DEFINING MATERIALITY: DRAFTING ENFORCEABLE MAC PROVISIONS IN BUSINESS COMBINATION AGREEMENTS FOLLOWING *IBP V. TYSON*

JOHN PRINZIVALLI*

I. INTRODUCTION

Much of commercial contracting involves the allocation of risk among transaction parties. Parties have a vested interest in strategically structuring deals so as to maximize their potential gain while minimizing loss. However, deal risk is not homogeneous nor monolithic; rather, it is diverse and case specific. Such risk can be conceptualized as encompassing systemic risk (e.g., changes in the broader economy), indicator risk (e.g., failure to reach performance targets), agreement risk (e.g., negative externalities from the deal making process), and business risk (e.g.,

* Associate, Investment Funds, Advisers & Derivatives Practice Group, Sidley Austin LLP, Chicago, IL; J.D. Candidate, 2016, Northwestern University Pritzker School of Law, 2016; B.A., *Cum Laude*, Boston College, 2009. .
The author would like to thank Professor Christopher M. Martin for his advice, guidance, and insight,; Professor Stephen F. Reed for his comments and criticism,; and Mr. Sean M. Carney, Partner at of Sidley Austin LLP, for early direction.

consequences of ordinary operations).[1] Traditionally, parties may leverage a litany of contract provisions, such as representations and warranties, covenants, and indemnification, to allocate deal risk both efficiently and equitably. Parties assume risk as a function of these provisions' scope, often manifest in how broadly or narrowly such clauses are drafted.[2] Even marginal changes in syntax shift risk between deal participants.[3]

Business combination agreements present unique challenges to drafters – warranting more nuanced contractual solutions. In corporate acquisitions, there is often an interim period between the time of deal signing and closing to comply with regulatory and securities laws, obtain antitrust and regulatory approval, and confirm all requisite third party consents.[4] This non-simultaneous signing and closing allows for the occurrence of intervening events that may impair the target's value before the final payment of consideration and transfer of ownership – which is of acute worry to buyers. Various risk-sharing devices exist to indirectly ameliorate buyers' concerns, including bring-down representations and warranties at the time of closing (allowing remedy for breach) and earn-out provisions (conditioning partial deal consideration on post-closing target performance).[5]

Additionally, parties may directly allocate pre-closing adverse change risk (risk that a material development will negatively impact the value of target during the interim period) using "material adverse change" ("MAC") or "material adverse effect" provisions ("MAE").[6] These terms are interchangeable and will be subsequently referred to as MAC clauses. MAC provisions allow a party in the agreement, often the buyer, to exit the deal free of cost and penalty upon the occurrence of such a materially adverse event. Though ubiquitous and heavily negotiated, MAC clauses are subject to a tradition of vague drafting and the near unanimous preference of courts to apply a strict standard for determining the existence of a MAC.[7] Finding of MAC occurrence is rare, particularly in Delaware, where courts have established a materiality standard[8] so rigorous that no buyer has successfully proven the existence of a MAC sufficient to terminate a deal to date.[9]

In addition to reflecting on the MAC materiality standard established by the Delaware Chancery Court, this article will discuss drafting solutions to facilitate MAC clause enforceability. Due to the Delaware Court's high materiality standard and parties' traditional preference for vague MAC clause drafting, the historical probability of deal cancellation from MAC provisions is low. Therefore, this article will weigh the marginal cost and benefit of vague MAC clause drafting relative to the alternative, with greater specificity. The article will argue that despite benefits from strategically vague drafting, MAC provision specificity, in the form of

---

[1] Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2073 (2009).
[2] TINA L. STARK, DRAFTING CONTRACTS: HOW AND WHY LAWYERS DO WHAT THEY DO 19 (2nd ed. 2014).
[3] *Id.* at 138.
[4] Miller, *supra* note 1, at 2017–18.
[5] Adam B. Chertok, *Rethinking the U.S. Approach to Material Adverse Change Clauses in Merger Agreements*, 19 U. MIAMI INT'L & COMP. L. REV. 99, 102 (2011).
[6] The term *material adverse effect* is often used as an alternative to the defined term *material adverse change*. *See* Kenneth A. Adams, *A Legal Usage Analysis of "Material Adverse Change" Provisions*, 10 FORDHAM J. CORP. & FIN. L. 9, 17 (2004); *see also* David Cheng, *Interpretation of Material Adverse Change Clauses in an Adverse Economy*, COLUM. BUS. L. REV. 564, 568 n.20 (2009).
[7] Bryan Monson, *The Modern MAC: Allocating Deal Risk in the Post-IBP v. Tyson World*, 88 S. CAL. L. REV. 769, 771 (2015).
[8] See further discussion *infra* Section III.
[9] Cheng, *supra* note 6, at 598.

explicit benchmarks and quantifiable thresholds, offers the most effective and efficient drafting strategy for both buyers and sellers in business combination agreements.

In sum, this article will provide a comprehensive review of Delaware's interpretation of MAC provisions since *IBP, Inc. v. Tyson Foods, Inc.* The *Tyson* case represents the seminal treatment of MAC provisions in Delaware and the logical anchor for discussion of the subject . Part II will set forth the general purpose of the standard MAC clause, by discussing the history, common syntax, and evolving application of the provision in business combination agreements . Part III will review Delaware case law interpreting MAC clauses, focusing on the seminal *Tyson* case and its lasting comment on the threshold for MAC clause materiality. This discussion will include a survey of cases subsequent to *Tyson* where parties attempted to thwart a previously signed deal by exercising a MAC clause. Part IV will discuss criticisms and consequences of modern MAC provision case law. Part V will outline practitioner best practices going forward, by offering solutions for the effective drafting of future MAC provisions from the perspective of both buyers and sellers. Part VI will conclude.

