining

The placement of the ordinary course covenant can have detrimental effects on the selling party. An ordinary course covenant can either be included in the actual MAC clause or written separately. As *AB Stable* demonstrated, separating an ordinary course covenant from the MAC clause can come with pitfalls.[235] In that case, because the covenant did not import MAC language as its measure for materiality, the court concluded that the two clauses were wholly unconnected.[236] Thus, even though the disasters and calamities carve-out shielded the seller from a finding of MAC, the acquiring party was still able to terminate because those protections did not extend to the ordinary course covenant.[237] The wording and placement of the ordinary course covenant can be a helpful negotiation tool to achieve other drafting goals regarding the MAC clause, namely setting a quantitative threshold, establishing a definition for durational significance, and pushing back the future MAC timeframe. By allowing the selling party to draft the ordinary course covenant within the MAC clause, or with MAC language, the acquiring party can incentivize the seller to accept the other provisions it advocates for.

IV. CONCLUSION

The implementation of the three drafting changes will result in a more equitable balance of risk for both parties and will improve the efficacy of MAC clauses as protective devices. First, by instituting a quantitative threshold and more precise definition of durationally significant, the parties can better control judicial interpretation of MAC clauses. Next, by setting the timeframe outside of the closing date for future MACs, the acquiring party would not be as limited in its available arguments. Furthermore, it would return the MAC analysis to its former understanding before *Channel Medsystems*. Finally, the drafting of the ordinary course covenant in connection with the MAC clause will likely create sufficient incentive for a selling party to accept the other recommendations. Otherwise, the selling party would be subject to a much greater risk of merger termination if a MAC-like predicate event transpired. This equitable scheme more fairly

[234] *See Frontier Oil*, 2005 WL 1039027, at *11–*12.
[235] *See AB Stable*, 2020 WL 7024929, at *73.
[236] *Id.*
[237] *See id.* at *73–*74.

balances the risks posed to both sides, and ultimately will protect the parties in the manner that they bargained for.