

# THE BIG MAC: HOW SHOULD COURTS APPROACH MAC CLAUSES IN MERGER AND ACQUISITION AGREEMENTS?

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## INTRODUCTION

Since the twentieth century, material adverse change (“MAC”) clauses—otherwise known as material adverse effect (“MAE”) clauses—have existed generally in the United States as perfunctory boilerplate provisions included in merger and acquisition agreements and received little, if any, attention in litigation.<sup>1</sup> Beginning in the early 2000s, however, MAC clauses began evolving into intricately detailed and complex transactional creatures with counsel on both sides vying to preemptively memorialize every condition that could constitute a MAC along with the relevant carve-outs.<sup>2</sup>

Although MAC clauses were once simple and unremarkable, the clause’s increased detail—and subsequent litigation—has been sparked, in part, by major world events including natural disasters, wars, terrorist attacks, international calamities, and, most recently, the COVID-19 pandemic.<sup>3</sup> Following the onset of the pandemic, for example, Advent International started getting cold feet regarding its previously consummated merger agreement with Forescout Technologies, leading Forescout to seek declaratory judgment that COVID-19 did not qualify as a material adverse event.<sup>4</sup> The parties ultimately settled the litigation by renegotiating for a lesser merger price.<sup>5</sup> Similarly, Louis Vuitton, the world’s leading luxury goods company, had announced plans to acquire Tiffany & Company in late 2019, a monumentally expensive deal worth nearly \$16 billion.<sup>6</sup> After a bitter legal dispute revolving around the agreement’s MAC

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1. Ronald J. Gilson & Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisitions*, 21 J.L. ECON. & ORG. 330, 331 (2005).

2. See Andrew C. Elken, *Rethinking the Material Adverse Change Clause in Merger and Acquisition Agreements: Should the United States Consider the British Model?*, 82 S. CAL. L. REV. 291, 293 (2009).

3. Vincent Scala, *Changes to Material Adverse Effect Clauses Following Major Events: Evidence from COVID-19*, 95 ST. JOHN’S L. REV. 549, 557 (2021).

4. *Forescout Commences Litigation Against Advent International*, GLOBE NEWSWIRE (May 20, 2020), <https://www.globenewswire.com/news-release/2020/05/20/2036337/0/en/Fore%20scout-Commences-Litigation-Against-Advent-International.html> [https://perma.cc/5KS9-C2AN].

5. *Forescout and Advent International Reach Amended Merger Agreement*, GLOBE NEWSWIRE (July 15, 2020), <https://www.globenewswire.com/news-release/2020/07/15/2062619/0/en/Forescout-and-Advent-International-Reach-Amended-Merger-Agreement.html> [https://perma.cc/P2XQ-LJM4].

6. *LVMH Shakes up Tiffany Management after \$15.8 Billion Acquisition*, CNBC (Jan. 7,

clause, the parties eventually renegotiated the deal price, lowering it by \$425 million.<sup>7</sup>

Fast forward to today and all sorts of socioeconomic events, from natural disasters to pandemics, have lit a fire under corporations seeking to use their MAC clauses as an escape hatch to get out of merger and acquisition agreements. And we can certainly expect more events in the future to similarly persuade corporations to enforce the MAC clause. Therefore, courts in all jurisdictions should work to articulate a uniform understanding of the foundational purpose of the MAC clause. Elucidating—and agreeing on—this underlying purpose will, in turn, help courts form a uniform interpretive approach to MAC clauses. Establishing a consistent interpretive approach to MAC clauses will increase certainty, clarity, and predictability for contracting parties.

This Note argues that the best way to understand the foundational purpose of the MAC clause is through a combination of Robert T. Miller’s acquirer-focused theory and Gilson & Schwartz’s seller-focused theory. Based on this understanding, courts can begin to form a more unified interpretive approach when determining if a MAC has occurred. With this uniform approach in place, contracting parties will have more predictability and certainty when determining if they are facing a MAC that could threaten their agreement. Part I of this Note provides background on how MAC clauses operate in merger and acquisition agreements and reviews the development and usage of MAC clauses as influenced by major events. Part II then surveys the major Delaware case law addressing enforcement of MAC clauses, providing the landscape of the fractured approach to the MAC clause. Finally, Part III argues that to bring predictability and certainty to this area, courts should adopt a uniform understanding of the MAC clause that involves both Miller’s and Gilson & Schwartz’s theories, but at different steps in the interpretive process. An integration of both theories will provide for an applicable, comprehensive interpretive approach to the MAC clause.

## I. BACKGROUND INFORMATION ON MAC CLAUSES

### *A. Purpose of MAC Clauses*

At the very beginning of any contractual relationship, the involved parties work to strategically structure the transaction to minimize potential losses and maximize potential gains. Carefully detailing this risk allocation is an especially important consideration for large commercial transactions with potentially enormous amounts of money on the line, namely merger and acquisition agreements.<sup>8</sup> The time between signing the agreement and transferring assets to

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2021), <https://www.cnn.com/2021/01/07/lvmh-shakes-up-tiffany-management-after-15point8-billion-acquisition.html> [https://perma.cc/XAY6-UX68].

7. *Id.*

8. STANLEY FOSTER REED ET AL., *THE ART OF M&A: A MERGER ACQUISITION BUYOUT GUIDE* 465 (4th ed. 2007) (explaining that merger agreement negotiations are “in large part, an effort

effectively close the deal is an especially risky period in merger and acquisition agreements because there is a chance that the target company's business could decline and become less valuable to the acquirer. Therefore, many of the risk-shifting devices used in merger and acquisition agreements address the potential that the target company may deteriorate during the gap period.<sup>9</sup> One such device is the MAC clause.

As a risk allocation mechanism, MAC clauses generally provide that if the target business suffers a MAC between selling and closing, the acquirer will have no obligation to close the transaction and will have a right to terminate the agreement with no further liability.<sup>10</sup>

### *B. Structure and Function of Modern MAC Clauses*

MAC clauses have historically been included in merger and acquisition agreements as mere boilerplate provisions, but their role—and complexity—has evolved significantly.<sup>11</sup> Modern MAC clauses generally start with a base definition of what occurrence(s) would constitute a MAC on the target company or various aspects of it, such as results of its operations, financial condition, or business.<sup>12</sup> The base definition of a MAC in a standard merger and acquisition agreement may read as follows:

[A]ny change, event, or effect that, either individually or in combination with all other changes, events, or effects: (1) has a material adverse effect on the business, operations, assets, liabilities (including contingent liabilities), financial condition, or results of operations of such entity and its subsidiaries taken as a whole, or (2) could reasonably be expected to materially impair the ability of such entity to consummate the merger and to perform its other obligations under the merger agreement.<sup>13</sup>

A list of exceptions typically follows the base definition that removes certain occurrences from the base definition of a MAC.<sup>14</sup> The exceptions can usually be characterized as: systematic risks that affect the entire market and not just the

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by the parties to allocate risk[.]”).

9. Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2012 (2009).

10. A buyer's right to terminate the transaction may stem from, for example, and most commonly, the inclusion of a closing condition favoring the acquirer that the target company has not suffered a MAC. See Robert T. Miller, *Material Adverse Effect Clauses and the COVID-19 Pandemic* 1 n.6 (U. Iowa Legal Studies Research Paper No. 2020-21, 2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3603055](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3603055) [<https://perma.cc/2QJ4-5ESK>].

11. See discussion, *supra* INTRODUCTION.

12. Miller, *supra* note 10, at 2.

13. Dennis J. Block, *Securities Law Aspects of Mergers, Acquisitions and Other Corporate Transactions*, in 2 UNDERSTANDING THE SECURITIES LAWS 2010 at 399 (Practising Law Inst. 2010).