II. Development and Purpose of Material Adverse Change Provisions

A. Deal Risk and Use of MAC Provisions to Ameliorate Risk Concerns

In many corporate acquisitions,[10] there is delay (the duration of which is deal-specific) between the time parties agree to deal terms (the signing) and the time the transaction is effectuated, ownership transferred, and consideration paid (the closing).[11] Various factors may drive this lag in deal finalization. Depending on deal structure, corporate and securities laws often require shareholder approval prior to transaction completion.[12] Target shareholders may have the right to vote on pending deals, particularly with regard to mergers and the sale of all or substantially all of the target's assets, while acquirer's shareholders retain similar approval power in certain stock-for-stock and cash-for-stock deals.[13] Such shareholder approval may take between forty to ninety days, depending on transaction structure.[14] Additionally, deal closing is conditional on antitrust and regulatory approvals.[15] The government is empowered through the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HRS") to vet business combinations where the parties meet guidelines with regard to the size of the transaction and the parties' net assets and sales.[16] Depending on the seriousness of the antitrust concern and the complexity of the pending transaction, deal closing can be delayed by as little as thirty days to over a year (though parties typically can roughly estimate this duration in advance).[17] Further, parties generally must obtain approval from requisite government agencies if operating in a regulated

---

[10] Not all business combination transactions have an interim period between deal signing and closing . Particularly with small business combinations, the transaction may be completed with simultaneous signing and closing . *See* JAMES C. FREUND, ANATOMY OF A MERGER: STRATEGIES AND TECHNIQUES FOR NEGOTIATING CORPORATE ACQUISITIONS 439 (1975).
[11] Robert T. Miller, *Cancelling the Deal: Two Models of Material Adverse Change Clauses in Business Combination* Agreements, 31 CARDOZO L. REV. 99, 108 (2009).
[12] Miller, *supra* note 1, at 2017.
[13] *Id.* at 2024-48.
[14] *Id.* at 2018-19.
[15] *Id.* at 2019.
[16] Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a (2006).
[17] Miller, *supra* note 1, at 2021.

industry.[18] Length of the vetting process is transaction specific; however, delay for regulatory approval is often longer than delays due to corporate, securities, or antitrust laws.[19] Finally, the process of seeking third party consents may further necessitate an interim period between deal signing and closing.[20] Many commercial contracts include clauses that provide that a party may not execute a future business combination without the consent – or approval – of the counterparty.[21] These clauses are designed to empower counterparties to affirmatively control whether they honor past contracts when the character of the other side to the deal changes through business combination.[22] As part of a pending transaction, parties to the business combination must either: (1) seek the consent of all contractual counterparties; or (2) breach the prior agreements.[23] Obtaining these third party consents requires time between signing and closing, though less time than incurred by previously mentioned legal and regulatory compliance.[24] Regardless of source, delayed performance is commonplace with business combination agreements — particularly with public companies.[25]

During this interim period, intervening events may occur that affect a party's desire to complete the deal.[26] Because no actor in the transaction — acquirer, seller, target — nor any external influence (e.g., industry trend) is static, such delay confers risk.[27] Parties are therefore burdened with allocating deal risk stemming from the interim period between signing and close.[28] Parties apply standard contract concepts to allocate risk, including representations and warranties, covenants, and closing conditions.[29] Further, parties may strategically include deal protection measures such as no-shop provisions (prohibiting seller from soliciting offers from other bidders) and termination fees (penalties paid by target to buyer if target walks from the deal prior to close) to prevent third parties from interfering with the pending transaction.[30] Perhaps the most direct attempt to allocate the risk stemming from this interim period, and the clause most heavily negotiated is the MAC provision.[31] This clause triggers a party's right to walk from a pending deal with the occurrence of a negative event not otherwise accounted for in the contract

---

[18] For example, a deal involving cable television companies may require approval from the Federal Communication Commission, while the Federal Reserve may have the authority to approve a deal between banks . *See* Miller, *supra* note 1, at 2021-22.
[19] Freund, *supra* note 10, at 437-39.
[20] Miller, *supra* note 1, at 2023.
[21] Freund, *supra* note 10, at 435-439.
[22] *Id.*
[23] Miller, *supra* note 1, at 2024.
[24] *Id.*
[25] RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 93 (7th ed. 2007).
[26] Richard A. Posner and Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83, 93 (1977).
[27] Note that in cash deals, interim deal risk is only an issue for buyers, while in stock-for-stock and cash-for-stock deals, deal risk is an issue for both buyer and seller . This is because consideration paid in target's stock saddles seller with an interest in the long term viability of the target past deal close, thus aligning buyer and sellers' interests . Such nuance aside, this article focuses on the most common scenario in which a buyer will claim that the target suffered a MAC as means of exiting a deal . *See* Miller, *supra* note 11, at 108–09.
[28] Kari K. Hall, *How Big is the MAC? Material Adverse Change Clauses in Today's Acquisition Environment*, 71 U. CIN. L. REV. 1061, 1062 (2003).
[29] 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, 426 (2007).
[30] *Id.*
[31] *Id.*

that threatens the target's value.[32] Rather than triggering liquidated damages, MAC clauses grant a contractual right that permits a party to exit a deal, theoretically without additional cost or penalty.[33] In practice, buyers either: (1) attempt to abandon the pending transaction; or (2) use a MAC clause as leverage to negotiate more favorable deal terms.[34] These provisions are ubiquitous in business combination agreements, particularly in public-company mergers.[35] Thus, MAC provisions serve as a tool to allocate pre-closing deal risk that is most often borne by the target or seller.[36]

