NOTE

BIG MACS: NOT-SO-HAPPY DEALS AND THE EUROZONE CRISIS

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I. INTRODUCTION

In January 2012, concerns over the state of the European Sovereign Debt Crisis ("Eurozone Crisis")[1] intensified as Greek Minister of State Pantelis Kapsis told Skai TV, "The bailout agreement needs to be signed otherwise [Greece] will be out of the markets, out of the euro [sic],"[2] which could ultimately lead to a collapse of the Greek banking system and of its economy.[3]

Even as Greece desperately tried to avoid defaulting on its debt,[4] American companies prepared for the worst possible scenario: that Greece could soon be forced to leave the Eurozone.[5] Merrill Lynch looked into "filling trucks with cash and sending them over the Greek border so clients [could] continue to pay local employees and suppliers in the event money [was] unavailable."[6] Ford configured its computer

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1 The "European Sovereign Debt Crisis" and the "Eurozone Crisis" are shorthand terms for the ongoing financial crisis that has been affecting the countries of the Eurozone since early 2009. Stefan Wagstyl, *Banks Ask for Crisis Funds for Eastern Europe*, FINANCIAL TIMES (Jan. 22, 2009), http://www.ft.com/intl/cms/s/0/9830fa0c-e809-11dd-b2a5-0000779fd2ac.html#axzz2zMLEpaCM. *See The Euro*, EUROPEAN UNION, http://europa.eu/about-eu/basic-information/money/euro/index_en.htm (last visited Mar. 2, 2014) (explaining that the term "Eurozone" is shorthand for the eighteen countries in the European Union that use the euro as their official currency, including Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain; additionally, there are ten countries in the European Union who do not use the euro); *see also* Caroline Jensen, *What Doesn't Kill Us Makes Us Stronger: But Can the Same Be Said of the Eurozone?*, 46 INT'L LAW. 759 (2012). "The roots and nature of the sovereign debt crisis are labyrinthine" but can be attributed to, among other causes, the adoption of the euro, the financial instability of certain countries who joined the European Union, and unsustainable debt. *Id*. at 760-69. *See infra* Part V.

2 *Greece Will Leave Euro If Second Bailout Fails, Says Kapsis*, THE TELEGRAPH (Jan. 3, 2012), http://www.telegraph.co.uk/finance/financialcrisis/8989275/Greece-will-leave-euro-if-second-bailout-fails-says-Kapsis.html.

3 Vicky Pryce, *Greece Would Face Dire Consequences from a Euro Exit—As Its People Know*, THE GUARDIAN (May 12, 2012), http://www.guardian.co.uk/business/2012/may/13/greece-must-stay-eurozone.

4 *Timeline: The Unfolding Eurozone Crisis*, BBC (June 13, 2012), http://www.bbc.co.uk/news/business-13856580 (in December 2009, Greece's debts reached 300 billion euros, the "highest in modern history," but the former Prime Minister stated the country was "not about to default on its debts"); *see also* Jim Zarroli, *Uncertainty Looms As Greek Debt Deadline Nears*, NPR (Mar. 7, 2012), http://www.npr.org/2012/03/07/148136882/uncertainty-looms-as-greek-debt-deadline-nears (explaining that, as of March 2012, Greece owed its creditors about 350 billion Euros, or $460 billion).

5 Nelson D. Schwartz, *U.S. Companies Brace for an Exit from the Euro by Greece*, N.Y. TIMES (Sep. 2, 2012), http://www.nytimes.com/2012/09/03/business/economy/us-companies-prepare-in-case-greece-exits-euro.html.

6 *Id.*

systems to handle a new Greek currency at a moment's notice.[7]

The situation was dire—and France, Italy, and Spain were also considered to be on the chopping block.[8] The U.K. Treasury even worked on contingency plans for the complete disintegration of the euro.[9]

No one knew how far the shock waves from the Eurozone Crisis would travel, but the global mergers and acquisitions ("M&A")[10] market felt tremors.[11] Since 2012, bailout programs[12], the lowering of interest rates by the European Central Bank ("ECB")[13] and cheap loans provided by the ECB[14] helped combat the Eurozone Crisis. While the worst of the Eurozone Crisis may be over, "the long-term consequences of the [C]risis have yet to surface."[15]

Because of the inherent risks of entering into large commercial transactions, modern contract provisions have evolved to enable parties to allocate various types of risks associated with a given transaction.[16] In light of a financial market's instability, many companies try to evade their contractual responsibilities by invoking Material Adverse Change ("MAC") clauses, which allow a party to walk away from a transaction when an adverse change not otherwise specifically accounted for in the

7 *Id.*

8 *Timeline: The Unfolding Eurozone Crisis*, *supra* note 4.

9 Philip Aldrick, *Treasury Plans for Euro Failure*, THE TELEGRAPH (Dec. 26, 2011), http://www.telegraph.co.uk/finance/financialcrisis/8976204/Treasury-plans-for-euro-failure.html.

10 *See infra* Part II.B.

11 *Our Insights into M&A Trends—Global Dynamics*, CLIFFORD CHANCE 15 (July 2012), *available at* http://www.cliffordchance.com/publicationviews/publications/2012/07/our_insights_intomatrends-globaldynamics.html ("Volatility and uncertainty in the Eurozone is continuing to influence M&A activity. Across the globe, uncertainty in the Eurozone is contributing to the general lack of confidence and slowing of activity.").

12 Heather Stewart, *Eurozone Bailouts: Which Countries Remain?*, THE GUARDIAN (Dec. 13, 2013), http://www.theguardian.com/business/2013/dec/13/eurozone-bailouts-greece-portugal-cyprus-spain.

13 Eva Taylor, *ECB Cuts Rates to New Low, Ready to Do More if Needed*, REUTERS (Nov. 7, 2013), http://www.reuters.com/article/2013/11/07/us-ecb-rates-idUSBRE9A600O20131107.

14 Juergen Baetz, *ECB's Draghi Hints at Another Round of Cheap Loans*, AP (Sept. 23, 2003), http://bigstory.ap.org/article/ecbs-draghi-hints-another-round-cheap-loans.

15 Joe Lynam, *Is the Eurozone crisis over?*, BBC NEWS (Dec. 31, 2013), http://www.bbc.com/news/business-25564499 ("While the sense of crisis in the currency zone is receding, the question of whether the euro would even survive seems to have gone away for now. Yet the problems are far from over, as unemployment is still rampant in many countries."); s*ee also* Jeremy Warner, *Eurozone Crisis is Just Getting Started*, THE TELEGRAPH (Feb. 14, 2014), http://www.telegraph.co.uk/finance/comment/jeremy-warner/10636290/Eurozone-crisis-is-just-getting-started.html.

16 Adam B. Chertok, *Rethinking the U.S. Approach to Material Adverse Change Provisions in Merger Agreements*, 19 U. MIAMI INT'L & COMP. L. REV. 99, 100 (2011).

contract occurs.[17]

In the United States, for example, "[i]n any large corporate acquisition, there is an interim period [the 'gap period'] between the time that the parties enter into a merger agreement [the 'execution date'] and the time the transaction is effected and the purchase price paid [the "closing date"]."[18] Many of the risk-shifting devices in these merger agreements try to protect the purchaser from the possibility "that the asset being acquired (the target company) might deteriorate during [the] gap period."[19]

In theory, MAC clauses appear extremely useful for buyers trying to terminate an agreement during economic instability, but in practice, U.S. courts[20] have upheld such a strict standard for events that constitute a MAC that their utility has been rendered illusory.[21] Buyers[22] face a nearly insurmountable burden in convincing U.S. courts that a change rises to the level of materiality espoused by courts.[23] Thus, after the 2007-2008 U.S. credit crisis, many buyers were unable to exit deals with companies that were severely downtrodden by the effects of the economy.[24] By contrast, the United Kingdom takes MAC disputes out of the courts and instead appoints a panel of financial experts to resolve the complex issues that arise in MAC disputes.[25]

This Note will analyze the current state of MAC jurisprudence and will discuss the advantages and disadvantages of a strict MAC standard, ultimately arguing that MAC disputes are nonjusticiable and should be resolved by an administrative body or through financial arbitration, as agreed upon by the parties during negotiations. Part II of this note will introduce the contract doctrine of impossibility and will explain the

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17 *Id.*

18 Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2007 (2009); *see also* Chertok, *supra* note 19, at 101-02.

19 Chertok, *supra* note 16, at 101.

20 Many U.S. corporate cases are tried in Delaware because more than 50% of all publicly-traded companies in the U.S. including 64% of the Fortune 500 are incorporated in Delaware. STATE OF DELAWARE: THE OFFICIAL WEBSITE OF THE FIRST STATE, http://www.corp.delaware.gov/aboutagency.shtml. The majority of U.S. cases discussed in this Note were tried in Delaware courts. *See infra* Part III.A-E.

21 Jeffrey Thomas Cicarella, *Wake of Death: How the Current MAC Standard Circumvents the Purpose of the MAC Clause*, 57 CASE W. RES. L. REV. 423, 447 (2007).

22 The terms "Acquirer," "Buyer" and "Purchaser" can all be used interchangeably in this context.

23 *See infra* Part III.A-E. *See also* Chertok, *supra* note 16 at 120.