14. Miller, *supra* note 10, at 4.

target company; indicator risks implying that the target company's business has been impaired<sup>15</sup>; and agreements risks arising from announcing the merger. Exceptions then shift these risks back to the acquirer.<sup>16</sup> However, systematic risks that disproportionately affect the target company are generally excluded from the exceptions ("Disproportionality Exception"), shifting the risk back to the target company by providing another avenue for the acquirer to potentially terminate the agreement.<sup>17</sup> Clearly, the MAC clause has the potential to be incredibly complex, a creature of interlacing risk allocations that punt the risk of the deal from the target company to the acquirer back to the target company.

If an acquirer seeks to use the MAC clause to terminate a deal, there is more back-and-forth involved. Enforcement of MAC clauses to terminate a transaction includes a burden-shifting scheme with the acquirer bearing the initial burden of proof to show a MAC has occurred concerning the target company within the meaning of the base definition.<sup>18</sup> If the acquirer meets this burden, the next consideration is whether the recognized MAC falls into any of the listed exceptions that would preclude the acquirer's ability to terminate the transaction.<sup>19</sup> However, whether the acquirer or the target company bears the burden on this step of the enforcement process is not clear and substantially varies case-to-case.<sup>20</sup> Next, if there is a Disproportionality Exception that removes some situations from the listed exceptions, the acquirer has the burden of proof to show the target company has been disparately impacted in comparison to its peers and that this constitutes a MAC.<sup>21</sup> If all of these steps are satisfied and the acquirer shows there has been a MAC in the target company, the acquirer can terminate the deal without facing any liabilities.

### *C. Development of MAC Clause Usage*

MAC clauses have garnered increased attention both by contracting parties and by courts in recent decades.<sup>22</sup> Economic volatility in the late 1980s and 1990s was compounded by increased unrest in the product and capital markets, leading

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15. Exceptions for indicator risks also usually expressly state that the underlying cause(s) for the appearance of the indicator risk are not exceptions themselves. *See id.* at 5.

16. *Id.*

17. *Id.*

18. *Id.* at 6.

19. *Id.*

20. *Id.*; *see Akorn, Inc. v. Fresenius Kabi AG*, C.A. No. 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. 2018), *aff'd* 198 A.3d 724 n.619 (Del. 2018) (dicta) (Vice Chancellor Laster suggests the burden shifts to the target company to prove the occurrence does fall within an exception); *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715 n.60 (Del. Ch. 2008) (suggestion that parties should instead explicitly provide in the contract which party has the burden of proof on this step).

21. Miller, *supra* note 10, at 6.

22. *See* accompanying text, *supra* note 1-7.

to the more intricately drafted provisions we now see in the 21st century.<sup>23</sup> In response to this increased socioeconomic uncertainty, contracting parties began supplementing the base definition of a MAC by providing for carve-outs or exceptions limiting the acquirer's ability to terminate the deal.<sup>24</sup> The clause's complexity builds on itself as both parties try to regain risk protection, resulting in the intricate structure and enforcement scheme outlined in the previous section.

Annual MAC surveys conducted by Nixon Peabody document the observed changes in MAC clauses in response to major world events affecting the economy such as terrorist attacks, natural disasters, and, most recently, worldwide pandemics. This development is most obvious in the MAC exceptions parties negotiate to include in the contract, reflecting the risks most salient to the parties at the time of contracting. For example, 15% of analyzed agreements between July 3, 2002 and June 2, 2003 contained a MAC exception for changes in the target company's business caused by acts of terror or war, representing a marked increase from the previous study period of September 11, 2001 to July 3, 2002, which showed only 7% of transactions including acts of terror or war language.<sup>25</sup> The 2003 survey reveals that in addition to the United States terrorist attacks of September 11th, the Afghanistan and Iraq wars "undoubtedly played a large role in this increase" of MAC language.<sup>26</sup> Exceptional language for acts of God following natural disasters experienced a similar trend. Ostensibly due to the catastrophic consequences of earthquakes in Haiti and Chile in 2010, MAC exceptions for acts of God appeared in 38% of reviewed agreements from June 1, 2009 to May 31, 2010.<sup>27</sup> This represented an increased presence, up from just 19% of agreements surveyed the previous year.<sup>28</sup> Finally, Nixon Peabody tracked COVID-related exceptions in its 2020 MAC Survey, finding their inclusion in 25% of reviewed agreements.<sup>29</sup> However, the survey states this percentage likely "understated the concern of dealmakers about the potential impact of the risk of the pandemic" because only a fraction of the reviewed agreements were entered into on or after February 1, 2020, which is around the time when the United States became aware of COVID-19.<sup>30</sup> Presumably, many more contracts than those reviewed included COVID-related exceptions.

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23. Molly Brooks, *The "Seller-Friendly" Approach to MAC Clause Analysis Should Be Replaced by a "Reality-Friendly" Approach*, 87 U. DET. MERCY L. REV. 83, 85 (2010).

24. *Id.*

25. Nixon Peabody LLP, *Second Annual MAC Survey*, 1 M&A ADVISOR 2 (2003), [https://www.nixonpeabody.com/-/media/Files/Alerts/MAAdvisor\\_07002003.ashx](https://www.nixonpeabody.com/-/media/Files/Alerts/MAAdvisor_07002003.ashx) [<https://perma.cc/Z87U-UFFL>].

26. *Id.*

27. NIXON PEABODY LLP, 2010 NIXON PEABODY MAC SURVEY 9 (2010), [https://www.nixonpeabody.com/-/media/Files/Alerts/MAC\\_Survey\\_2010.ashx](https://www.nixonpeabody.com/-/media/Files/Alerts/MAC_Survey_2010.ashx) [<https://perma.cc/FQD8-PVGG>].

28. *Id.*

29. NIXON PEABODY LLP, MAC SURVEY: NP 2020 REPORT 9 (2020), [https://www.nixonpeabody.com/-/media/Files/PDF-Others/NP\\_MAC\\_SURVEY\\_2020.ashx?la=en&hash=41116207B7C918092071745EF5BF65B3](https://www.nixonpeabody.com/-/media/Files/PDF-Others/NP_MAC_SURVEY_2020.ashx?la=en&hash=41116207B7C918092071745EF5BF65B3) [<https://perma.cc/K9MS-8YE9>].

30. *Id.* at 9-10.

The statistics show the drafting of MAC clauses in merger and acquisition agreements is becoming increasingly complex with bouts of increased attention brought on by significant socioeconomic events such as the recent COVID-19 pandemic. The heightened usage should urge courts to develop a uniform interpretive approach for addressing MAC clause enforcement, the foundation for which can be found in Delaware case law.<sup>31</sup>

## II. DELAWARE MAC CASE LAW

### A. *In re IBP, Inc. Shareholders Litigation*<sup>32</sup>

Although MAC clauses have been ubiquitous in merger and acquisition agreements for a long time, the Delaware Court of Chancery's 2001 decision in *IBP* was among the first to conclusively decide whether a MAC had occurred, laying the foundation for future MAC clause litigation.<sup>33</sup> Prior to the *IBP* ruling, MAC case law was uncertain with no established framework for determining the materiality of a change in the target's business, arguably the most important factor in MAC litigation.<sup>34</sup>

In *IBP*, Tyson, the nation's leading chicken distributor, sought to out-bid a competitor to acquire IBP, aiming "to create the world's preeminent meat products company."<sup>35</sup> Despite being made aware of flaws within IPB including accounting fraud, Tyson increased their bid and ultimately signed a merger agreement containing scarce language addressing IPB's problems.<sup>36</sup> After signing the agreement, a harsh winter negatively impacted both Tyson and IPB, and the Securities and Exchange Commission ("SEC") began looking closely at IPB's accounting discrepancies, leading Tyson to claim a MAC had occurred and express intent to terminate the agreement.<sup>37</sup> The Delaware Court of Chancery held that no MAC had occurred and ordered specific performance of the merger

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31. Delaware's Court of Chancery is the nation's preeminent business court. Its Chancellor and Vice Chancellors are incredibly versed in corporate and commercial matters, resulting in the courts' most sophisticated and comprehensive written decisions on complex corporate law issues like the MAC clause. See *Litigation in the Delaware Court of Chancery and the Delaware Supreme Court*, DELAWARE.GOV, <https://corplaw.delaware.gov/delaware-court-chancery-supreme-court/> [<https://perma.cc/BL7Z-5Z5U>] (last visited Feb. 26, 2023).