B. Evolution of the Modern MAC Provision

Historically, MAC provisions were mere boilerplate.[37] Used since at least 1947, MAC clauses originally were not the subject of nuanced focus nor protracted negotiation in the crafting of business combination agreements – they were brief and easily replicated.[38] A typical clause would allow a party to exit the deal before closing due to the occurrence of "any change, occurrence or state of facts that is materially adverse to the business, financial condition or results of operations" of the seller (i.e., the target).[39] These traditional MAC clauses were both broad and ambiguous (e.g., they often would contain lack of clarity regarding the sufficiency of adverse changes to prospective cash flows).[40] Despite these potential drafting issues and the high stakes of the transactions for which they were crafted, traditional MAC clauses were rarely invoked and litigated.[41]

In time, the marginalization of the MAC provision by practitioners pivoted to enhanced attention as buyers embraced the clause as an important risk mitigation tool . By the late 1980s, MAC clauses became the subject of increased litigation amid macroeconomic instability.[42] Volatility in the capital and product markets of the 1990s prompted further use and negotiation.[43] These changes were observable in substantial growth in the modification of the traditional MAC clause, particularly in the sophistication of exceptions and carve-outs (an approach that continues today).[44] This trend in MAC provisions – reflected in practitioners' substantial focus on their drafting and negotiation – fully materialized in the early 2000s.[45] Three developments drove the maturation of MAC provision approach and construction.[46] First, the recession of 2001

---

[32] Chertok, *supra* note 5, at 102.
[33] Miller, *supra* note 1, at 2012.
[34] Dennis J. Block & Jonathan M. Hoff, *Material Adverse Change Provisions in Merger Agreements*, N.Y.L.J., Aug. 23, 2001, at 1.
[35] Chertok, *supra* note 5, at 102.
[36] Cicarella, *supra* note 29, at 426.
[37] It would not be until the 1990s that the elements constituting a MAC (and the exceptions thereof) would expand substantially . *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, 292 (2009).
[38] Ronald J. Gilson and Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisitions*, 21 J.L. ECON. & ORG. 330, 331 (2005).
[39] *Id.* (citing Freund, *supra* note 10, at 259–61).
[40] *Id* .
[41] *Id.*
[42] *See, e.g.*, Bear Stearns Cos., Inc. v. Jardine Strategic Holdings Ltd., No. 31731/-87, slip op. (N.Y. Sup. Ct. June 17, 1988), *aff'd mem.*, 533 N.Y.S.2d 167 (App. Div. 1988); Borders v. KRLB, Inc., 727 S.W.2d 357 (Tex. App. 1987).
[43] Gilson & Schwartz, *supra* note 38, at 339.
[44] 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).
[45] *Id.*
[46] Yair Y. Galil, *MAC Clauses in a Materially Adversely Changed Economy*, 2002 COLUM. BUS. L. REV. 846, 846 (2002).

– with the deterioration of equity markets and slowed economic growth – cooled merger and acquisition deal flow and drove renewed interest in, and motivation for, transaction termination.[47] MAC provisions were an obvious tool to pursue this goal. Second, the Delaware Chancery Court released the seminal *Tyson* decision that June, binding parties to a contested deal through the imposition of an elevated MAC materiality standard.[48] Among other consequences, the *Tyson* decision intensified debate among practitioners about the proper use of MAC provisions.[49] And finally, the terrorist attacks of September 11, 2001, caused lawyers to rethink the context of MAC provisions, leading to painstaking provision drafting, new carve-outs and carve-ins, and further stress on pending transitions by parties attempting to exercise their contractual rights under existing provisions to exit deals.[50] Parties responded to these exogenous pressures by increasingly contesting the negotiation of MAC provisions – which is reflected in the growth of the length and nuance of the modern MAC clause as well as the burgeoning professional literature on the subject.[51]

Even with the rebound of the economy and the passage of time from September 11, 2001, the developments of the early 2000s ushered in lasting change with regard to MAC provision construction and debate. Current MAC clauses serve as complex risk-allocation devices, including increasingly nuanced carve-outs that allow for the granular balancing of deal uncertainty between buyer and seller.[52] Their use and debate remains as topical as ever. For example, the credit crisis of 2007-2008 brought renewed attention to MAC provisions.[53] During this period, thirteen major MAC disputes arose, the largest of which involved deals valued from $1.5 billion to $25.3 billion.[54] If anything, these disputes publicized the modern approach to MAC provision drafting and further clarified the MAC clause materiality standard as one challenging, and if not impossible, for buyers to meet in a court of law.[55] Despite the difficulty in enforcing these clauses, MAC provisions remain hotly contested and central to the debate over acquisition risk allocation – giving rise to more disputes and litigation than "any other provision of business combination agreements."[56]

C. Function of the Modern MAC Provision

Again, MAC provisions are designed to protect buyers (and the target in stock-for-stock and cash-and-stock deals) from the negative contingencies that may arise before closing.[57] "Material adverse change" definitions exist in virtually every business combination agreement,