24 *See* Hexion Specialty Chem. v. Huntsman Corp., 965 A.2d 715, 732-33 (Del. Ch. 2008) (denying existence of a MAC when target's earnings fell below projections that acquirer had relied on in entering the deal).

25 *See infra* Part IV.

evolution and structure of the modern MAC clause. Part II will also introduce MAC carve-out provisions, which will set the tone for Part III's discussion of the complex case law surrounding MAC clauses.

Part III will provide an overview of the landmark U.S. cases interpreting MAC clauses and discuss different events that have been alleged to trigger MACs. Part IV will briefly discuss the British Takeover Panel and its nuanced approach to MAC disputes.

To set the stage for the main argument in favor of revamping the United States' approach to MAC litigation and interpretation, Part V will discuss the novelty and materiality of adverse change that the global economy can expect from the Eurozone Crisis and will explain how the current MAC standard is untenable during this period of instability.

Part VI will argue that the only effective way to fairly litigate such complex issues is to encourage arbitration by financial experts. Part VII will supplement this ambitious recommendation with practical drafting advice to ensure that contract clauses are broad enough to cover events or issues resulting from the Eurozone Crisis.

II. WHAT IS A MAC?

A. Risk Allocation in Contracting

The doctrine of impossibility "excuses what would otherwise be a breach of contract under very limited and narrowly-defined circumstances" and is invoked when "supervening circumstances make performance of one of the terms of the contract impracticable."[26] Events giving rise to a claim of impossibility must not be foreseeable at the time of contracting.[27]

The landmark case establishing the modern doctrine of contract avoidance by impossibility was *Taylor v. Caldwell*,[28] in which the plaintiff and defendant entered into a contract whereby the plaintiff would have the use of Surrey Gardens and Music Hall for the purpose of giving a series of four concerts.[29] After the Music Hall was destroyed by fire (without fault by either party) prior to plaintiff's

26 30 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 77:1 (Richard A. Lord ed., 4th ed. 2013) ("This is a strict standard that can only be called upon when circumstances truly dictate and is not available when under the contract one party assumes the risk that fulfillment of a condition precedent will be prevented.").

27 *Id.*

28 Taylor v. Caldwell, (1863) 122 Eng. Rep. 309 (K.B.).

29 *Id.*

planned stay, the plaintiff wanted the loss to fall on the defendant, since the fire frustrated the purpose of his stay—use of the Music Hall for planned concerts.[30] Ultimately, the court held that

> if the performance of the promise . . . becomes impossible because [the subject of the contract] has perished, this impossibility (if not arising upon the fault of the borrower or bailee from some risk which he has taken upon himself) excuses the borrower or bailee from the performance of his promise to redeliver the chattel.[31]

When parties enter into contracts, they "agree on such things as the nature and quality of the performance, the time for performance, the amount of payment, and how and when payment is to be made. The failure without excuse by one party to perform its promise is a breach of contract."[32] "The parties may agree, however, to 'hedge their bets'" and provide defensive protection "by expressly conditioning a promise" on the occurrence or non-occurrence of certain events.[33] "[T]he failure of an express condition discharges the promisor from its duty to perform but normally does not give a cause of action for damages . . . ."[34] Parties allocate risk in various contractual clauses, including *force majeure* clauses.[35] The "important difference between typical MAE provisions and force majeure clauses is that the MAE clause is specific with respect to contingencies that will not excuse performance, while the force majeure clause specifies which events will excuse performance."[36]

B. Mergers and Acquisitions, Generally

"A merger is a combination of two companies to form a new company, while an acquisition is the purchase of one company by another in which no new company is formed."[37] Notable mergers and

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30 *Id.*

31 *Id.*

32 IAN AYRES & RICHARD E. SPEIDEL, STUDIES IN CONTRACT LAW 782 (7th ed. 2008).

33 *Id.*

34 *Id.*

35 A force majeure clause is a clause in a contract excusing a party on the occurrence of specified types of events. Nathan Somogie, Note, *Failure of a "Basic Assumption": The Emerging Standard for Excuse under MAE Provisions*, 108 MICH. L. REV. 81, 89 (2009).

36 *Id.*

37 *Mergers and Acquisitions—M&A*, INVESTOPEDIA, http://www.investopedia.com/terms/m/mergersandacquisitions.asp#ixzz2KhCXzjhg (last visited Apr. 6, 2014).

acquisitions ("M&A") over the past few decades include[38] AOL's acquisition of Time Warner to become AOL Time Warner in 2000,[39] Exxon's acquisition of Mobil to become ExxonMobil in 1998,[40] and Pzifer's acquisition of Warren-Lambert in 2000.[41]

"Merger agreements enumerate the parties' legal rights and obligations in four primary components—representations and warranties, covenants, conditions to closing, and indemnification."[42] MAC provisions are thought to perform the same function as a *force majeure* clause by allocating the risk of negative changes or effects between the parties.[43]

C. Evolution of the MAC

While MAC provisions have been a contract staple for decades, "the form and substance of these provisions has evolved" over the years.[44] "Until recently, MAC clauses had been considered mere 'boilerplate' provisions, which were typically drafted broadly and demanded little attention from drafting attorneys."[45] Traditional MAC clauses provided that the clause would be triggered, and a party would have the right to walk away from the transaction, if "'any change, occurrence or state of facts that is materially adverse to the business, financial condition or results of operations' of the target after execution

38 Eleanor Wason, *Factbox—World's 10 Largest M&A Deals*, REUTERS, Feb. 6, 2008, *available at* http://uk.reuters.com/article/2008/02/05/riotinto-bhpbilliton-deals-idUKSYD18826920080205.

39 Seth Sutel, *AOL Buys Time Warner for $162 Billion*, JOURNAL TIMES (Jan. 10, 2000, 12:00 AM), http://journaltimes.com/aol-buys-time-warner-for-billion/article_58e29eb9-14a7-5f95-a6a4-dd4ed68ca948.html ("With the AOL deal, Time Warner acquired an online platform of 22 million subscribers . . . for delivering its content to computer users, a goal it has had for some time. 'This really completes the digital transformation of Time Warner,' [Time Warner chairman Gerald] Levin said. 'These two companies are a natural fit.'").

40 *Exxon, Mobil in $80B Deal*, CNNMONEY (Dec. 1, 1998, 7:55 PM), http://money.cnn.com/1998/12/01/deals/exxon/ ("Exxon and Mobil [were] the largest and second-largest U.S. oil producers, respectively, with combined annual revenue of $193.1 billion and production of 2.5 million barrels of oil a day. . . . Exxon Mobil [was expected to be] the third-largest company in the world, behind only General Electric (GE) and Microsoft (MSFT).").

41 Martha Slud, *Pfizer, W-L Strike Deal*, CNNMONEY (Feb. 7, 2000, 9:09 AM), http://money.cnn.com/2000/02/07/deals/warner_lambert/ ("Pfizer Inc. agreed Monday to pay about $90 billion in stock for Warner-Lambert Co., creating the world's second-largest drug company.").

42 Michelle Shenker Garrett, *Efficiency and Uncertainty in Uncertain Times: The Material Adverse Change Clause Revisited*, 43 COLUM. J.L. & SOC. PROBS. 333, 335 (2010).

43 Somogie, *supra* note 35, at 89.

44 Garret, *supra* note 42, at 336.

45 Chertok, *supra* note 16, at 103.

of the contract" occurred.[46] Following the economic volatility of the later 1980s, and in the 1990s, MAC clauses began to garner more attention from drafting attorneys, academic commentators and companies themselves.[47]

Because of economic volatility and the inherent risks associated with entering into new deals, "MAC provisions have become the object of extensive negotiations, and now commonly contain numerous exceptions ('carve-outs') as well as exclusions from such carve-outs."[48] Today, the definition of a MAC in a merger agreement might 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.[49]

In addition to the base definition, merger agreements will enumerate a list of carve-outs that "limit the scope of the MAC provision by shifting liability to the buyer should one of the exceptions arise."[50] Several common carve-outs include adverse changes: (i) affecting the global economy, the U.S. economy, or the seller's industry;[51] (ii) affecting the target's industry generally, unless such conditions have a disproportionate effect on the target as compared to the industry as a whole;[52] (iii) resulting from changes in laws and regulations or in interpretation of laws by courts or government

46 *Id.*

47 *Id.* at 103-04.

48 Garrett, *supra* note 42, at 337.

49 Chertok, *supra* note 16, at 107.

50 Jonathon M. Grech, Comment, *"Opting Out": Defining the Material Adverse Change Clause in a Volatile Economy*, 52 EMORY L.J. 1483, 1490 (2003).

51 *See* BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET: THE BEST AND LATEST INVESTMENT ADVICE MONEY CAN BUY 241 (6th ed. 1996) (This carve-out eliminates the effects of systematic risk on the value of the target company's stock price. "Systematic risk, also called market risk, captures the reaction of individual stocks . . . to general market swings."); *see also* NIXON PEABODY, 2012 NIXON PEABODY MAC SURVEY 7 (2012).