32. *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14 (Del. Ch. 2001). The Delaware Court of Chancery decided *IBP* under New York state law but later adopted *IBP*'s holding under Delaware law in its 2005 decision in *Frontier Oil Corp. v. Holly Corp.*, No. CivA. 20502, 2005 WL 1039027 (Del. Ch. 2005).

33. See Andrew A. Schwartz, *A "Standard Clause Analysis" of the Frustration Doctrine and the Material Adverse Change Clause*, 57 UCLA L. REV. 789, 827-28 (2010).

34. See Sherri L. Toub, "Buyer's Regret" No Longer: *Drafting Effective MAC Clauses in a Post-IPB Environment*, 24 CARDOZO L. REV. 849, 859, 871 (2003).

35. *In re IBP*, 789 A.2d at 22.

36. *Id.*

37. *Id.* at 22-23.

agreement.<sup>38</sup>

The Court reasoned that Tyson simply had buyer's remorse and was looking for any way to get out of a deal they no longer considered financially profitable.<sup>39</sup> Part of Tyson's argument was that IBP's poor first quarter business performance—64% behind the comparable period the previous year—constituted a MAC allowing them to terminate the deal, but the Delaware Court of Chancery stated that MACs can only be considered in the context of changes to the “business or results of operations that [are] consequential to the company's earning power over a commercially reasonable period, which one would think would be *measured in years rather than months*.”<sup>40</sup> The Court further stated that the specifics of IBP's poor performance in the first quarter were not material.<sup>41</sup> The Court considered the materiality of IBP's accounting improprieties but ultimately found them irrelevant because the part of the company with the accounting issues was a “tiny fraction of IBP's overall business and that total shut-down of [this part] would likely have little effect on the future results of a combined Tyson/IBP.”<sup>42</sup>

*IBP* laid the foundation for materiality in MAC clause litigation by stating that an adverse change in the target company's business will only qualify as material if it substantially affects the target's earnings potential when viewed over years rather than months.<sup>43</sup> This opinion cemented MAC litigation strongly in favor of the selling target companies yet failed to delineate exactly when changes are considered durationally significant.<sup>44</sup> Such seller-friendliness in the post-*IBP* environment made it difficult for acquirers to litigate MAC clauses to completion, but acquirers were still able to leverage MAC clauses to try to renegotiate more favorable terms.<sup>45</sup>

#### B. Hexion Specialty Chemicals, Inc. v. Huntsman Corp.<sup>46</sup>

Seven years after *IBP* was decided, the Delaware Court of Chancery took on the *Hexion* case. *Hexion* continued the *IBP* narrative that acquirers face an uphill battle in proving the occurrence of a MAC.

This case involves two large chemical companies, Hexion Specialty

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38. *Id.* at 84.

39. *Id.* at 65 (“[I]t is useful to be mindful that Tyson's publicly expressed reasons for terminating the Merger did not include an assertion that IBP had suffered a [MAC].”); *see id.* at 50-51 (outlining the process Tyson used to decide to terminate the agreement, making clear that a MAC was not considered until after the decision to terminate had been made).

40. *Id.* at 69 (emphasis added).

41. *See id.* at 69-72.

42. *Id.* at 70.

43. *Id.*

44. *Id.*

45. STEVEN M. DAVIDOFF, *GODS AT WAR: SHOTGUN TAKEOVERS, GOVERNMENT BY DEAL, AND THE PRIVATE EQUITY IMPLOSION* 70, 65 (2009).

46. 965 A.2d 715 (Del. Ch. 2008).

Chemicals, Inc. and Huntsman Corp., who entered into a merger agreement.<sup>47</sup> After the parties signed the merger agreement, Hexion, the buyer, claimed Huntsman's poor earnings report in the period after signing the agreement constituted a MAC.<sup>48</sup> Like *IBP*, the Court, however, found a MAC had not occurred, citing the *IBP* opinion that there must be a change in the target's business that is consequential to the company's earnings power over a period of years.<sup>49</sup> The Court evaluated Huntsman's decline by comparing its performance against the results in the same quarter the previous year, which showed Huntsman experiencing only a 3% decline in its earnings before interest, taxes, depreciation, and amortization (EBITDA) from 2006 to 2007 and management further expecting just a 7% decline from 2007 to 2008.<sup>50</sup> The Court also found that the "Chemical Industry" carve-out included in the agreement did not operate to remove Huntsman's poor performance from the base definition of the MAC clause.<sup>51</sup> Therefore, the Court's analysis was limited to determining if Huntsman suffered a MAC within the meaning of the base definition.<sup>52</sup> The Court concluded it had not, so Hexion was not entitled to terminate the agreement.<sup>53</sup>

In finding that Hexion, an acquirer seeking to invoke a MAC clause to terminate an agreement, had not met its burden in proving the existence of a MAC, the Delaware Court of Chancery reaffirmed and clarified the "heavy burden" an acquirer bears in this context.<sup>54</sup>

#### C. Akorn, Inc. v. Fresenius Kabi AG<sup>55</sup>

In 2018, the Delaware Court of Chancery seemed to open the door for change in tone in MAC clause litigation. The *Akorn* decision marked the first time a Delaware court had found that a MAC had occurred, marking a monumental ruling for acquirers.

In *Akorn*, Fresenius, a German pharmaceutical company, signed a merger agreement with Akorn, an American pharmaceutical company, creating a deal worth almost \$5 billion.<sup>56</sup> However, after signing, Akorn suffered multiple quarters of disastrous business decline and two whistleblowers informed

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47. *Id.* at 721.

48. *Id.* at 721-22.

49. *Id.* at 738 (citing *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14, 67 (Del. Ch. 2001)).

50. *Id.* at 742.

51. *Id.* at 736-37.

52. *Id.* at 737.

53. *Id.* at 736.

54. *Id.* at 738.

55. No. 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018), *aff'd* 198 A.3d 724 (Del. 2018).

56. *Id.* at \*1; see Tom Hals, *Delaware Judge says Fresenius can walk away from \$4.8 Billion Akorn Deal*, REUTERS (Oct. 1, 2018), <https://www.reuters.com/article/us-akorn-m-a-fresenius-ruling/delaware-judge-says-fresenius-can-walk-away-from-4-8-billion-akorn-deal-idUSKCN1MB2PY> [<https://perma.cc/373M-6SBV>].