---

[47] *Id.*
[48] *Id.* at 846–47. –47 . See further discussion *infra*in Section III.A.
[49] See further discussion *infra* in Section V.B; *see also* . *In re* IBP, Inc. *S'holders Litig.* v. Tyson Foods, Inc., 789 A.2d 14, 68 (Del. Ch. 2001) (commenting that "even where a Material Adverse Effect condition is . . . [broadly written . . .], that provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner").
[50] Galil, *supra* note 46, at 847.
[51] Gilson & Schwartz, *supra* note 38, at 331.
[52] Elken, *supra* note 37, at 292.
[53] *Id.* at 291–-92.
[54] Chertok, *supra* note 5, at 105.
[55] *Id.*
[56] Daniel Gottschalk, *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, 1058 (2010).
[57] MAC provisions exclude deliberate wrongdoing by target's management, which is addressed by interim covenants . Miller, *supra* note 1, at 2045.

despite the contentiousness of their negotiation and their penchant for litigation.[58] Though the specifics of the definition's construction is deal-specific, scholars can generalize common terms via empirical survey of publicly available provisions.[59] Today, a common MAC definition may read:

> [A]ny event, fact, circumstance, development, or change that, either singly or in the aggregate, would reasonably be expected to have a material adverse effect on various items, which usually include the business, financial condition, and results of operations of the company and its subsidiaries taken as whole, as well as the assets, liabilities, condition, properties, and prospects of the party.60

Such continuity in MAC definition is observable industrywide across the past five years (see Table 1 below). Despite such standardization, sellers generally advocate for narrow MAC definitional elements and broad exceptions in an effort to shift risk to buyers.[61] Such behavior is designed to increase the probability of transaction close and preserve the deal price even if the value of the target declines in the interim period. Conversely, buyers aim to shift such risk to sellers by expanding the elements of the MAC definition and minimizing carve-outs (exceptions to the definition).[62] These efforts effectively increase the probability of deal exit or term renegotiation in the event a target's value is threatened.

Table 1. Frequency of MAC Provision Elements/Exceptions (% of all deals >$100m)[63]

	2014	2013	2012	2011	2010
MAC on business, operations, financial condition	95	98	89	90	86
MAC on target's ability to close deal	55	56	44	51	43
MAC on bidder's ability to close deal	31	12	13	10	10
Losses over a specified threshold deemed to be a MAC	0	1	n/a	5	1

---

[58] *Id.*
[59] *Id.*
[60] *Id.* at 2045–46.
[61] *Nixon* PEABODY LLC,*MAC Survey:* MAC SURVEY 2014 at, NIXON PEABODY LLP, 4, http://www.nixonpeabody.com/files/171839_NP_MAC_SURVEY_2014.pdf (last visited Aug. 1, 2017) (hereinafter, the "NIXON PEABODY 2014 MAC SURVEY").
[62] *Id.*
[63] *Id.*; *id.* at 4; 6 (defining the sample as drawing from "publicly filed acquisition agreements for transactions with values in excess of $100 million that were dated between June 1 of the preceding year and May 31 of the current year . For this survey, [Nixon Peabody] generated a list of deals executed between June 1, 2013, and May 31, 2014, from publicly available information filed with the U.S. Securities and Exchange Commission") and *Nixon Peabody MAC Surveys* circa 2010, 2011, 2012, and 2013.

MAC on the benefits contemplated by the agreement	0	0	n/a	n/a	1
Ability of bidder to maintain continuity in operations pre/post closing	1	2	1	1	1
Ability of target to maintain continuity in operations pre/post closing	1	2	2	1	1
MAC on target prospects	2	1	4	5	1
MAC on agreement validity or enforceability	0	0	2	1	1

Structurally, MAC provisions, building on their initial definition, generally function as: 1) representation and warranties; or 2) closing conditions in a business combination agreement.[64] As a representation and warranty, parties can assert the nonoccurrence of a MAC since a given date (e.g., "since January 1, no MAC has occurred").[65] Further, MAC provisions can modify an exogenous representation, to serve as a seller assurance that a MAC has not occurred or as qualification to other representations and warranties (e.g., "no seller is a party to any litigation that would reasonably be expected to result in a MAC").[66] The effect of such clause is to cause minor breaches to become irrelevant . Additionally, a MAC definition may be incorporated as a stand-alone clause among the conditions precedent to closing (colloquially deemed a "MAC out").[67] Such provisions delineate circumstances that would empower seller to exit the transaction without liability; however, such drafting can be redundant.[68] Business combination agreements are often drafted with a "bringdown" of representations, where parties verify that representations claimed at signing remain accurate at closing – effectively duplicating the work of closing conditions.[69] Regardless of syntax or redundancy, there is much latitude in MAC definition and application to accommodate creative bargaining among parities for the facilitation of efficient risk allocation.

Though scholars observe some continuity in MAC definitions across transaction agreements, carve-outs are subject to intense negotiation and frequent deal-specific customization. Targets often include carve-outs in an attempt to isolate systemic or industry risk from the MAC definition as well as to exclude risks know by parties at the time of contracting.[70] The most common carve-outs cover general economic or business conditions, industry and financial market developments, force majeure events like war, terrorism, change in law, or changes in GAAP, or announcement of the agreement itself (along with concurrent actions taken in furtherance of the agreement).[71] Carve-outs addressing failure to meet internal financial projections or the estimates of industry analysts are also observed, though with less regularity.[72]