52 *See* NIXON PEABODY, *supra* note 51, at 6 (explaining that the carve-out for changes or effects having a disproportionate effect "is intended to ensure that the applicable exclusions such as changes in law or regulations and changes in the general conditions in a specific industry apply only where the target is caught up with the rest of its industry, but do not excuse the target if it is less nimble than its competitors").

entities;[53] and (iv) resulting from terrorism, acts of war, and changes in political conditions.[54]

In a recent merger, for example, the Gores Group, a global private equity firm, was set to purchase Pep Boys, an auto parts retailer.[55] The MAC definition in the merger agreement contained a carve-out for "any failure by the Company to meet any published analyst estimates . . . or any failure by the Company to meet internal or published projections," which provided a defense against any MAC claim for that event.[56] After execution of the agreement, but before closing, Pep Boys announced deteriorating earnings for the first quarter that would fall below expectations.[57] However, since the MAC definition contained an exception for "projections," the Gores Group was unable to prove that a MAC had occurred.[58]

53 *See* Allegheny Energy, Inc. v. DQE, Inc., 74 F.Supp.2d 482, 491, 519 (W.D. Pa. 1999) (As a result of Pennsylvania's adoption of the Electricity Generation Customer Choice and Competition Act, which facilitated the deregulation of electric generating utilities, a subsidiary of Allegheny Energy was only able to recover one-third of its projected $1.6 billion in stranded costs. Per DQE, the effects of the restructuring legislation constituted a MAC in Allegheny's business, even though the definition of a "Material Adverse Effect" provided that any "effect resulting from . . . the application of the Pennsylvania Restructuring Legislation . . . shall only be considered when determining if a Material Adverse Effect has occurred to the extent that such effect on one such party exceeds such effect on the other party." The court ultimately agreed with DQE and held that "Allegheny failed to satisfy, and could not readily satisfy, the MAE Condition because as of October 5, 1998, it had already been adversely affected by the West Penn restructuring order to a material extent, and therefore had suffered a MAE."). *But see* S.C. Johnson & Son, Inc. v. Dowbrands, Inc., 167 F.Supp.2d 657, 661-63, 670 (2001) (S.C. Johnson entered into an Asset Purchase Agreement to purchase certain assets of DowBrands, Inc. A few months after closing, Tenneco Packaging and Specialty Consumer Products, Inc. filed suit against S.C. Johnson alleging that the sliding mechanism on the new Slid-Loc technology infringed a patent held by Tenneco. The court found that the pending Tenneco litigation did not constitute a MAC because the "sole decision by a third party to bring a lawsuit does not bring about any change in the company's assets.").

54 Chertok, *supra* note 16, at 108-09.

55 David Benoit, *Deal for Pep Boys Collapses*, WALL ST. J. (May 30, 2012, 1:50 PM), http://online.wsj.com/article/SB10001424052702303552104577436191373148270.html.

56 NIXON PEABODY, *supra* note 51, at 5 ("[T]he merger agreement also included a reverse break-up fee arrangement whereby Gores agreed to pay Pep Boys a $50 million break-up fee in the form of liquidated damages if Gores failed to consummate the transaction once all closing conditions have been satisfied. . . . Gores ultimately paid the stipulated break-up fee and did not pursue its MAC claim.").

57 *Id.*

58 *Id.*

D. Negotiating the MAC

MAC clauses are among the most heavily negotiated provisions in merger agreements.[59] From the seller's point of view, carve-outs and narrow MAC clauses protect it from "developments extrinsic to its business—events over which the seller has no control but which might impact its bottom line."[60] Sellers want as many carve-outs as possible, while buyers want broad MAC clauses with fewer carve-outs.[61]

The prevalence of MAC inclusions and exclusions[62] in public merger agreements—and thus the negotiating power that buyers or sellers have—varies in response to historical events. During certain periods of economic volatility, merger agreements tend to include MAC clauses with "less expansive inclusions and an ever-increasing list of exclusions."[63] This is preferential to sellers because it limits "the scope of the definition of MAC in order to decrease the potential for a court to find a change or combination of changes sufficient to constitute a MAC under an agreement."[64]

On the other hand, following the credit crunch in 2008 and 2009, "a reversal of that trend became apparent, pointing toward an increase in the bargaining power of acquirors."[65] Acquirors tend to push for broad MAC definitions because it "increases the chances that a court will find a change or combination of changes to constitute a MAC."[66] This shift has been attributed to market trends in merger agreements and the availability of credit to finance larger acquisitions.[67] As credit financing for business combinations becomes increasingly difficult to obtain, sellers recognized the need to make concessions in order to complete transactions.[68]

III. INVOKING A MAC CLAUSE

A buyer will usually invoke a MAC clause because of a perceived adverse change in the seller's profitability. Because of the perceived change, the acquirer may feel they are no longer getting the deal they

59 Somogie, *supra* note 35, at 87.
60 Grech, *supra* note 50, at 1490.
61 Somogie, *supra* note 35, at 87.
62 "Exclusions" and "carve-outs" are synonymous. Chertok, *supra* note 16, at 108
63 Chertok, *supra* note 16, at 107.
64 *Id.*
65 *Id.*
66 *Id.*
67 *Id.*
68 Somogie, *supra* note 35, at 88.

bargained for.[69]

As discussed above, "[m]any events may cause a seller's value to decline, such as pending litigation, a change in government regulation, changes in the industry in which the target operates, general economic changes, and changes that result from the announcement of the merger."[70] While these events may be excluded from the MAC definition via carve-outs, many merger agreements are "often silent with respect to the treatment of such events."[71] This silence leads to issues in interpretation, since many MAC clauses ultimately fail to define what changes would be deemed "material."[72]

While "vague contracts are 'generally regarded as being antithetical to efficient business decision making,' . . . vagueness may be justified 'when the expected larger litigation costs are outweighed by saving on the front end, in lower drafting costs.'"[73] By adding more specific elements, such as a failure to meet specific financial milestones, decreases in sales levels beyond a certain threshold, or customer defections and other 'quantifiable' terms that may unequivocally excuse performance, parties could more clearly communicate their understanding of what constitutes a material adverse change.[74] This strategy could help bypass judicial interpretations of vague MAC clauses.[75]

As an alternative to MAC clauses with more specificity, potential buyers often supplement MAC provisions by using "closing conditions, target bring-down representations, and termination rights through the use of a reverse break-up fee arrangement."[76] While these other risk-shifting devices typically call for liquidated damages, when one party suffers a MAC, "the other party has the right to walk-away [sic] from that transaction without incurring any associated cost."[77]

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69 Grech, *supra* note 50, at 1491.

70 *Id.* at 1491-92.

71 *Id.* at 1492.

72 Daniel Gottschalk, Comment, *Weaseling out of the Deal: Why Buyers Should Be Able to Invoke Material Adverse Change Clauses in the Wake of a Credit Crunch*, 47 HOUS. L. REV. 1051, 1057 (2010).

73 Chertok, *supra* note 16, at 111 (quoting Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 869 (2010)).

74 NIXON PEABODY, *supra* note 51, at 5.

75 *Id.*

76 *Id.*

77 Chertok, *supra* note 16, at 102.

A. U.S. Case Law—General Approach to MAC Cases

MAC litigation has produced case law that is both "complex and perplexing."[78] "Most cases turn on the particular fact patterns involved and give rise to conflicting standards."[79] The notion of a MAC is "imprecise and varies both with the context of the transaction and its parties and with the words chosen by the parties."[80]

The chronic vagueness of MAC language leaves it to courts to determine whether a change constitutes a MAC under the agreement's nebulous definition. When interpreting MAC provisions, courts apply principles of contract law—first looking to the language of the text to determine the parties' intent.[81] If the language is ambiguous, the courts turn to extrinsic evidence (the specific details and circumstances surrounding the negotiation and invocation of a MAC clause) to determine the parties' intentions.[82]

The party seeking to terminate a merger agreement by invoking a MAC clause often bears the burden of proving that a MAC has occurred.[83] Despite numerous litigated attempts to invoke MAC clauses, the Delaware Chancery Court noted that "Delaware courts have never found a material adverse effect to have occurred in the context of a merger agreement."[84]

If the party seeking to terminate the merger agreement can prove that a MAC has occurred and that the MAC does not fall into a carve-out, then the invoking party may terminate the contract legally.[85] When conducting a MAC analysis, a court begins with the elements of a MAC, as provided in the parties' merger agreement, which customarily

78 Yair Y. Galil, *MAC Clauses in a Materially Adversely Changed Economy*, 2002 COLUM. BUS. L. REV. 846, 847 (2002).

79 *Id.*

80 Garrett, *supra* note 42, at 341.

81 Grech, *supra* note 50, at 1497-98.

82 *Id.* at 1498-1500 (providing the illustrative example of *Borders v. KLRB, Inc.*, 727 S.W.2d 357, 359 (Tex. App. 1987), where the Texas Court of Appeals held that a fifty percent drop in a radio station's Arbitron ratings, resulting from a loss of over half its listeners, did not constitute a MAC because the court found "no mention of Arbitron ratings and no language guaranteeing or promising [the buyer] that the station would maintain its audience share"; in reaching its decision, the court cautioned that the "ultimate restraint is that a court cannot, through the construction process, make a new contract for the parties, one they did not make").