Fresenius of Akorn's less-than-compliant regulatory processes and quality assurance programs, prompting Fresenius to initiate its own investigation into the target company.<sup>57</sup> This investigation showed "serious and pervasive data integrity problems."<sup>58</sup> Fresenius declared a MAC and gave notice that it was terminating the merger agreement.<sup>59</sup>

The Court held Akorn had suffered a MAC, entitling Fresenius to terminate the merger agreement.<sup>60</sup> Following *IBP*'s definition of materiality, the Court stated the adverse change in the target company's business must "substantially threaten the overall earnings potential of a target in a durationally-significant manner" of years rather than months to be considered material.<sup>61</sup> The Court also followed *Hexion*<sup>62</sup> in evaluating the materiality of Akorn's decline by comparing its performance against the results in the same quarter the previous year.<sup>63</sup> Specifically, Akorn's EBITDA declined by 86% on a year-by-year basis, which constituted an observed "departure from its historical trend."<sup>64</sup> The Court found this to be a durationally significant change because it had existed for a year with no sign of reversing.<sup>65</sup> The Court also dismissed Akorn's argument that there could be no MAC as long as Fresenius still profited from the deal.<sup>66</sup>

The *Akorn* decision was a breath of relief to acquirers, revealing an atmosphere of increased buyer-friendliness in MAC clause interpretation. At the very least, the ruling showed it was not virtually impossible for acquirers to succeed on terminating an agreement on MAC clause grounds.<sup>67</sup>

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57. *Akorn, Inc.*, 2018 WL 4719347, at \*2.

58. *Id.*

59. *Id.* ("Fresenius asserted that Akorn's representations regarding regulatory compliance were so incorrect that the deviation would reasonably be expected to result in a Material Adverse Effect. Fresenius also cited Akorn's failure to comply in all material respects with its contractual obligations under the Merger Agreement, including Akorn's obligation to use commercially reasonable efforts to operate in the ordinary course of business in all material respects. Fresenius also cited the section in the Merger Agreement that conditioned Fresenius's obligation to close on Akorn not have suffered a Material Adverse Effect.").

60. *Id.* at \*47.

61. *Id.* at \*53 (quoting *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14, 68 (Del. Ch. 2001)).

62. *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008).

63. *Akorn, Inc.*, 2018 WL 4719347, at \*53. Importantly, the Court notes that this materiality inquiry is fact-specific with the existing possibility that lesser or greater magnitudes of change could be considered (or not considered) MACs in other situations. *See id.*

64. *Id.* at \*55.

65. *Id.* at \*55-56 (also noting that analysts projected an EBITDA decrease of more than 60% for the coming year, which was more than five times greater than the downturn expected across the industry as a whole).

66. *Id.* at \*57 (discussing the application of the frustration doctrine to the immediate situation).

67. Samuel Shapiro, *Rethinking MAC Clauses in the Time of Akorn, Boston Scientific, and COVID-19*, 10 MICH. BUS. & ENTREPRENEURIAL L. REV. 241, 259 (2021) (arguing that "a compelling argument can be made that [Vice Chancellor] Laster's ruling gives courts the leeway to start to make more permissive MAC rulings in the future").

D. Channel Medsystems, Inc. v. Boston Scientific Corp.<sup>68</sup>

In late 2019, the Delaware Court of Chancery returned again to the MAC clause, deciding the *Boston Scientific* case.<sup>69</sup> Despite the post-*Akorn* uptick in buyer-friendliness, the court found a MAC clause had not occurred.<sup>70</sup>

In this case concerning two medical technology companies, Boston Scientific had agreed to acquire the remaining outstanding equity of Channel Medsystems, of which it was already a minority owner, for \$275 million with a condition precedent that the FDA would approve Channel Medsystem's only product, Cerene.<sup>71</sup> Channel Medsystems then discovered its Vice President had falsified documents to pilfer over \$2.5 million from the company.<sup>72</sup> In response, Channel Medsystems notified Boston Scientific of the fraud, hired a forensic accounting firm to investigate the extent of the fraud, and filed a remediation plan with the Food and Drug Administration ("FDA"), which was accepted.<sup>73</sup> Nevertheless, Boston Scientific announced its intent to terminate the agreement despite Cerene's subsequent FDA approval, the non-approval of which would have been the primary grounds for a MAC.<sup>74</sup> The Court ultimately held that no MAC had occurred and ordered specific performance.<sup>75</sup>

Although the court found that no MAC had occurred, it also stated that even one falsified report "may be significant enough to establish material noncompliance[,]" presenting the potential for a lower materiality threshold that is reminiscent of *Akorn*.<sup>76</sup> Similar to the court's emphasis on Tyson's corrupt motives in *IBP*, the court here also noted evidence that Boston Scientific was merely looking for a way out of the deal due to perceived difficulties in marketing Cerene.<sup>77</sup> Overall, the *Boston Scientific* court speaks of *Akorn*'s reasoning in positive and approving terms but ultimately had no choice but to reject the MAC claim in this instance given the FDA's approval of Cerene.<sup>78</sup>

E. AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC<sup>79</sup>

In one of the most recent opinions concerning MAC clauses, the Delaware Supreme Court agreed with the finding of the Delaware Court of Chancery that

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68. No. 2018-0673-AGB, 2019 WL 6896462 (Del. Ch. 2019).

69. *Id.*

70. *Id.* at \*28.

71. *Id.* at \*5.

72. *Id.* at \*1.

73. *Id.* at \*6-12.

74. *Id.* at \*13-14.

75. *Id.* at \*1.

76. *Id.* at \*21.

77. *Id.* at \*38.

78. Shapiro, *supra* note 67, at 272-73.

79. No. 2020-0310-JTL, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020), *aff'd*, 268 A.3d 198 (Del. Dec. 8, 2021).

the COVID-19 pandemic fell within the plain meaning of the agreement's MAC clause providing for a "natural disasters or calamities" carve-out.<sup>80</sup> Events falling in the carve-out or exceptions provision would generally protect the seller from liability, shifting the risk back to the purchaser by not allowing it to terminate the deal on MAC clause grounds.<sup>81</sup> However, the Court of Chancery ultimately ruled in favor of the buyer because the seller breached another clause in the agreement—the ordinary course covenant.<sup>82</sup> The acquirer, as a result of this breach, was ultimately relieved of its obligation to close the deal.<sup>83</sup> However, this case still sheds light on how the structure of a contract's MAC clause impacts a court's interpretation and conclusion.

AB Stable, through its wholly owned subsidiary, owned hotel and resort properties in the United States and had contracted to sell its entire stake in the subsidiary to MAPS Hotels and Resorts One LLC ("MAPS").<sup>84</sup> This agreement was dated September 10, 2019.<sup>85</sup> Before the deal could close, however, COVID-19 morphed into a worldwide pandemic.<sup>86</sup> When the scheduled closing date arrived in April of 2020, MAPS asserted AB Stable had failed to satisfy all the necessary conditions to closing—one of which being that a MAC had not occurred—and, as a result, MAPS was no longer obligated to close.<sup>87</sup> Following this refusal to close, AB Stable sued for specific performance and litigation ensued.<sup>88</sup>

In addressing the issues of this case, the Court of Chancery put forth nothing less than a herculean effort to effectively read and interpret the contract between the parties. As mentioned previously, the MAC clause in the parties' agreement contained an exception for natural disasters or calamities.<sup>89</sup> If COVID-19 was found to fall within this exception, it would *not* be considered a MAC that would excuse MAPS's refusal to close.

To determine the appropriate scope of this exception, the court first examined multiple sources to determine the plain meaning of "natural disasters or calamities."<sup>90</sup> In concluding that the effects of the COVID-19 pandemic fit within the plain meaning of the words included in the exception, the court first considered the definition of "calamity" as included in Black's Law Dictionary as well as the vernacular meaning.<sup>91</sup> Indeed, the pandemic can be described as "[a] state of extreme distress or misfortune, produced by some adverse circumstance

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80. *Id.* at \*57.

81. *See* Miller, *supra* note 10, at 4.

82. *AB Stable*, 2020 WL 7024929, at \*105.

83. *Id.*

84. *Id.* at \*1.

85. *Id.*

86. *Id.*

87. *Id.* at \*1.

88. *Id.*

89. *Id.* at \*57.