[64] Adams, *supra* note 6, at 10-12.
[65] *Id.* at 10.
[66] *Id.* at 11.
[67] Chertok, *supra* note 5, at 106.
[68] Adams, *supra* note 6, at 11-12.
[69] *Id.*
[70] Chertok, *supra* note 5, at 108.
[71] Miller, *supra* note 1, at 2047 (providingMiller provides empirical data regarding the granular frequency of MAC provision elements, including carve-outs, in a study of 353 business combination agreements occurring between July 1, 2007 and June 30, 2008).
[72] *Id.*

Use and application of such MAC provision carve-outs has mirrored market, social, and economic events.[73] The period following September 11, 2001 was marked by buyer-friendly MAC provision drafting, with significant expansion of carve-outs for acts of terrorism, war, and broad market-wide volatility. [74] Seller-friendly drafting grew in the years following, reflected in growing lists of enumerated exceptions during the cycle of economic recovery between 2004 and 2007.[75] The credit crisis of 2008 abruptly halted this trend; however, as deal flow returned from 2010 to 2012, sellers regained negotiating strength.[76] Today, a more balanced dynamic exists – indicating cautious optimism regarding economic stability and sustained growth.[77] Thus, the drafting of MAC provisions, like the larger business combination agreements of which they are part, are as much a function of macro factors (such as the strength of credit markets to finance large acquisitions) as they of party-specific considerations. With that said, practitioners still have incentive to draft MAC provisions that are thoughtful, nuanced, and enforceable – an exercise made difficult by MAC jurisprudence that is at times ambiguous.

D. Conceptual Motivations for MAC Provisions

Before addressing the case law, the conceptual underpinnings of the MAC provision warrant review. Though the function of a MAC clause is to allocate risks associated with changes in the target's business, various factors may motivate parties – both buyers and sellers – to bargain for and agree to MAC provisions. Three main motivations help explain the behavior of contracting parties. First, MAC provisions provide an incentive for parties to share information.[78] Buyers may be concerned about information asymmetry – for the seller, through proximity and experience, is more informed about the target – which could depress transaction price or prevent an offer altogether (this is colloquially referred to as the "lemon problem").[79] MAC provisions can alleviate these worries by encouraging the seller to share information . In return for shifting pre-closing risk, rational buyers are potentially willing to pay more to complete the deal.[80]

Second, MAC provisions may incentivize sellers to preserve target value between signing and closing.[81] Illustrative examples of such investment include allocations for research and development, maintenance of human capital, and preservation of customer or supplier relationships.[82] Buyers may fear that seller, post signing, has less incentive to maintain the target absent a long term interest in the target's upside.[83] Thus, the target is susceptible to actions or omissions that may impair value.[84] This "investment theory" argues that MAC provisions help

---

[73] *Nixon Peabody* 2014 *MAC Survey*, *supra* note 61, at 1; Karlee Weinmann, *Wary M&A Buyers Up Use Of Performance-Based MAC Clauses*, LAW360 (Oct. 22, 2012, 6:58 PM EDT), https), http://www.law360.com/mergersacquisitions/articles/388430/wary-m-a-buyers-up-use-of-performance-based-mac-clauses (where David Martland, head of Nixon Peabody's global and business transactions practice, commented that "in studying MAC clauses, [Nixon Peabody has] consistently found that their use and interpretation are strong indications of market conditions").

[74] NIXON PEABODY 2014 MAC SURVEY, *supra* note 61, at 1.

[75] *Id.*

[76] *Id.*

[77] *Id.*

[78] Galil, *supra* note 46, at 849.

[79] *Id.*

[80] Brooks, *supra* note 44, at 89.

[81] Gilson &and Schwartz, *supra* note 38, at 337.

[82] *Id.*

[83] *Id.*

[84] Brooks, *supra* note 44, at 89.

realign incentives in order to facilitate efficient operation and management of the target during the interim period.[85] And third, MAC provisions encourage competitive deal consideration by providing symmetrical price adjustments to buyers.[86] Prospective buyers may be wary of committing to a deal, for though they are bound at signing, sellers potentially could walk from the transaction if a more compelling offer arose.[87] Under the "symmetry theory," MAC provisions empower buyers with the same capacity to terminate the transaction between signing and closing under requisite circumstances.[88] Absent this symmetrical right, buyers have less incentive to contract, depressing deal prices.[89] Thus, MAC provisions may be employed to properly align incentives for the facilitation of deal signing and consideration maximization . Though no explanation is alone dispositive, each of these three theories provide insight into the ubiquity of MAC provisions and parties' continued affinity for their inclusion in business combination agreements.

III. DELAWARE CASE LAW INTERPRETING MAC PROVISIONS

Though seemingly empowering buyers with a tool to allocate greater deal risk to sellers, MAC provisions have increasingly been interpreted by the Delaware Chancery Court with growing suspicion when used to exit a pending transaction. This aversion is reflected in the fact that the court has never once found facts sufficient to terminate a deal under a MAC provision.[90] In Delaware, buyers must meet a high standard of materiality to establish MAC occurrence in business combination agreements[91] – rendering enforcement of these provisions limited and calling into question the time and expense incurred in the negotiation and drafting of these provisions.