83 *See* Chertok, *supra* note 16, at 120 (providing that this approach can be problematic when "the target presumably has greater access to the information necessary to establish the occurrence or non-occurrence of a MAC").

84 Hexion Specialty Chem., Inc. v. Huntsman Corp., 965 A.2d 715, 738 (Del. Ch. 2008) ("A buyer faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close.").

85 Grech, *supra* note 50, at 1497.

include "a change to the assets, liabilities or result of operations . . . (1) taken as whole, that is (2) material and (3) adverse."[86] In other words, the change in the target company's business must be significant.[87] Courts also consider "the duration of the change, the measure of the change and whether the change relates to an essential purpose or purposes the parties sought to achieve by entering into the merger . . . ."[88]

Since the seminal 2001 decision *In re IBP Shareholders Litigation* ("*IBP*"),[89] U.S. judges have set a very high standard of materiality.[90] Before *IBP*, "[a]nything and everything could be a MAC": MACs were considered a "catch all" so that "any negative event seemed an appropriate trigger for a MAC violation."[91] The following case law will provide insight into what courts have considered in determining whether changes are sufficiently material.

B. Required Materiality of Effect: In re IBP, Inc. Shareholders Litigation *(2001)*[92]

By acquiring IBP (the nation's largest meatpacking firm), Tyson (the nation's number one beef distributor and number two pork distributor) hoped to create the world's preeminent meat products company that would "dominate the meat cases of supermarkets in the United States and eventually throughout the globe."[93] Don Tyson was so excited about the possibility of combining the companies that he "had even been dreaming about the companies' combined balanced

86 Genesco, Inc. v. Finish Line, Inc., No. 07-2137-II(III), 2007 WL 4698244 at *34 (Tenn.Ch. 2007).

87 *Id.*

88 *Id. See also* Galil, *supra* note 78, at 850 (Courts view the "purposes of the buyer" as relevant in a MAC analysis thus: "For instance, if an acquiror is interested in a small biotech company solely for the sake of a patent it holds, a sudden plummeting of the company's sales should not be material. While the plummet is clearly material to the company as a going concern, it does not impact the purposes of the acquiror in making the deal.").

89 *In re* IBP, Inc. S'holder Litig., 789 A.2d 14 (Del. Ch. 2001); *see infra* Part III.B.

90 Somogie, *supra* note 35, at 91.

91 Ross B. Bricker, Courtney M. Beemer & Jodi K. Newman, *Living in a Material World: The Evolution, Purpose, and Future of Material Adverse Change Clauses*, BLOOMBERG L. REP.: MERGERS & ACQUISITIONS, Nov. 10, 2008 (events designated as MACs have included "decline in earnings, operating losses, reductions in income, reduction in sales volumes, customer losses, reduction in target audience, reduction in value of acquired properties, cancellation of a contract, general economic or business conditions that have a disparate impact on a company compared to the economy as a whole, and future prospects") (internal citations omitted).

92 *In re* IBP, Inc. S'holder Litig., 789 A.2d at 14.

93 *Id.* at 22.

sheets [sic] at bedtime."[94] During the auction process, Tyson was alerted to financial problems that IBP was experiencing.[95] After learning of these problems, Tyson was still interested in acquiring IBP.[96]

However, during February of 2001, Tyson became increasingly nervous about the IBP deal and began to stall for time.[97] Tyson's anxiety was heightened due in large part to a severe winter, "which adversely affected livestock supplies and vitality."[98] During Tyson's first quarter in 2001, it earned twelve cents a share, down from twenty-five cents during the first quarter of 2000.[99] Tyson "described the period as involving the 'most difficult operating environment' [it] had seen since 1981, and admitted that [it] had suffered from the 'on-going effect of the severe winter weather.' . . . IBP was experiencing similar problems."[100]

Tyson felt "buyer's regret" and sought to terminate the agreement, arguing, among other things, that IBP's disappointing first-quarter performance was evidence of a MAC, which justified Tyson's termination of the agreement.[101] Section 5.10 of the agreement, found in the representations and warranties section, defined a material adverse effect 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 . . on the condition (financial or otherwise), business, assets, liabilities or results of operations of [IBP] and [its] Subsidiaries taken as a whole.[102]

Tyson argued that the decline in IBP's performance in the last quarter of 2000 and the first quarter of 2001 evidenced the existence of a Material Adverse Effect.[103]

In its opinion, the court conceded that a MAC analysis is often imprecise because of the deceptive nature of MAC language:

> The simplicity of § 5.10's words is deceptive, because the

94 *Id.* at 29.

95 *Id.* at 22. One of IBP's subsidiaries was "victimized by accounting fraud to the tune of over $30 million in charges to earnings," and as a result, "IBP was projected to fall seriously short of the fiscal year 2000 earnings predicted in projections . . . ." *Id.*

96 *Id.*

97 *Id.* at 47.

98 *Id.* at 22.

99 *Id.* at 48.

100 *Id.*

101 *Id.* at 52.

102 *Id.* at 65 (internal quotation marks omitted, changes in original).

103 *Id.*

> application of those words is dauntingly complex. On its face, § 5.10 is a capacious clause that puts IBP at risk for a variety of uncontrollable factors that might materially affect its overall business or results of operation as a whole. Although many merger contracts contain specific exclusions from MAE clauses that cover declines in the overall economy or the relevant industry sector, or adverse weather or market conditions, § 5.10 is unqualified by such express exclusions.[104]

The court characterized the notion that Tyson could walk away from the agreement simply because of a downturn in cattle supply as "untenable."[105] Instead, Tyson needed to show that the event had the "required materiality of effect."[106]

To determine if the requisite materiality of effect was met, the court examined the "negotiating realities" between the parties (the history of the transaction and Tyson's knowledge of the risks involved) and the purpose of the investment (whether it was for long-term or short-term profitability).[107] In the larger context in which the parties were transacting, short-term "swings in IBP's performance were part of its business reality."[108] The court explained that, "[t]o a short-term speculator, the failure of a company to meet analysts' projected earnings for a quarter could be highly material. Such a failure is less important to an acquiror who seeks to purchase the company as part of a long-term strategy."[109] In this case, the court believed Tyson could not view short-term "blips" as material, though the court later cited cases where short-term blips *were* material.[110] The test applied by the court was whether the MAC "'(1) substantially threaten[ed]' (2) 'the overall earnings potential' of the acquired company; (3) 'in a durationally-significant manner' (measured in years not in months); and (4) [was] prove[n] to have been a change, not an event known when the acquisition agreement was signed."[111]

104 *Id.* at 65-66 (internal citations omitted).

105 *Id.* at 66.

106 *Id.*

107 *Id.* at 67; *see also* Bricker, Beemer & Newman, *supra* note 91, at 5.

108 *In re* IBP, Inc. S'holder Litig., 789 A.2d 14, 67 (Del. Ch. 2001).

109 *Id.*

110 *Id.* at 67, 68. The *IBP* court cited: (1) *Pan Am Corp. v. Delta Air Lines*, 175 B.R. 438 (S.D.N.Y. 1994) (finding that a MAC occurred when Pan Am airlines suffered a sharp decline in bookings over a three-month period that was shocking to its management; Delta was providing funding to Pan Am and, as a result, was greatly affected by Pan Am's financial deterioration); and (2) *Katz v. NVF Co.*, 100 A.D.2d 470 (1st Dep't 1984) (two merger partners agreed that one partner had suffered a MAC when its full year results showed a net loss of over $6.3 million, compared to a $2.1 million profit a year before).

111 Gottschalk, *supra* note 72, at 1062.

Though the court admitted its holding was reached with "less than the optimal amount of confidence," and that the question of what constitutes a MAC still "remains a close one," it held that "IBP remains what the baseline evidence suggests it was—a consistently but erratically profitable company . . . [with] results of operations in line with the company's recent historical performance."[112]

C. Degree and Duration of Threatened Effect: Frontier v. Holly *(2005)*[113]

In contemplating a merger between mid-sized petroleum refiners Frontier Oil Corporation ("Frontier") and Holly Corporation ("Holly"), Frontier's CEO predicted that the two companies together would be "one incredible company" that would be "either the largest or second largest refiner" in the Rocky Mountain region.[114] In March 2003, the parties had agreed upon the basic terms of the merger.[115] In advance of a definitive merger agreement, the parties proceeded with their due diligence efforts.[116] One of the items provided by Frontier to Holly was an article from the February 22, 2003, edition of the *Los Angeles Times* entitled "Cancer Cluster Alleged," which described plans by activist Erin Brockovich to bring a mass toxic tort suit against a wholly-owned subsidiary of Frontier.[117]

When Holly confronted Frontier about the Beverly Hills lawsuit, Frontier's CEO characterized the claims as "a bunch of hooey" and a "Hollywood stunt."[118] Holly was assuaged by reassurance from Frontier, and they negotiated a Merger Agreement that gave Frontier various exit strategies.[119] The representations and warranties provided the definition of "material adverse effect," as well as specific language about the Beverly Hills litigation and the definition of "threatened litigation."[120] Frontier provided in Section 4.8 of the Merger Agreement:

112 *In re* IBP, Inc. S'holder Litig., 789 A.2d at 68, 71.
113 Frontier Oil Corp. v. Holly Corp, No. Civ.A. 20502, 2005 WL 1039027 (Del. Ch. 2005).
114 *Id.* at *1.
115 *Id.* at *2.
116 *Id.*
117 *Id.*
118 *Id.* at *3.
119 *Id.* at *3-7 ("[T]here were, in general, three avenues: (1) if a party's representations and warranties in the Merger Agreement were or, in some instances, became inaccurate, including, if threatened litigation would have or would reasonably be expected to have a Material Adverse Effect; (2) if a party exercised its 'fiduciary out'; and (3) if the parties mutually agreed to termination.").
120 *Id.* at *33.