90. *Id.*

91. *Id.*

or event” and a “cause of loss or misery.”<sup>92</sup> The COVID-19 pandemic, then, is one example of an event that the Delaware courts have found to fall within the oft-included “calamities” MAC exception.<sup>93</sup>

While Black’s Law Dictionary provides no definition of “natural disaster,” the court credited a vernacular definition, concluding that the pandemic fit the definition of “a sudden and terrible event in nature ... result[ing] in serious damage and many deaths.”<sup>94</sup> Ultimately, the plain meaning of the “natural disasters or calamities” exception controlled, and the court found that it encompassed the COVID-19 pandemic and its effects.<sup>95</sup>

Also aiding the court in coming to this conclusion is the generally seller-friendly nature of the MAC definition that serves to allocate systematic risk to the purchaser. The court observed that AB Stable and MAPS utilized the typical MAC clause structure in their agreement, which resulted in the typical seller-friendliness.<sup>96</sup> That is, the parties broadly reallocated the systematic risks of the transaction back to the buyer through the listed exceptions, including the carve-out for natural disasters or calamities.<sup>97</sup> Because the risk from a global pandemic is a systematic risk, it is rational to read the term “calamity” as shifting that risk back to the purchaser, MAPS.<sup>98</sup> The structural risk allocation in the MAC definition, therefore, also suggests including the pandemic in the carve-out, which is the same outcome reached in the plain-language interpretation.<sup>99</sup>

Further, the court determined the content of the MAC definition, in addition to its structure, also supports allocating the risk from the COVID-19 pandemic to the acquirer.<sup>100</sup> The parties’ agreed-to MAC definition included broad seller-friendly language that resulted in MAPS assuming a greater-than-normal range of risks as the purchaser.<sup>101</sup> Interestingly, the MAC clause also did not contain a disproportionality exclusion.<sup>102</sup> As discussed in Part I, a disproportionality exclusion removes certain events from the carve-outs if they disproportionality affect the target company. This would shift the risk back to the seller and reinstate the acquirer’s ability to terminate the deal. The omission of a disproportionality exclusion in the agreement between AB Stable and MAPS, then, further denotes an overall seller-friendly MAC clause.<sup>103</sup>

Lastly, the court highlighted the notably limited forward-looking nature of

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92. *Id.* at \*57 (quoting BLACK’S LAW DICTIONARY (6th ed. 1990)).

93. *Id.*

94. *Id.* (quoting *Natural Disaster*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/dictionary/natural%20disaster> [<https://perma.cc/9A8Z-WM4Y>] (last visited Jan. 9, 2024)).

95. *Id.* at \*59.

96. *Id.* at \*60.

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* at \*61.

103. *Id.*

the MAC definition as included in the parties' contract.<sup>104</sup> For example, the MAC definition does not include the "prospects" of AB Stable and the hotels, which greatly reduces the forward-looking nature of the provision.<sup>105</sup> As the court explained:

A more explicitly forward-looking definition is more favorable to the buyer, who can more easily claim that the seller suffered a material adverse effect if the seller fell short of its projected results. A less explicitly forward-looking definition is more favorable to the seller, because the seller can argue for comparing its results to a historical trend[.]<sup>106</sup>

Overall, the court adopted a plain-language interpretation of the "natural disasters or calamities" carve-out; considered the structure and content of the parties' MAC definition; and examined the limited forward-looking nature of the MAC definition in finding that the COVID-19 pandemic fell within the exception.<sup>107</sup> Although the court reached a seller-friendly conclusion on the MAC clause issue, the buyer, MAPS, ultimately prevailed on different grounds.<sup>108</sup> The Court of Chancery's seller-friendly MAC clause discussion, though, illuminates the modes of interpretation a court is likely to utilize when determining if an event, such as the COVID-19 pandemic, falls within a stated MAC carve-out.

### III. ADOPTING A UNIFORM UNDERSTANDING OF MAC CLAUSE INTERPRETATION

#### *A. Uncertainty in Delaware MAC Case Law and Competing Theories*

The preceding survey of Delaware court decisions regarding MAC clauses undoubtedly lays the foundation for establishing a uniform approach to MAC clause interpretation. However, there are still inconsistencies and unanswered questions in the Delaware courts' analyses. For example, who has the burden of proof during MAC clause litigation is still largely unclear.<sup>109</sup> One perspective follows the seller-friendly approach of *IBP*<sup>110</sup> and provides that the acquirer should always bear the heavy burden of proving a MAC had occurred.<sup>111</sup> The Court of Chancery in *Hexion* followed this view, stating that "the burden of proof

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104. *Id.* at \*62.

105. *Id.* at \*61.

106. *Id.*

107. *Id.* at \*48.

108. *Id.* at \*105 ("Seller failed to cure its breach of the Ordinary Course Covenant, and Buyer properly terminated the Sale Agreement.")

109. This issue is only present, of course, when the parties do not allocate the burdens themselves as a matter of contract.

110. *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14 (Del. Ch. 2001).

111. *See also* *Frontier Oil v. Holly Corp.*, No. Civ.A. 20502, 2005 WL 1039027, at \*34 (Del. Ch. Apr. 29, 2005).

with respect to a material adverse effect rests on the party seeking to excuse its performance under the contract.”<sup>112</sup> However, commentators have pointed out that the target businesses presumably have greater access to the pertinent information required to establish the occurrence or non-occurrence of a MAC.<sup>113</sup>

Perhaps the most elusive element in MAC clause interpretation, however, is determining what qualifies as a material occurrence, event, or development that would allow a party to terminate an agreement. Absent parties defining what constitutes “material” as a matter of contract, Delaware courts have been reluctant to establish a clear threshold for materiality and instead favor a case-by-case inquiry.<sup>114</sup> In *IBP*, the Delaware Court of Chancery laid the first groundwork for determining materiality by stating that the change must substantially threaten the overall earnings potential of the acquired company in a durationally-significant matter that is measured not in months, but years.<sup>115</sup> Subsequent Delaware MAC opinions elaborated on this threshold, yet ultimately failed to provide any true clarity necessary to provide contracting parties with some sort of practical guidelines when drafting and negotiating MAC clauses.<sup>116</sup> *IBP*’s contribution to the materiality standard is also lackluster.<sup>117</sup> “Substantial” is simply another word for “material” and adds nothing to the legal understanding of materiality.<sup>118</sup> “Durationally-significant” and “earnings potential” also lack any definiteness and are not very useful in practice for determining exactly when a change will be considered material.<sup>119</sup>

Each MAC clause inquiry will be incredibly fact-specific, especially with regard to the materiality factor. Attempting to articulate a bright-line rule that will prove true and just in every scenario, therefore, would be a fool’s errand.<sup>120</sup> In order for contracting parties to have a better idea of what a court may consider a material change that would constitute a MAC, it is necessary to revisit and solidify the core purposes and functions of the MAC clause. Most importantly, it is imperative to determine from whose perspective the MAC clause should primarily be viewed—the seller’s or the acquirer’s. This will heavily influence a court’s interpretation and foundational understanding of the MAC clause and, therefore, the outcome of the case.

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112. *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715, 739 (Del. Ch. 2008).

113. *Brooks*, *supra* note 23, at 105.

114. *See Akorn, Inc. v. Fresenius Kabi AG*, No. 2018-0300-JTL, 2018 WL 4719347, at \*53 (Del. Ch. Oct. 1, 2018), *aff’d* 198 A.3d 724 (Del. 2018).

115. *In re IBP, Inc.*, 789 A.2d at 68.

116. *See Hexion Specialty Chems.*, 965 A.2d 715; *Akorn, Inc.*, 2018 WL 4719347; *Channel Medsystems, Inc. v. Boston Sci. Corp.*, No. 2018-0673-AGB, 2019 WL 6896462 (Del. Ch. 2019).