A. *IBP, Inc. v. Tyson Foods, Inc.*

In the seminal case *IBP, Inc. v. Tyson Foods, Inc.*, the Delaware Chancery Court, interpreting New York law, reinforced this elevated threshold – rejecting Tyson's claim that intervening events permitted termination of the pending $4.7 billion deal.[92] By acquiring IBP (the

[85] Gilson &and Schwartz, *supra* note 38, at 337.
[86] *Id.* at 335.
[87] For example, per *Revlon*, in certain circumstances where sale or firm break up is inevitable, the fiduciary duties of the target's directors are narrowed so that the targettarget's board's sole responsibility is to maximize immediate stockholder value by securing the highest deal price available . *See id.*; *see also*, *Id.* and Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,. 506 A.2d 173, 184 (Del. 1986).
[88] Gilson &and Schwartz, *supra* note 38, at 335-336.
[89] *Id.*
[90] Hexion Specialty Chems.,*Chemicals* Inc. v. Huntsman Corp., 965 A.2d 715, 738 (Del. Ch. 2008).
[91] MAC provisions are also utilized in contracts other than business combination agreements, including as conditions precedent to funding via loan agreements and commitment letters . Few courts have developed a standard test to determine when a MAC has occurred with these agreements, mirroring uncertainty in the Delaware Chancery Court's treatment of business combination agreement MAC provisions . Douglas S. Buck, Elizabeth L. Corey, and Erick S. Harris, *CMBS Lenders Begin Invoking MAC Clauses with Investors*, FOLEY & LARDNER LLP (, Feb. 5, 2008), https://www.foley.com/cmbs-lenders-begin-invoking-mac-clauses-with-investors-02-05-2008., at 3. Courts have often found these non-acquisition MAC provisions to be ambiguous as drafted. *See* Capitol Justice LLC v. Wachovia Bank, N.A., 706 F. Supp. 2d 23, 29 (D.D.C. 2009) (rejectingwhere the court rejected Wachovia's efforts to distinguish from the Delaware Chancery Court's decision in Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 738 (Del. Ch. 2008), deferring to a fact-finder to determine whether Wachovia used– *see* Section III.C – Wachovia's use of a MAC provision to avoid loan agreement obligations). , deferring to a fact-finder to determine whether a MAC occurred) .
[92] *IBPTyson*, 789 A.2d at 47.

largest American beef producer and second-largest pork producer), Tyson (the nation's largest chicken producer) attempted to become the world's preeminent meat products company.[93] Despite the fact that both firms were incorporated under the laws of Delaware, the merger agreement included a New York choice of law provision (which neither party contested in the litigation).[94] Part of the pending merger agreement included a broad MAC provision, permitting buyer exit with the:

> ...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.[95]

Note that IBP failed to include exceptions for general changes to the economy or either party's industry, seemingly shifting the majority of deal risk from buyer Tyson to seller IBP.[96] Despite this construction, the court looked beyond this explicit language in rendering its decision, narrowing the board provision through judicial interpretation .

Tyson asserted that target IBP's performance decline after deal signing (measured by drop in realized EPS relative to projected EPS) constituted an adverse change under the broadly negotiated MAC provision.[97] Specifically, Tyson claimed that the target's revised projections deviated materially from performance in past years, so much so that the upcoming year, 2001, would be the entity's worst since 1997.[98] The court acknowledged this performance was sub-optimal; however, failed to distinguish this decline in projections from the cyclical nature of the industry.[99] Specifically, in the near term, the court commented that such financial performance "for the next two years would not be out of line with its historical performance during troughs in the beef cycle."[100]

Ultimately, the court held that target IBP had not suffered a MAC (despite decline in bottom-line performance and accounting irregularities), and, that as a result, buyer Tyson was obligated to complete the transaction.[101] The court reasoned that a MAC must be a long term negative effect rather than a mere short-term downturn in prospects.[102] Specifically, Vice Chancellor Strine asserted that:

> A short-term hiccup in earnings should not suffice [to invoke a Material Adverse Effect exception to its obligation to close]; rather the Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquiror.[103]

The court argued that a MAC is best understood as a "backstop" protecting the buyer from unknown events that "substantially threaten" the target's earning potential in a "durationally-significant manner."[104] The court speculated that this period of adverse effect should be measured

---

[93] *Id.* at 21–-22.
[94] *Id.Tyson*, 789 A.2d at 54.
[95] *Id.*
[96] *Id.* at 65–-67.
[97] *Id.* at 65–-66.
[98] *IBP*, 789 A.2d*Id.* at 69.
[99] *Id.* at 71.
[100] *Id.*
[101] *Id. Tyson*, 789 A.2d at 71.
[102] *Id.* at 68.
[103] *Id.*
[104] *IBP*, 789 A.2d at 68. *Id* .

in years – not months.[105] Vice Chancellor Strine affirmed this position by drawing a distinction between strategic and financial buyers, arguing that though short-term declines in target value may be material to a financial buyer, a strategic buyer (with an inherently longer investment horizon) should lack this sensitivity.[106] Further, the Court stressed that both buyer and seller were equally sophisticated parties, bargaining at arms length with the aid of "expensive and highly skilled" advisors.[107] As Vice Chancellor Strine remarked: "*caveat emptor* is still the basic law of New York, and it applies with full force in [this case]."[108] Thus, general economic and industry downturns observed in the near term are insufficient to trigger deal exit or representation breach – imposing a high materiality threshold on buyers attempting to invoke a MAC provision to exit a deal.