> Except as set forth on Schedule 4.8 of the Frontier Disclosure Letter, there are no actions, suits or proceedings . . . , to Frontier's knowledge, threatened against Frontier or any of its Subsidiaries, . . . other than those that would not have or reasonably be expected to have, individually or in the aggregate, a Frontier Material Adverse Effect.[121]

Schedule 4.8 to the Merger Agreement set forth a specific reference the Beverly Hills lawsuit:

> For avoidance of doubt and only for the limited purpose of the Agreement, Frontier agrees with, and for the sole benefit of, Holly that this potential litigation will be considered as "threatened" (as such term is used in Section 4.8 of the Agreement) and that the disclosure of the existence of this "threatened" litigation herein is not an exception to Section 4.8, 4.9 or 4.13 of the Agreement and despite being known by Holly, will have no effect with respect to, or have any limitation on, any rights of Holly pursuant to the Agreement.[122]

During the fourteen weeks following execution of the merger agreement, litigation was commenced in the Brockovich action.[123] Shortly thereafter, Holly sent Frontier a letter that asserted that Frontier had breached its representations in the Merger Agreement because the Beverly Hills litigation constituted a MAC.[124] The crux of Holly's argument was that the threatened litigation would effect, or would reasonably be expected to effect, a MAC.[125]

The court ultimately denied the existence of a MAC, holding that Holly would have needed to establish "some degree and duration of the threatened effect," rather than the mere existence of a lawsuit.[126] The court felt "it was reasonable to conclude that Frontier could absorb the projected defense costs without experiencing an MAE."[127]

121 *Id.* Significantly, the parties defined a material adverse effect as "a material adverse effect with respect to (A) the business, assets and liabilities (taken together), results of operations, conditions (financial or otherwise) or prospects of a party and its Subsidiaries on a consolidated basis." *Id.*

122 *Id.* at *5.

123 *Id.* at *11.

124 *Id.* at *25.

125 *Id.* at *37. "Holly relie[d] on testimony from Frontier's comptroller to the effect that $10 million would have been material to Frontier in 2002 and testimony from a Frontier director that tens of millions of dollars in defense costs would have made the litigation material." *Id.* (internal citations omitted).

126 Gottschalk, *supra* note 72, at 1063.

127 *Frontier Oil Corp.*, 2005 WL 1039027, at *37.

D. Durationally Significant Short-Term Changes: Genesco v. Finish Line *(2007)*[128]

In the spring of 2007, Alan Cohen, the president of Finish Line, a retailer of athletic, lifestyle, and outdoor footwear and apparel, saw a press release stating that his only competitor, Foot Locker, was making a hostile move to acquire Genesco, a retailer of shoes, hats, and apparel.[129] Cohen believed that a merger between Finish Line and Genesco would result in a combined company with huge growth potential.[130]

On June 17, 2007, Finish Line and Genesco signed a merger agreement that provided that if the merger did not close by December 31, 2007, either party could terminate the transaction.[131] Within a couple of months, Genesco's quarterly earnings were significantly short of projections (actually, their lowest in ten years).[132] On September 17, 2007, while Genesco pressed to close the merger, UBS[133] "delayed and requested information on the drop in Genesco's performance, asserting its concern that a Material Adverse Effect had occurred."[134]

Under the terms of section 7.2(a) of the merger agreement, a prerequisite for Genesco to obtain specific performance was that it

128 Genesco, Inc. v. Finish Line, Inc., No. 07-2137-II(III), 2007 WL 4698244 (Tenn.Ch. 2007); *see also* Gottschalk, *supra* note 72, at 1065 (noting that the precedential value of *Genesco* is limited because the case is from Tennessee and not Delaware).

129 *Genesco*, 2007 WL 4698244, at *2 (Genesco's banners include Journeys, Hat World, and Johnston & Murphy).

130 *Id.* at *2. A retail expert at trial also testified that the diversity of the combined company would provide more flexibility and strength in withstanding future trends.

131 *Id.* at *1. The merger agreement was highly leveraged with UBS providing financing. Finish Line was to buy Genesco for $1.5 billion.

132 *Id.*

133 UBS was a global financial services company, hired by Finish Line. *Id.* at *2.

134 *Id.* at *4.

demonstrate the absence of a Material Adverse Effect.[135] While Finish Line argued that Genesco's poor performance was a MAC, Genesco asserted that there was no MAC because the decline in performance was due to general economic conditions that affected consumer spending—such as high gas prices and housing and mortgage issues—which fell within the MAC carve-outs.[136]

The Chancery Court of Tennessee cited both *Tyson*[137] and *Frontier Oil*[138] in formulating the test of whether a MAC had occurred.[139] The court "required 'the change in the target company's business . . . be significant'" and examined "(1) the change's duration, (2) its measure, and (3) its relation to the purposes the parties sought to achieve by entering into the merger."[140] The court determined that all three of the test's factors were met and that a MAC had occurred.[141] Significantly, the court suggested that "a more nuanced approach towards materiality may be needed in today's world of mergers and acquisitions" and that

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135 *Id.* at *13. The agreement defined a "Company Material Adverse Effect" as

> any event, circumstance, change or effect that, individually or in the aggregate, is materially adverse to the business, condition (financial or otherwise), assets, liabilities or results of operations of the Company and the Company Subsidiaries, taken as a whole; provided, however, that none of the following shall constitute, or shall be considered in determining whether there has occurred, and no event, circumstance, change or effect resulting from or arising out of any of the following shall constitute, a Company Material Adverse Effect: . . . (B) changes in the national or world economy or financial markets as a whole or changes in general economic conditions that affect the industries in which the Company and the Company Subsidiaries conduct their business, so long as such changes or conditions do not adversely affect the Company and the Company Subsidiaries, taken as a whole, in a materially disproportionate manner relative to other similarly situated participants in the industries or markets in which they operate; . . . (D) the failure, in and of itself, of the Company to meet any published or internally prepared estimates of revenues, earnings or other financial projections, performance measures or operating any such failure may, except as may be provided in subsection (A), (B), (C), (E), (F) and (G) of this definition, be considered in determining whether a Company Material Adverse Effect has occurred . . . .

Id. at *13-14.

136 *Id.* at *14.

137 Discussed *infra* Part III.B.

138 Discussed *infra* Part III.C.

139 *Genesco*, 2007 WL 4698244, at *15.

140 Gottschalk, *supra* note 72, at 1064.

141 *Genesco*, 2007 WL 4698244, at *14-16 (stating that the three prongs of the test were met because: (1) the merger agreement provided that the significant term for a MAC would be from June 17 to December 31 of 2007, and the MAC had persisted throughout this period and was thus durationally significant; (2) the change was material in degree because Genesco's May quarterly earnings were some of the lowest in ten years, which hadn't been mitigated or offset; and (3) the purpose of the agreement was frustrated because Finish Line's long-term strategic goals in entering into the merger (diversification, synergies from reduced costs, opportunity for growth) had all been frustrated).

"Tyson should not be interpreted as a bar on finding materiality for short-term changes."[142]

Next, the court looked to see if the MAC was included in any of the merger agreement's enumerated carve-outs.[143] Finish Line presented expert testimony that the loss in earnings was caused by fashion trends and a decline in average selling price of footwear, which they argued was an intra-industry condition that was disproportionate to others in its industry.[144] The court rejected Finish Line's argument and attributed the loss in earnings to general economic conditions, which were *not* disproportionate to its peers in the industry.[145] Since general economic conditions were carved out of the MAC definition, Finish Line was unable to terminate the agreement.[146]

E. Failure to Meet Projections: Hexion v. Huntsman *(2008)*[147]

In *Hexion*, the most recent landmark decision among those interpreting MAC clauses, the court rejected Hexion's claim that Huntsman had suffered a MAC because of disappointing results in earnings performance due in part to the credit bubble of 2008.[148]

In 2007, Hexion, the world's largest producer of binder, adhesive, and ink resins for industrial application, sought to acquire Huntsman, a manufacturer of chemical products.[149] The merger agreement was signed in July 2007, just before the "onset of the ongoing crisis affecting the national and international credit markets."[150]

Huntsman's results from the time of signing were disappointing and well below the projections it had presented to bidders in June 2007.[151] Hexion filed suit on June 18, 2008, seeking a declaratory judgment that Huntsman had suffered a MAC because it repeatedly missed its forecasts, as evidenced by shortfalls from the 2007 projections.[152] The main crux of Hexion's complaint was that section 6.2(e) of the merger agreement stated that its obligation to close was conditioned on the absence of "any event, change, effect or