117. *In re IBP, Inc.*, 789 A.2d 14.

118. *See id.* at 68.

119. *Id.*

120. *See Akorn, Inc.*, 2018 WL 4719347, at \*53 (noting that, in one instance, a buyer could show less than a 40% diminution in the present value of the target company’s expected future cashflow constituted a MAC and that, in another, a buyer could fail to show more than a 40% diminution constituted a MAC).

Robert T. Miller argues for a forward-looking foundational understanding of the MAC clause in which the effects of the alleged MAC are viewed from the perspective of a reasonable acquirer.<sup>121</sup> As will be discussed in the next section, this understanding is generally supported by case law: The Delaware Court of Chancery tends to approach materiality from the point of view of the acquirer.<sup>122</sup>

However, Gilson & Schwartz have propounded an influential understanding of the MAC clause that focuses primarily on the perspective of the seller.<sup>123</sup> This theory of the MAC clause focuses on the risks borne by the target company as well as its motivations for entering into the sale agreement.<sup>124</sup> Gilson & Schwartz's theory provides an all-encompassing, more general understanding of how the MAC clause operates instead of focusing primarily on the materiality component. Because this theory concerns the MAC clause as a whole,<sup>125</sup> it can provide great interpretive value to courts and offer guidance on how the courts should approach the MAC clause in the first place. Gilson & Schwartz's seller-focused understanding—and specifically their investment theory—is also supported by Delaware case law.

*B. Miller's Theory: Determining Materiality from the Perspective of a Reasonable Acquirer*

As support for his theory, Miller notes that the Delaware courts have stated in one way or another that a MAC should be analyzed from the “longer-term perspective of a reasonable acquirer.”<sup>126</sup> This is because it is assumed that, absent evidence to the contrary, a corporate acquirer intends to purchase the target company as part of a long-term strategy.<sup>127</sup> Viewing a MAC from the perspective of a reasonable acquirer also aligns with a basic tenet of contract law that defines material breaches as those that “deprive the injured party of the benefit that is justifiably expected.”<sup>128</sup> When acquirers attempt to invoke the MAC clause to terminate an agreement, they are claiming a MAC has occurred and rendered them the injured party because they no longer stand to receive the benefit they expected from the transaction.

The reasonable-acquirer perspective of materiality is further supported by

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121. See generally Miller, *supra* note 10, at 12.

122. See, e.g., *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715, 738 (Del. Ch. 2008).

123. See generally Gilson & Schwartz, *supra* note 1.

124. *Id.*

125. *Id.*

126. Miller, *supra* note 10, at 7 (citing *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14, 68 (Del. Ch. 2001); *Hexion Specialty Chems., Inc.*, 965 A.2d at 738; *Akorn, Inc. v. Fresenius Kabi AG.*, No. 2018-0300-JTL, 2018 WL 4719347, at \*53 (Del. Ch. 2018), *aff'd* 198 A.3d 724 (Del. 2018); *Channel Medsystems, Inc. v. Boston Sci. Corp.*, No. 2018-0673-AGB, 2019 WL 6896462, at \*34 (Del. Ch. 2019)).

127. *Hexion Specialty Chems., Inc.*, 965 A.2d at 738.

128. Schwartz, *supra* note 33, at 826.

Vice Chancellor Laster's words in the *Akorn*<sup>129</sup> decision. Akorn, the target company, argued Fresenius, the acquirer, could not successfully claim a MAC had occurred unless the circumstances had changed so drastically that Fresenius would make zero profit on the deal.<sup>130</sup> Laster stated that "it should not be necessary for Fresenius to show a loss on the deal before it can rely on the contractual exit right it negotiated."<sup>131</sup> Finding that a MAC occurred—even when the acquirer still stood to make some profit on the deal—supports the view that MAC clauses should be interpreted from the perspective of a reasonable acquirer. Even if an acquirer stands to gain a small profit from a transaction, it may still seek to terminate the deal via the MAC clause if the profit is no longer as advantageous due to changes in the target company's business.

Based on this acquirer-focused sentiment, Miller has proposed a framework for evaluating the materiality of a change in the target company's business.<sup>132</sup> This framework begins with the presumption, as articulated in the Delaware cases, that a MAC should be understood from the perspective of a reasonable acquirer.<sup>133</sup> Miller's framework provides that a material change can be determined by evaluating a change in the reasonable valuation of the target company.<sup>134</sup> A reasonable acquirer would be concerned with the economic value of the target company<sup>135</sup>, so it is reasonable that this value should lie at the center of a materiality determination.

To make this evaluation, Miller proposed that a court should compare the present value of the target company's expected future cashflows as they were reasonably expected to be at signing with the present value of the target company's expected future cashflows as they were reasonably expected to be at the time of the alleged MAC.<sup>136</sup> This framework for determining materiality then necessarily requires two discounted cashflow analyses: One at the time of signing and one at the time of the alleged MAC.<sup>137</sup> Delaware courts have historically only focused on changes in expected future cashflows, which is just one part of a discounted cashflow analysis.<sup>138</sup> The Delaware Court of Chancery came close to fully adopting Miller's discounted cashflow theory in *Akorn* when it compared analyst projections of the target company's cashflows for the following three years made at signing with similar analyst projections made at the time of the alleged MAC.<sup>139</sup> But the court considered only the future expected cashflows in

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129. *Akorn, Inc.*, 2018 WL 4719347.

130. *Id.* at \*57.

131. *Id.*

132. *See generally* Miller, *supra* note 10.

133. *Id.* at 12.

134. *Id.* at 13.

135. *Id.* at 12.

136. *Id.* at 13.

137. *Id.*

138. *Id.*

139. *Akorn, Inc. v. Fresenius Kabi AG.*, No. 2018-0300-JTL, 2018 WL 4719347, at \*56 (Del. Ch. 2018), *aff'd* 198 A.3d 724 (Del. 2018).



isolation, not a full discounted cashflow analysis.<sup>140</sup> Additionally, the court in *Boston Scientific* was presented with evidence from the acquirer's expert analyst showing diminutions in the value of the target company by comparing the target's value at the time of signing the agreement with the value at the time of the alleged MAC.<sup>141</sup> However, the court did not credit these valuations because it did not agree with certain presumptions the analyst made with respect to Boston Scientific's need to shelve Cerene, the target company's only drug, for two to four years.<sup>142</sup> The court also criticized the analyst's choice to increase the discount rate without any apparent basis for doing so.<sup>143</sup>

After considering the two sets of discounted cashflow analyses from both the target company's analysts and the acquirer's analysts, Miller proposes that the court would decide if the diminution in value between these two points in time was material from the perspective of a long-term acquirer.<sup>144</sup> According to Miller's framework, the key point of significance with this determination is whether the diminution in the value of the company is sufficiently large to be considered material.<sup>145</sup> Miller suggests a complex procedure for determining materiality at this stage, including establishing a *range of valuations* both at the time of signing the agreement ("Deal Range") and at the time of the alleged MAC ("MAC Range").<sup>146</sup> After comparing these two ranges, the court would determine if the midpoint of the MAC Range is lower than the low-end of the Deal Range.<sup>147</sup> If so, the target company has suffered a MAC.<sup>148</sup> This process includes the court gathering multiple sets of various inputs to conduct the two sets of valuation ranges, including multiple sets of cashflow projections and different equity costs of capital.<sup>149</sup>

Ultimately, Professor Miller's proposed framework for determining materiality in the context of MAC clauses can be articulated as follows: "[F]rom the point of view of a reasonable acquirer, a material adverse effect [or change] on the company is a material change in the present value of the company's expected future cashflows."<sup>150</sup> Again, Miller argues this theory makes sense when viewing materiality from the perspective of a reasonable acquirer who is heavily concerned with the acquired company's value.<sup>151</sup>

Viewing a MAC as a "very significant diminution in the value of the

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140. *Id.*

141. *Channel Medsystems, Inc. v. Boston Sci. Corp.*, No. 2018-0673-AGB, 2019 WL 6896462, at \*34-35 (Del. Ch. 2019).