B. *Frontier Oil Corp. v. Holly Corp.*

Later decisions reinforced the holding from *Tyson*. The bar for triggering a MAC provision in Delaware is high and acquirers should be cautious about relying on such a provision to avoid transaction completion. Although the decision in *Tyson* was analyzed under New York law, its analytical framework was adopted soon after by the Delaware Chancery Court, applying Delaware law in *Frontier Oil Corp. v. Holly Corp.*[109] Factually *Frontier Oil* was different from *Tyson*. In Frontier Oil, the parties amended the agreement, post signing, to include a representation and warranty that no event was pending or threatened against the firm or a subsidiary that would constitute a MAC.[110] Soon after the amendment, activist Erin Brockovich brought a series of toxic tort lawsuits against a subsidiary.[111] The court estimated that potential legal costs would range from $15 to $20 million from these suits with potential liability between $500 million and $1 billion.[112] Experts estimated Frontier Oil's enterprise value at $338 million.[113] Though Frontier Oil took efforts to avoid liability as parent, they ultimately were pulled into the litigation through a commitment to guarantee the obligations of the subsidiary through a lease agreement.[114]

In the litigation, buyer Holly asserted that target Frontier breached its representation and warranty, arguing that the filing of a toxic tort lawsuit against the target constituted a MAC.[115] The court held that the acquirer failed to meet its burden of demonstrating that a MAC had occurred or would reasonably be expected to occur despite the fact that the litigation posed "serious" risks to the target that could be financially "catastrophic."[116] The court reasoned that there was insufficient quantification of the litigation's probability of adverse outcome or projected financial impact.[117] However, the court reserved the right to find that in some future cases, "litigation can be so certain, the outcome so predictable, and the likely consequences…so negative,

---

105 *Id* .
106 *Id.* at 67.
107 *Id.* at 72–-73.
108 *Id.* at 73.
109 Frontier Oil Corp. v. Holly Corp., C.A. No. 20502, 2005 WL 1039027, 34 (Del. Ch. 2005).
110 *Id.* at 4–-5.
111 *Id.* at 2.
112 *Id.* at 21, 36.
113 *Id.* at 37 n.230.
114 *Id.* at 2, 11.
115 *Frontier Oil*, 2005 WL 1039027 at 35.
116 *Id.Frontier Oil*, C.A. No. 20502, 2005 WL 1039027 at 35–36.
117 *Id.* at 36–37.

that an observer could readily conclude that the impact that one would reasonably expect to result from the litigation would be material and adverse."[118] Beyond rejecting the acquirer's attempt to claim an adverse change, the ruling reinforced the central holding of *Tyson* (despite its application of New York law) by adopting *Tyson's* language that confined MAC provisions to situations where the overall earning potential of the target is impaired in a "durationally-significant manner," under Delaware law.[119]

C. *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*

Three years later, in *Hexion Specialty Chemicals Inc. v. Huntsman Corp.*, the Delaware Chancery Court again reinforced the poor track record of acquirers invoking MAC provisions – asserting that Delaware courts have never found a MAC to have occurred with regard to a merger agreement.[120] *Hexion* involved a merger between two chemical firms, whereby Hexion would acquire target Huntsman for a purchase price of $10.6 billion.[121] The agreement contained a MAC provision, qualifying the definition with two carve-outs, excluding from "material adverse effect": 1) adverse changes to general economic or financial market conditions; and 2) conditions affecting the chemical industry generally.[122] Prior to closing, Huntsman reported quarterly earnings much lower than expected. Huntsman's first-half 2008 EBITDA (earnings before interest, taxes, depreciation, and amortization) was down 19.9% year-over-year from its first-half 2007 EBITDA.[123] This served as catalyst for the resultant litigation and grounds for the claim of MAC breach by Hexion.

The court rejected the acquirer Hexion's contention that target Huntsman's disappointing EBITDA, five percent increase in net debt, and underperformance in two secondary business lines following deal signing triggered the MAC provision.[124] The court held that target fell short of MAC realization, thus binding the acquirer to complete the closing.[125] The court reasoned that a year-over-year comparison of EBITDA rendered the financial results disappointing, though not sufficiently compelling to sustain a MAC claim, debt increase was immaterial, and the poor performance of several business lines responsible for a minority of firm EBITDA was too narrow an adverse change for MAC determination.[126] Like *Frontier Oil*, *Hexion* relied upon *Tyson* to assert that several poor quarters of performance are an insufficient MAC trigger.[127] Thus, *Hexion* confirms the high materiality standard necessary for successful MAC claim in Delaware, though leaves outstanding what events may be sufficiently material so as to trigger this threshold.

---

[118] *Id.* at 35.
[119] *Id.* at 34.
[120] *Hexion*, 965 A.2d at 715, 738..
[121] *Id.*
[122] *Id.* at 736.
[123] *Id.* at 725, 740.
[124] *Id.* at 741.
[125] *Id.* at 740-44.
[126] *Id.*
[127] *Id.* at 738.

Table 2. Summary of Delaware MAC Case Law

Case	Adverse Change(s)	Sufficiently Material
IBP v. Tyson (2001)	Missed short-term revenue projections; 64% decline in year-over-year earnings; $60m charge due to fraud.	No: target impairment was cyclical and only significant in the short-term (which is of secondary concern to a strategic buyer).
Frontier Oil v. Holly (2005)	$15-20m litigation costs projected at firm with $338m enterprise value.	No: litigation exposure can be absorbed due to scale and financial strength of the firm.
Hexion v. Huntsman (2008)	20% EBITDA decline last six months; net debt increased $178m (vs. expectation of $1b reduction)	No: decline in EBITDA and other financial metrics in line with historical, cyclical trend.