142 Garrett, *supra* note 42, at 350.
143 *Genesco*, 2007 WL 4698244, at *15.
144 *Id.*
145 *Id.*
146 *Id.*
147 Hexion Specialty Chem. v. Huntsman Corp., 965 A.2d 715, 720-721 (Del. Ch. 2008).
148 *Id.* at 740-43.
149 *Id.* at 715.
150 *Id.* at 720-21.
151 *Id.* at 740.
152 *Id.* at 740, 751.

development that has had or is reasonably expected to have, individually or in the aggregate," a MAC.[153] Hunstman filed an answer, denying the existence of a MAC.[154]

The court took the *Tyson* approach and looked at the transaction's context.[155] The court looked at the company's long-term earning power, rather than short-term, because, "[i]n the absence of evidence to the contrary, a corporate acquirer may be assumed to be purchasing the target as part of a long-term strategy."[156] The court stated that "[t]he ubiquitous material adverse effect clause should be seen as providing a 'backstop protecting the acquirer from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner" and that "[a] short-term hiccup in earnings should not suffice."[157] The court pointed out that evidence of significant decline can constitute a MAC, but only if the poor earnings can be expected to persist significantly into the future.[158]

The court also rejected the argument that Huntsman's shortfall of its projections was sufficient to trigger Hexion's walk-away rights.[159] The court pointed to the merger agreement's explicit disclaimer of any representation or warranty by Huntsman as to any of its projections, forecasts, or other estimates, and construed the disclaimer as a signal that the parties "specifically allocated the risk to Hexion that Hunstman's performance would not live up to management's

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153 *Id.* at 736. The merger agreement defined a MAC as:

> any occurrence, condition, change, event or effect that is materially adverse to the financial condition, business, or results of operations of the Company and its Subsidiaries, taken as a whole; *provided*, *however*, that in no event shall any of the following constitute a Company Material Adverse Effect: (A) any occurrence, condition, change, event or effect resulting from or relating to changes in general economic or financial market conditions, except in the event, and only to the extent, that such occurrence, condition, change, event or effect has had a disproportionate effect on the Company and its Subsidiaries, taken as a whole, as compared to other Persons engaged in the chemical industry; (B) any occurrence, condition, change, event or effect that affects the chemical industry generally (including changes in commodity prices, general market prices and regulatory changes affecting the chemical industry generally) except in the event, and only to the extent, that such occurrence, condition, change, event or effect has had a disproportionate effect on the Company and its Subsidiaries, taken as a whole, as compared to other Persons engaged in the chemical industry . . . .

Id. at 736-37.

154 *Id.* at 723.

155 *Id.* at 738.

156 *Id.* (providing that one would expect such a period to be "measured in years rather than months").

157 *Id.*

158 *Id.*

159 *Id.* at 741.

expectations."[160]

IV. APPROACH BY THE U.K. TAKEOVER PANEL

While the United States courts have upheld a strict standard for materiality, the United Kingdom has acknowledged a wide application of MAC clauses.[161] In the United Kingdom, the Panel on Takeovers and Mergers ("Takeover Panel") regulates public merger agreements and is granted ultimate authority as to the determination of whether a MAC has occurred in a particular transaction.[162] The Takeover Panel's main function is "to issue and administer the City Code on Takeovers and Mergers" (the "Code").[163] The Code was developed in 1968 and has evolved "to reflect the collective opinion of those professionally involved in the field of takeovers as to appropriate business standards and as to how fairness to shareholders and an orderly framework for takeovers can be achieved."[164] Under Rule 13 of the Code, an acquirer cannot terminate a deal unless granted authority by the Takeover Panel.[165]

One huge difference between the U.S. and British approach to MAC interpretation is that, "[i]n the U.S., there is no equivalent administrative body injecting such public policy into the market for mergers."[166] The British Takeover Panel is comprised of professionals in the field of mergers and acquisitions, whereas United States judges, who may have no business background, decide whether a potentially complex event will trigger a MAC clause.[167] In addition, British clauses often lack "the highly negotiated MAC exceptions characteristic

160 *Id.* at 741. The court explained that the proper benchmark for determining whether a MAC has occurred "is to examine each year and quarter and compare it to the prior year's equivalent period" and not, as Hexion pled, to examine whether a target has met its advertised projections. *Id.* at 742.

161 Chertok, *supra* note 16, at 129-30.

162 *Id.* The Takeover Panel consists of up to thirty-four members drawn from business and financial organizations. *Id.* at 129.

163 THE TAKEOVER PANEL, http://www.thetakeoverpanel.org.uk/ (last visited Mar. 2, 2014). The Takeover Panel on Takeovers and Mergers is an independent body "designated as the supervisory authority to carry out certain regulatory functions in relation to takeovers pursuant to the Directive on Takeover Bids (2004/25/EC)." *Id.* Its statutory functions are set out in and under Chapter 1 of Part 28 of the Companies Act 2006. *Id.* The Companies Act 2006 is an Act of the Parliament of the United Kingdom, which forms the primary source of UK company law. *Id.*

164 *The Takeover Code*, THE TAKEOVER PANEL, http://www.thetakeoverpanel.org.uk/the-code/download-code (last visited Mar. 2, 2014).

165 *Id.*

166 Chertok, *supra* note 16, at 132.

167 *Id.*

of MAC clauses in the U.S."[168]

In *Tempus Group PLC v. WPP Group PLC*,[169] advertising firm WPP executed a merger agreement to acquire industry competitor Tempus Group a day before the September 11, 2001 terrorist attacks in the United States.[170] After the attacks, WPP wanted to invoke its termination rights under the agreement's general MAC clause, which included any "material adverse change or deterioration having occurred in the business, assets, financial or trading position or profits or prospects of any member of the wider Tempus Group."[171]

The Takeover Panel held that "while the economic impact of September 11, 2001 w[as] 'exceptional' and 'unforeseeable' and clearly contributed to the market declines already impacting advertising, it nonetheless did not undermine the rationale behind WP[P']s desire to enter into the merger agreement nor the price of its offer."[172] The Takeover Panel reasoned that a MAC doesn't have to rise to the level of legal frustration of contract, but the threshold for invoking a MAC clause remains a "high one," and the material change asserted still must be "very considerable significance striking at the heart of the purpose of the transaction."[173]

In Adam Chertok's "Rethinking the U.S. Approach to the Material Adverse Change Clauses in Merger Agreements," Chertok posits that the most important difference between the U.S. and U.K. approaches to MAC clause jurisprudence "is the very existence of the Takeover Panel and City Code's general principles of fairness, openness and equality among shareholders."[174]

> In the U.S., there is no equivalent administrative body injecting such public policy into the market for mergers. Furthermore, in the U.K., the public policy embodied in the City Code creates a strong

168 *Id.* at 130-31 ("A typical MAC clause in a British public merger agreement might read: ' . . . no adverse change or deterioration having occurred in the business, assets, financial or trading position or profits or prospects or operational performance of an [sic] member of the Group which in any case is material in the context of the wider Group taken as a whole.'"); *see also* Jeffrey Rothschild et al., *Drafting Material Adverse Change Clauses*, *in* INTERNATIONAL MERGERS & ACQUISITIONS: CREATING VALUE IN AN INCREASINGLY COMPLEX CORPORATE ENVIRONMENT 93 (2008), *available at* http://www.strategyand.pwc.com/media/file/eBook_Intl_Mergers_and_Acquisitions.pdf.

169 THE TAKEOVER PANEL, PANEL STATEMENT NO. 2001/15, OFFER BY WPP GROUP PLC FOR TEMPUS GROUP PLC (Nov. 6, 2001), *available at* http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/2001-15.pdf [hereinafter Takeover Panel Statement].

170 *Id.* ¶ 1.

171 *Id.* ¶ 8.

172 Chertok, *supra* note 16, at 132.

173 *Id.* (quoting Takeover Panel Statement, *supra* note 168, ¶ 16).

174 Chertok, *supra* note 16, at 132.

> presumption that the acquiror assumes the risk associated with unexpected events. In contrast, U.S. courts have recognized no such public policy presumption, and rather, have relied exclusively on contract law and the intent of the parties as expressed in determining which party should bear such risk. Finally, in the U.S., a MAC clause is not subject to any industry or economic specific carve-outs, unless specifically bargained for, whereas the City Code incorporates such carveouts whether or not bargained for, as discussed above. [175]

V. THE EUROZONE CRISIS

A. Economic Volatility and Contracting

As discussed above, economic volatility breeds increased litigation over deals that no longer seem desirable to a party to the contract.[176] Daniel Gottschalk argues that "a buyer wishing to escape its obligations for a 2007, 2008, or 2009 merger or acquisition should have sufficient grounds to assert a MAC if the lack of available credit [due to the credit crisis] has materially affected the target's present and future business."[177] He further argues that "the key to successfully asserting a MAC based on the credit crunch of 2007-2008 lies in convincing a court that the durational element is met."[178]

> While many companies have been forced to file bankruptcy in the wake of the current economic downturn, those with a few poor quarters have not yet met their burden of proof. Specifically, these buyers must show that the depressed financial quarters will continue into the coming years. Therefore, these buyers may only invoke a MAC clause in 'exceptional circumstances' which strike 'at the very heart of the purpose of the transaction,' causing serious damage to the 'longer-term prospects' of the target company.[179]

According to Gottschalk, a court would be "legally unjustified in upholding the strict MAC standard in the wake of a credit crunch."[180]

The current European Crisis is even direr than the U.S.'s 2007-2008 credit bubble, and financial leaders are not taking the crisis lightly;

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175 *Id.*

176 *See infra* Part I.