142. *Id.* at \*34.

143. *Id.* at n.402.

144. Miller, *supra* note 10, at 17.

145. *Id.*

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.* at 12-13.

151. *Id.* at 12.

company[,]”<sup>152</sup> however, presents problems. Miller’s theory is helpful only for determining the specific issue of materiality and only when the particular data from the target company needed for his proposed evaluation are available and sufficiently accurate. During events like the COVID-19 pandemic—events that would spur acquirers to invoke the MAC clause in order to terminate a transaction—this critical data may not be available or accurate, rendering it unhelpful for determining if a MAC has occurred. Indeed, Miller himself admits that “the effect of the pandemic on the present value of [the target company’s] future cashflows is exceedingly difficult to gauge.”<sup>153</sup> Such a difficulty suggests his theory alone may not be the most practical approach for interpreting MAC clauses.

### *C. Gilson & Schwartz’s Investment Theory*

From the outset, Gilson & Schwartz approach the MAC clause differently than Miller. The MAC clause, they explain, “relates to that subset of *seller* actions” that have the potential to devalue the target company in the time between signing the deal and closing it.<sup>154</sup> These propositions are informed by Gilson & Schwartz’s investment hypothesis, which is founded on the seller’s ability to make certain investments during the time between executing and closing the agreement that would impact the post-closing value of the new combined company.<sup>155</sup> They refer to these relation-specific actions as “synergy investments.”<sup>156</sup> The inclusion of MAC clauses in standard acquisition agreements, they argue, creates an *incentive for the seller* to make these synergy investments by allowing the acquirer a credible means of terminating the deal if the target company suffers a MAC.<sup>157</sup> In other words, if the acquirer has an escape route written into the contract, the seller has more of an incentive to keep the target business going in that critical time between signing and closing. This aligns with the core of Gilson & Schwartz’s investment theory, which is that “an efficient acquisition agreement will impose endogenous risk on the seller and exogenous risk on the buyer.”<sup>158</sup> Endogenous risks are risks that are specific to the target business and are “caused by actions the seller took or failed to take.”<sup>159</sup> Gilson & Schwartz identify three categories of these actions (i.e., investments) that the target company can take, which constitute these endogenous risks.<sup>160</sup>

The first type of investment relates to actions the target company can take to

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152. *Id.* at 18.

153. *Id.*

154. Gilson & Schwartz, *supra* note 1, at 337.

155. *Id.* at 333.

156. *Id.*

157. *Id.* at 334.

158. *Id.* at 339.

159. *Id.* at 356.

160. *Id.* at 337.

facilitate integration of the two merging companies.<sup>161</sup> This could include beginning to integrate its product line with that of the acquirer and freezing funding in new technology that the acquirer already possesses.<sup>162</sup> Early steps like these taken by the target company can increase the probability that the acquisition will succeed. Next, Gilson & Schwartz describe investments in which the target company puts forth effort to “retain the cohesiveness of its work force.”<sup>163</sup> These efforts are especially important because when an acquisition is announced, it may be received in a hostile manner by the target company’s existing employees.<sup>164</sup> The employees could suspect layoffs or undesired changes in the work environment and management structure.<sup>165</sup> If the target company takes steps to quell these fears, they may be able to eliminate or mitigate the adverse impact of the announcement on employee morale.<sup>166</sup> This, too, will help the transaction proceed smoothly and without decrease in the target company’s value. Lastly, Gilson & Schwartz describe investments in which the seller makes an effort to “preserve the expected profitability of the new enterprise.”<sup>167</sup> This includes maintaining relationships with customers and suppliers, primarily so that competitors do not take advantage of the uncertainty customers may feel in the face of the acquisition.<sup>168</sup> Ensuring that suppliers and customers feel secure that their needs will continue to be met during and after the acquisition is vital for preserving the value of the new company.

Gilson & Schwartz suggest that these investments made by the target company create a moral hazard.<sup>169</sup> As the seller uses its resources during the post-execution/pre-closing time to make these investments and aid in the success of the acquisition, the seller functionally becomes the agent of the buyer.<sup>170</sup> If there is no MAC clause in the acquisition agreement, the target company, as the agent instead of the principal, becomes less incentivized to make the investments. This is because the target company realizes that the majority of the benefits stemming from the investments will be reaped by the acquirer after the transaction closes. Additionally, if the combined business turns out to have a lower value at closing than the agreed merger price due to the lack of synergy investments, the seller can still enforce the deal at the merger price because there is no MAC clause to allow the acquirer to terminate.<sup>171</sup> The absence of a MAC clause, Gilson & Schwartz suggest, protects the seller in situations like this where the new company is less valuable after closing due to the target company’s failure to take value-increasing

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161. *Id.*

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.* at 338.

170. *Id.*

171. *Id.*

action.<sup>172</sup> This causes the acquisition to be inefficient.

According to Gilson & Schwartz, the MAC clause operates as a vehicle for mitigating this moral hazard on behalf of the seller and the resultant inefficiency in acquisition agreements.<sup>173</sup> The MAC clause acts to reduce the target company's protections that arise from the fixed purchase price as promised by the acquirer in the acquisition agreement. By allowing the acquirer to exit the deal if the target company experiences a MAC, the MAC clause reintroduces the incentive for the seller to make the relevant synergy investments despite becoming the buyer's agent after execution of the contract.<sup>174</sup> As a result, the acquisition agreement once again becomes efficient.

According to Gilson & Schwartz's investment theory, therefore, "an efficient acquisition agreement will impose endogenous risk on the seller and exogenous risk on the buyer."<sup>175</sup> The MAC clause can serve this purpose by placing risks to the continued value of the target business related to the three classes of investments on the target business. That is, the seller will bear only endogenous risk related to the transaction. This makes sense because the seller is in the best position to prevent this type of risk by making the relevant investments in the time between executing and closing the deal. If a MAC occurs as a result of their failure to do so (i.e., the MAC materializes from endogenous risk), then the acquirer can credibly terminate the deal. The base definition of a MAC, then, represents the endogenous risk that is allocated to the seller.

The exogenous risk of the deal is allocated to the buyer in the exceptions that follow the MAC base definition.<sup>176</sup> As previously discussed, the exceptions list certain circumstances that do not qualify as MACs and are therefore removed from the MAC base definition. This aligns with the core idea that the acquirer, as the future long-term owner of the business, can more efficiently bear exogenous risk and take precautionary action in anticipation of it. When viewed this way, the MAC clause serves to incentivize the target company to make synergy investments in the critical time period between closing and signing.<sup>177</sup>

Ultimately, Miller and Gilson & Schwartz disagree fundamentally on what the MAC clause is intended to mean and what it is supposed to represent. Miller suggests the relevant comparison to be made in a MAC clause inquiry is between the actual state of the target business at closing and the actual state of the target business at the time of signing.<sup>178</sup> A reasonable acquirer, he states, would be concerned with this comparison.<sup>179</sup> Alternatively, Gilson & Schwartz propose that the relevant comparison for determining a MAC is between the actual state of the target business at closing and the state it may have been in had it taken certain

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172. *Id.*

173. *Id.*; see Shapiro, *supra* note 67, at 245 n. 22.

174. *Id.*

175. *Id.* at 339.

176. *Id.*

177. *Id.* at 337.