177 Gottschalk, *supra* note 72, at 1075.

178 *Id.* at 1073.

179 *Id.* at 1074 (internal citations omitted) (citing sources that argue the credit crunch of 2007-2008 was an exceptional circumstance because it was not a mere economic downtrend but a prolonged recession, plagued with an exceptional increase in bankruptcies of even previously healthy companies).

180 *Id.* at 1075.

for example, Sir Mervyn King, the Governor of the Bank of England, once called the Euro-Zone crisis "the most serious financial crisis we've seen, at least since the 1930s, if not ever."[181] While the Eurozone has come a long way since the beginning of the crisis in 2009, the crisis is far from over.[182] "[G]rowth is still stagnant in Europe and a host of economic and social problems of the crisis, such as high youth unemployment, remain."[183]

While the court's rejection or acceptance of a MAC will depend on the specific negotiations of the contracting parties, the merger agreement itself, and any extrinsic evidence proffered by the parties, an overview of the financial causes and ramifications of the contemporary European crisis is helpful in illumining potential MAC claims and their likelihood of success.

B. The Contemporary European Crisis

In 1979, the long-debated creation of a single currency for the European community became a reality in the form of the European Monetary System ("EMS").[184]

> The main objective of the EMS was "to attain a zone of internal and external monetary stability in Europe involving both low inflation and stable exchange rates; to provide the framework for improved economic policy cooperation between Member States . . . and to help to alleviate global monetary instability through common policies vis-à-vis third currencies."[185]

Sixteen countries adopted the Euro, and "[i]nternational confidence in the new currency grew steadily. . . . It is firmly established as the world's second most important currency."[186]

Caroline Jensen attributes the crisis to (1) problems created by the

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181 James Kirkup, *World Facing Worst Financial Crisis in History, Bank of England Governor Says*, THE TELEGRAPH (Oct. 6, 2011, 10:00 PM), http://www.telegraph.co.uk/finance/financialcrisis/8812260/World-facing-worst-financial-crisis-in-history-Bank-of-England-Governor-says.html.

182 Press Trust of India, *Eurozone showing signs of recovery; but crisis far from over*, BUSINESS STANDARD (Jan. 24, 2014), http://www.business-standard.com/article/international/eurozone-showing-signs-of-recovery-but-crisis-far-from-over-114012400303_1.html.

183 Catherine Boyle & Julia Chatterley, *Markets wrong to think euro crisis over: UBS chair*, CNBC (Apr. 13, 2013), http://www.cnbc.com/id/101579100.

184 Hannes Hofmeister, *Goodbye Euro: Legal Aspects of the Withdrawal from the Eurozone*, 18 COLUM. J. EUR. L. 111, 113 (2011).

185 *Id.*

186 *Id.* at 120.

adoption of the Euro as common currency;[187] (2) non-enforcement and abandonment of Maastricht criteria;[188] and (3) unprecedented and unsustainable debt.[189] The telltale sign of the eurozone's debt-related stress is the series of bailouts over the past couple of years: "[t]he EU and IMF have provided €85, €110, and €78 billion to Ireland, Greece, and Portugal respectively since the crisis began. The trend has been to pair international assistance with agreed austerity measures."[190]

Greece in particular found itself in a precarious situation as it edged toward a disorderly default on March 20, 2012, when a €14.5 billion bond payment became due, and Europe's leaders began to question whether the country was worth saving, as the bailout-austerity program in place was no longer sustainable.[191] While the treaties and arrangements creating the euro "d[id] not explicitly contemplate either forced or voluntary departure of one or more member states from the European Monetary Union," the eventual departure of a country from the eurozone [was a possibility].[192]

C. A MAC Event?

The Eurozone Crisis is having a huge effect on the global economy.[193] There is the possibility that the effects of the crisis could constitute a MAC—especially if the MAC clause is broadly drafted—if the party invoking the MAC can prove that a durationally significant

187 Jensen, *supra* note 1, at 760 (arguing that the adoption of the Euro (1) "fueled sovereign debt by making cheap credit readily available . . . . Nations that would have been weaker were buoyed by their association with stronger Eurozone members"; and (2) "meant that the disparate economic competitiveness of European nations would no longer be automatically adjusted by exchange rate devaluations," which results in diverging wages among peers).

188 *Id.* at 761. The Maastricht Criteria entailed keeping inflation below 1.5% a year and maintaining a budget deficit of less than three percent of GDP, as well as a debt-to-GDP ratio of less than sixty percent. "The entry treaties empower the European Commission and Council to monitor member states, and impose sanctions for unrepentant violators. . . . The image of a teenager with a brand new credit card springs to mind." *Id.* "Today, the Maastricht Criteria is largely a moot point because most Eurozone countries are running huge deficits and unprecedented debts. The Criteria loses both credibility and relevance as countries become either unwilling or unable to comply." *Id.*

189 *Id.* (noting that total debt-to-GDP levels in the eighteen core countries of the Organization for Economic Co-operation and Development rose from 160% in 1980 to 321% in 2010).

190 *Id.* at 762 (internal citations omitted).

191 *Id.* at 779.

192 *The Euro Crisis: Impacts on Cross-Border Contracts*, MCDERMOTT WILL & EMERY (June 14, 2012), http://www.mwe.com/The-Euro-Crisis-Impacts-on-Cross-border-Contracts-06-14-2012/?PublicationTypes=d9093adb-e95d-4f19-819a-f0bb5170ab6d.

193 Catherine Boyle & Julia Chatterley, *Markets wrong to think euro crisis over: UBS chair*, CNBC (Apr. 13, 2013), http://www.cnbc.com/id/101579100.

material adverse change has occurred.[194] However, in U.S. courts at least, asserted MACs based on losses in earnings due to the effects of the contemporary crisis will likely fail to protect buyers based on the reasoning in *Genesco*.[195]

U.K. law firm Slaughter & May explained that "[a]s a general principle, it is not anticipated that many contracts governed by English law are likely to be frustrated by [the effects of the crisis], as the legal criteria for frustration are difficult to satisfy."[196] Since English law's standard for materiality is more flexible than the American approach,[197] it is unlikely that U.S. courts would recognize a MAC in this context either. But is this fair to buyers who entered into contracts with no foreseeability that the Eurozone would have problems?

VI. ALTERNATE APPROACHES TO THE STRICT MAC STANDARD

A. Disadvantages of a Strict MAC Standard

There are distinct advantages and disadvantages of upholding a strict MAC standard.[198] Those who argue against the strict MAC standard claim that it may go against the fundamentals of contract law.[199] Under contract law, the intentions of the parties control the interpretation of an ambiguous clause.[200] Usually, M&A deals are made based on current projected earnings of a particular target, and "[w]hen a substantial event such as the credit crunch is added to the equation, the objectives of the parties suddenly fall short."[201] In other words, the buyer did not get what he bargained for, so courts should not frustrate the intentions of the parties by denying him the option of walking away from the deal.

Opponents of a strict MAC standard also argue that, in Delaware and elsewhere, it is virtually impossible to prove materiality under the

194 *See infra* Part III.D.

195 *See* Genesco, Inc. v. Finish Line, Inc., No. 07-2137-II(III), 2007 WL 4698244 (Tenn.Ch. 2007).

196 *Briefing, Eurozone Crisis: What do Clients need to know?* SLAUGHTER & MAY (Oct. 2011), *available at* http://www.slaughterandmay.com/what-we-do/publications-and-seminars/publications/newsletters-and-briefings/2011/eurozone-crisis—-what-do-clients-need-to-know.aspx.

197 *See infra* Part IV.

198 The "strict MAC standard" refers to the approach taken by Delaware courts, which have never found a material adverse change to satisfy their criteria—typically considered to be "seller-friendly."

199 Gottschalk, *supra* note 72, at 1068.

200 *Id.* at 1068.