178. Miller, *supra* note 10, at 2061.

179. *Id.* at 7.

synergistic actions between signing and closing.<sup>180</sup> This is embodied in the pair's seller-focused idea of risk allocation as represented by the MAC clause: The target company should be responsible for the endogenous risk of the deal, and the exogenous risk should be shifted to the acquirer through the carve-outs.

*D. A Combined Approach to MAC Clauses Will Provide a Uniform Interpretive Tool for Courts and Contribute to Clarity for Parties*

Miller's theory and Gilson & Schwartz's theory, I contend, are not mutually exclusive. Rather, each theory is important for understanding the MAC clause, but at different steps in the interpretive process. By utilizing both theories to interpret a MAC clause, courts can begin to formulate a uniform interpretive approach that will, in turn, provide predictability to contracting parties.

When a court is first faced with an alleged MAC, its initial inquiry is whether the event giving rise to the alleged MAC falls within the meaning of the base definition of the MAC clause as outlined in the parties' agreement. Alternatively, the event giving rise to the MAC could fall in one of the listed carve-outs that removes certain events from the base definition. During this critical stage of initial interpretation, a court should view the MAC clause through a seller-focused lens as prescribed by Gilson & Schwartz. To this end, the court should proceed with the understanding that the inclusion of the MAC clause was meant to incentivize the seller to make relevant investments in the time between signing the contract and closing. Accordingly, the seller will bear any endogenous risk flowing from their relevant action or inaction during this time. The buyer, alternatively, will bear any systematic/exogenous risk as specified by the carve-outs. At the outset of the inquiry, this binary understanding that sellers are allocated endogenous risk and buyers are allocated exogenous risk (according to the carve-outs included) provides a critical foundation for a court's interpretation of the MAC clause.

The Delaware Court of Chancery's decision in *Akorn* provides support for employing the Gilson & Schwartz theory in this first interpretive step. There, the court found a MAC had occurred because of internal events peculiar to the target company, Akorn.<sup>181</sup> Specifically, Akorn suffered severe data integrity problems, and its program development process failed to comply with regulatory requirements, leading to a change in business that the court considered a MAC.<sup>182</sup> This aligns with Gilson & Schwartz's theory that the seller should make investments that lend to the synergy and eventual success of the transaction.<sup>183</sup> This includes *not* engaging in acts that would *reduce* this synergy. Because the target company, Akorn, suffered a detrimental change in its business due to its own actions, the court reasoned they, as the seller, should bear this endogenous

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180. See generally Gilson & Schwartz, *supra* note 1.

181. *Akorn, Inc. v. Fresenius Kabi AG*, No. 2018-0300-JTL, 2018 WL 4719347, at \*3 (Del. Ch. 2018), *aff'd* 198 A.3d 724 (Del. 2018).

182. *Id.*

183. Gilson & Schwartz, *supra* note 1, at 337.

risk, which entitled the acquirer to terminate the deal.<sup>184</sup> The change in business was clearly not attributable to any exogenous risk that would be allocated to the acquirer, so the court did not find that any carve-outs were applicable.<sup>185</sup> In its initial interpretation of the MAC clause, the court worked to determine whether the event giving rise to the alleged MAC was covered by the base definition or fell under a carve-out, and, in doing so, considered whether the events giving rise to the MAC stemmed from endogenous or exogenous risk.<sup>186</sup>

The Court of Chancery's recent decision in *AB Stable* also reflects this proposed first interpretive step. The court was faced with determining if the COVID-19 pandemic fell under the "natural disasters or calamities" carve-out.<sup>187</sup> Because the worldwide pandemic was not caused by any action of AB Stable, the seller, it was not covered by the base definition, which corresponds with endogenous risk allocated to the seller.<sup>188</sup> The court then used traditional contract principles, like the plain language approach, in ultimately determining that the pandemic was an exogenous risk, according to the language of the contract, which was allocated to the acquirer.<sup>189</sup> Again, the court's conclusion aligns with Gilson & Schwartz's idea that sellers should be allocated endogenous risk and buyers should bear exogenous risk.<sup>190</sup>

If a court determines that the event giving rise to the MAC falls under the base definition of the MAC clause, the next consideration is whether the change was material. Here, the focus should shift to consider the expectations of a reasonable acquirer as Miller contends. The court now must determine if the target company suffered a MAC within the meaning of the base definition. Under Gilson & Schwartz's theory, events falling under the base definition correspond to endogenous risk that is allocated to the seller.<sup>191</sup> As a result, the court should continue with the understanding that the seller has been allocated the risk for the event leading to the MAC because it falls under the base definition. It is rational, then, that the court would interpret the MAC clause at this step, when determining materiality, through the lens of a reasonable acquirer. To evaluate materiality, the court should compare the value of the target company at the time of closing with the value at the time of signing, as proposed by Miller's framework.

The materiality inquiry in this second step is incredibly fact-specific, as previously mentioned, but viewing it from the perspective of a reasonable acquirer can provide courts with at least an interpretive foundation on which to base their decision. Understanding the materiality aspect of the this second

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184. *See Akorn, Inc.*, 2018 WL 4719347, at \*62.

185. *Id.* at \*51-52.

186. *Id.* at \*46-52.

187. *AB Stable, VIII LLC v. MAPS Hotels and Resorts One LLC*, 2020 WL 7024929, at \*2 (Del. Ch. 2020), *aff'd*, 268 A.3d 198 (Del. 2021).

188. *Id.* at \*63.

189. *Id.* at \*56-57.

190. Gilson & Schwartz, *supra* note 1, at 339.

191. *See id.*

interpretive step from the point of view of an acquirer is also heavily supported by the Delaware case law, which proclaims repeatedly that MACs should be understood from the longer-term perspective of a reasonable acquirer.<sup>192</sup> This second step based on Miller's theory of the MAC clause complements using Gilson & Schwartz's theory for the court's first interpretive step, providing for a comprehensive approach to the MAC clause. As Gilson & Schwartz said: "The interpretive task should be eased for courts when they understand what the parties are attempting to achieve."<sup>193</sup>

#### CONCLUSION

In the wake of COVID-19 and similar socioeconomic major events, corporations like Louis Vuitton and Advent International have been drawn to MAC clauses as a mechanism for escaping previously made merger and acquisition deals when it became clear that a pandemic, hurricane, or other event rendered the deal no longer feasible. As more unexpected events happen in the future, corporations will likely return again and again to the MAC clause to terminate agreements. Jurisdictions across the United States should cement a clear and uniform approach to understanding the MAC clause so as to provide some certainty and predictability to contracting parties.

An approach utilizing both Gilson & Schwartz's seller-focused theory and Miller's acquirer-focused theory provides a comprehensive understanding of the MAC clause. The initial interpretation—whether the event giving rise to the MAC falls within the base definition or a listed carve-out—should be approached with the understanding that the base definition of the MAC clause generally operates to allocate endogenous risk to the seller and exogenous risk to the buyer, per Gilson & Schwartz. Next, as the court attempts to determine materiality within the base definition of the MAC clause, an acquirer-focused approach should be employed as Miller suggests. Adopting this uniform understanding of how a MAC clause works and consequently, how it should be interpreted, would provide contracting parties with certainty when attempting to determine both before and during litigation if a MAC has occurred.

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192. See *In re IBP, Inc. S'holders Litig.*, 789 A.2d at 68 (Del. Ch. 2001); *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d at 738 (Del. Ch. 2008); *Akorn, Inc. v. Fresenius Kabi AG.*, No. 2018-0300-JTL, 2018 WL 4719347, at \*53 (Del. Ch. 2018), *aff'd* 198 A.3d 724 (Del. 2018); *Channel Medsystems, Inc. v. Boston Sci. Corp.*, No. 2018-0673-AGB, 2019 WL 6896462, at \*34 (Del. Ch. 2019).

193. Gilson & Schwartz, *supra* note 1, at 358.