201 *Id.* at 1072.

current MAC standard.[202] In *Frontier Oil*,[203] the court "saddled Holly with the burden of trying another party's toxic tort suit to prove materiality."[204] In *IBP*,[205] the court required "evidence showing an earnings impairment that spanned years" when Tyson "only produced evidence of an earnings loss occurring over the span of months."[206]

Opponents of the strict MAC standard argue that an "exit right is illusory"[207] if it does not exist in practice and that the current standard creates a windfall to the seller.[208] The *Hexion* court suggested that, rather than relying on a MAC provision, acquirers in Hexion's position are better served by negotiating for an earn-out provision, representations and warranties, or any number of alternatives, which might provide greater specificity in order to protect against a target's failure to meet projections.[209] If one of the goals of MAC clauses is to allocate risk between buyers and sellers, then buyers seem to be carrying more than their share of the weight.[210]

B. Advantages of a Strict MAC Standard

Supporters of the strict MAC standard argue that, in executing an M&A deal, each party knows the risks involved.[211] As a result, some believe that the MAC clause should be read against the buyer because the buyer should have "built the possibility of an economic downturn into their acquisition models."[212]

Further, during times of economic volatility, allowing buyers to terminate deals would further weaken a struggling economy by "derailing the stability of the deal market."[213] If buyers were able to terminate deals easily, this would seriously affect the business of the target, who may be viewed as a sullied asset, thereby losing investment opportunities.[214] Judges may also feel justified in setting a strict precedent for interpretation of MAC clauses when it concerns a "deal of

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202 Garrett, *supra* note 42, at 356.
203 *See infra* Part III.C.
204 Cicarella, *supra* note 21, at 447.
205 *See infra* Part III.D.
206 *Id.* (arguing that it was "at least unreasonable and at most ludicrous" to expect Tyson to be able to obtain this long-term evidence).
207 Cicarella, *supra* note 21 at 448.
208 Grech, *supra* note 50, at 1500.
209 *See infra* Part III.D.
210 Garrett, *supra* note 42, at 356.
211 Gottschalk, *supra* note 72, at 1070.
212 *Id.*
213 Gottschalk, *supra* note 72, at 1076.
214 *Id.*

great enough magnitude to affect the entire economy," such as the Bank of America merger with Merrill Lynch.[215]

C. A Different MAC Standard for Courts

A different approach to the MAC standard eschews the materiality test in favor of a causation-oriented approach, in which the causes of the MAC are important factors under consideration when determining whether a party can terminate.[216] For example, the court would weigh causation factors, such as whether one party failed in the due diligence process or whether the target engaged in activities that adversely affected its value.[217] Instead of emphasizing the extent of the value-change in the target, "a court should focus on causation and ask 'whether the event was within the seller's ability to affect.'"[218] Another approach is to rely on numerical thresholds for materiality.[219] However, such provisions can "deter the other party and cause the deal to collapse."[220]

D. Drafting Solutions

In her Note "Efficiency and Certainty in Uncertain Times: The Material Adverse Change Clause Revisited," Michelle Shenker Garrett argues that choosing particular indicia for measuring materiality is unworkable, so parties should use reverse termination fees instead of MAC clauses.[221] Reverse termination fees allow a buyer to pay a seller

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215 *Id.* at 1076-77 (citing Sue Reisinger, How Bank of America Used Merrill Losses to Bully the Government, Corp. Couns. (Sept. 29, 2009), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202434125526 (reporting then-Treasury Secretary Henry Paulson's statements concerning the deal's effect on the health of the U.S. economy)).

216 Cicarella, *supra* note 21, at 448.

217 *Id.*

218 *Id.* (quoting Ronald J. Gilson & Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisitions*, 21 J.L. ECON. & ORG. 330, 334 (2005)).

219 Galil, *supra* note 78, at 865. For this premise, Galil cites George Fussianes, Managing Director of Goldman Sachs, who describes the difficulty with such provisions:

> The dynamic that we have experienced in negotiations is that when the parties start to talk about this kind of thing, somebody may throw out a number, saying, "Let's define a material adverse change as a situation where EBIT-DA drops by X amount of dollars." That starts down a path that gets very, very difficult. The first thing that the buyer thinks is, "Why did he or she choose that number? Do they know something I don't know?" All of a sudden the parties get into a very obtuse discussion of how to define what a material adverse change might be.

Id.

220 *Id.*

221 Garrett, *supra* note 42, at 358-61.

a fixed price to exit an agreement.[222] This way, buyers have a legitimate exit recourse, and sellers have an incentive to take profit-maximizing actions to prevent their buyers from terminating the agreement.[223]

E. Arbitration By Financial Experts

In Adam Chertok's Note "Rethinking the U.S. Approach to Material Adverse Chance Clauses in Merger Agreements," Chertok suggests that parties consider "negotiating a dispute resolution clause calling for binding arbitration by a panel of financial experts and agreeing to the identity of those experts at the time of contracting." Similar to the U.K. approach[224] to MAC jurisprudence, this privately-run arbitration panel approach is attractive in part because is the arbiters would be comprised of financial experts.[225] Perhaps the more appropriate forum for resolution of such disputes is in front of a panel composed of experts, rather than in front of judges.[226]

Second, this solution would promote judicial economy. Courts are overwhelmed with MAC disputes, especially in times of economic uncertainty, and the court's time and resources might be better utilized elsewhere.

Third, resolving MAC disputes outside of court would be favorable to parties who do not want to publicize their difficulties or make sensitive business information publicly available. If a company publicly asserts that a target has suffered a MAC, it can tarnish the reputation of the seller.

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222 *Id.* at 358.

223 *Id.* at 360-61.

224 *See infra* Part IV.

225 Chertok, *supra* note 16, at 139. *See also* THE TAKEOVER PANEL, CITY CODE ON TAKEOVERS AND MERGERS A7-A8 (11th ed. 2013), *available at* http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf. The City Code on Takeovers and Mergers states:

> The Panel comprises up to 35 members: (i) the Chairman, who is appointed by the Panel; (ii) up to three Deputy Chairmen, who are appointed by the Panel; (iii) up to twenty other members, who are appointed by the Panel; and (iv) individuals appointed by each of the following bodies: The Association for Financial Markets in Europe (with separate representation also for its Corporate Finance Committee and Securities Trading Committee); The Association of British Insurers; The Association of Investment Companies; The Association of Private Client Investment Managers and Stockbrokers; The British Bankers' Association; The Confederation of British Industry; The Institute of Chartered Accountants in England and Wales; Investment Management Association; The National Association of Pension Funds.

Id. at A8.

226 Chertok, *supra* note 16, at 139.

VII. DRAFTING RECOMMENDATIONS

Whether MAC litigation is deemed justiciable or not, parties can take practical steps to protect themselves when entering into deals during times of economic instability. In a volatile economy, parties should pay more attention than usual to the full range of financial and legal risk management issues.[227]

Parties should pay attention to impracticability clauses (including MACs), particularly where a counterparty is in a peripheral Eurozone country or may be affected by its difficulties.[228] Parties should include terms that "permit flexibility to terminate and/or adjust on a Eurozone Exit or Eurozone Breakup."[229] The MAC clause should be broad enough to cover a Eurozone breakup or exit and should cover termination or adjustment of the contract. Both parties should immediately disclose any relation to potential consequences of the Euro-Zone crisis that might lead a party to be particularly vulnerable to the economic fallout.[230]

Sophisticated sellers should ask for and negotiate a "best efforts" clause into a transaction document; this type of clause requires a buyer to use its best efforts to enforce debt and equity financing letters.[231] Sellers can also push for "hell or high water" clauses, which require buyers, especially in regulated industries, to ensure they comply with regulatory mandates in a timely manner.[232] Reverse termination fee clauses are useful as well, as they typically provide a buyer with a right to abandon the transaction in return for payment of a fixed fee to the seller, generally in cash.[233]

When contemplating an acquisition, companies should engage in due diligence. As part of the due diligence process, it would be appropriate to consider "whether the relevant target has material exposures to weaker Eurozone member states or counterparties or to vulnerable EU banks."[234] Businesses with substantial exposures within the Eurozone should undertake a general review to identify their high-

227 *Eurozone Crisis: What Do Clients Need to Know?*, *supra* note 196.

228 *Id.*

229 *International Contracts and the Eurozone Crisis*, ASHURST 11 (Jan. 2012), http://www.ashurst.com/doc.aspx?id_Content=6505.

230 *Id.* at 12.

231 John Cromie, *Leading Lawyers on Structuring Transactions, Negotiating Agreements, and Addressing Management Concerns: Closing M&A Deals in a Challenging Environment*, M AND A NEGOTIATIONS, 2010 WL 3628971 at *7 (2010 ed.).

232 *Id.*

233 *Id.*

234 *Eurozone Crisis: What Do Clients Need to Know?*, *supra* note 196.

risk assets, transactions, and relationships.[235]

VIII. CONCLUSION

Commentators have described a MAC clause as a contract clause that "keeps transaction lawyers pulling their hair out at night, triggers distrust between potential merger partners, and inspires fear in corporate executives."[236] This frustration is due in part to the limited applicability of these clauses. In practice, MAC clauses have proven unsuccessful at allocating risks.[237] In attempting to conform to contract principles, judges have made the clause worthless.[238] Buyers looking to contract clauses for protection will have more success relying on reverse termination fees or break-even clauses, as it is difficult to imagine a scenario where a court will uphold the invocation of a MAC.[239]

235 *The Euro Crisis: Impacts on Cross-border Contracts*, MCDERMOTT, WILL & EMERY, *supra* note 192. "This includes material assets and properties, significant subsidiaries and affiliates, bank loans, bond issues and other significant financial transactions . . . ." *Id.*

236 Bricker, Beemer & Newman, *supra* note 91.

237 Galil, *supra* note 78, at 849.

238 *See infra* Part III.A-E.

239 *See infra* Part VI.D-E.