Ultimately, by choosing Delaware law to govern an acquisition agreement, parties make it difficult for acquirers to successfully terminate a deal between signing and closing by invoking the high threshold for MAC realization imposed by the state's chancery court. Currently, the state's MAC provision standard allows the acquiring company to back out of a deal when events covered by the MAC clause, "significantly impair the long term earning potential of the target."[128] Determination of the requisite degree of materiality is fact intensive, and thus ambiguous . With that said, no decision – neither *Tyson*, *Frontier Oil*, nor *Hexion* – has resulted in the finding that a MAC has occurred . Nor has the Delaware court ever found a MAC occurrence derivative from a merger agreement . Importantly, the court has provided little guidance as to what constitutes a MAC occurrence . Taken in the aggregate, this line of cases calls into question the value of MAC provisions and the wisdom in expending finite resources on their drafting and negotiation if they ultimately are to be rendered inoperative by the court . Practitioners need to be mindful of alternative methods of ensuring their ex ante allocation of deal risk is executed in practice .

IV. Criticisms and Consequences of Modern MAC Case Law

A. Criticism – Materiality Standard Unclear and Buyer's Burden of Proof Too High

IBP, Inc. v. Tyson Foods, Inc. still resonates today as the seminal case treating MAC provisions. Specifically, *Tyson* (and its progeny), established a general framework for MAC provision interpretation in Delaware. While prior case law was inconsistent with regard to what constituted sufficient materiality and whether short term declines in target value could trigger deal exit, *Tyson* spoke definitively (though the lack of precision in this line of cases is problematic). Taken together, *Tyson*, *Frontier Oil*, and *Hexion* reveal the modern MAC standard as requiring a highly fact-intensive and case-specific determination of materiality.[129] Further, the burden of proof borne by buyers attempting to walk from deals is substantial – so much so that "no Delaware court has ever found a MAC…in the acquisition context."[130] Thus, it is clear that the

[128] Cicarella, *supra* note 29, at 424.
[129] Monson, *supra* note 7, at 798.
[130] *Hexion*, 965 A.2d 715 at 738.

Delaware Chancery Court strongly disfavors parties abandoning pending transactions . However, the case law: 1) fails to provide clarity as to what events are sufficiently adverse so as to trigger a finding of materiality, and 2) imposes a burden of proof too stringent to provide buyers relief in the event of legitimate pre-closing hardship.

Specifically, the *Tyson* decision can be read as establishing a four-part test of MAC provision materiality. To constitute a MAC, an event must:

> (1) "substantially threaten" (2) "the overall earnings potential" of the acquired company; (3) "in a durationally-significant manner" (measured in years, not in months); and (4) be proved to have been a change, not an event known when the acquisition agreement was signed.[131]

However, in practice, this test lacks sufficient clarity to provide lawyers guidance in drafting and negotiating agreements. The degree of abject subjectivity involved in this definition provides latitude for disagreement among even the most seasoned of practitioners. For example, a conference of bankers at the law firm Clifford Chance was asked to vote on which of the following events were sufficiently damaging so as to constitute a MAC: 10% drop in the target's EBITDA, 25% drop in EBITDA, destruction of a high profit-margin factory responsible for the production of 20% of inventory turnover, and regulatory change constituting significant negative financial impact on the firm.[132] Though the pool of practitioners generally discounted the initial scenario, the audience was split evenly as to whether alternative events were sufficiently material so as to trigger the MAC provision.[133] Though case law delineates a standard for MAC materiality, the standard lacks sufficient granularity so as to provide parties and practitioners adequate direction – which is to the determinant of their corporate clients and the shareholders for whom they operate.

Such uncertainty as to the definition of the term "material" is troubling for practitioners seeking to draft future provisions – for lawyers lack workable legal definition from which to predictably guide the allocation of deal risk. As is discussed further in Section V.A, this uncertainty is partly the fault of the parties themselves, due to their general reluctance to specifically define the parameters of the term "material" as it relates to MAC provisions. However, the Delaware courts shoulder partial blame for this uncertainty by failing to develop clear guidelines or quantitative benchmarks for discerning when adverse events are sufficiently material. Rather, Delaware courts defer to case-specific analyses that lead to unpredictable results and, in conjunction with the steep threshold upheld in the case law to date, render MAC provisions practically ineffective at terminating deals – no matter how legitimate the impairment in target value.

B. Consequence – Negative Externalities from MAC Claims

Various negative externalities are observable as a result of Delaware's modern MAC materiality standard. Bereft of clarity and imposing an onerous burden of proof, the modern MAC standard generates dispute between parties that otherwise could have been avoided with specific materiality benchmarks (albeit from judicial precedent or defined by the parties' agreements). Even though deal disillusion is unlikely under the modern MAC standard, a seller's mere claim of

---

[131] Gottschalk, *supra* note 56, at 1062.
[132] Jamie Ivey, *Takeover Ruling Fuels Adverse Change Debate*, CORP. FIN., at 1 (Nov. 2001).
[133] *Id.*

a MAC may have detrimental effects on the target – regardless of the ultimate judicial decision regarding the matter.[134]

Specifically, the mere act of claiming a MAC through a public forum like litigation imposes significant systemic risk on the target, for the public exposure required by response to a MAC claim is more damaging than merely suffering the adverse event's immediate ramifications.[135] Such negative externalities are far reaching.[136] Public dispute as to whether a MAC has occurred: 1) exacerbates preexisting business disruption due to the pending transaction; 2) threatens the target's relations with employees, customers, creditors, rating agencies, and other business partners; 3) publicly disseminates negative information about the firm that, but-for, would have remained confidential, and 4) exposes the target to disparagement by the counterparty (who is incentivized to make the target's impairment look as severe as possible, even if the claims are unfounded). Perhaps most damaging, is that if the dispute is litigated, cause of action to enforce a MAC can lead to the court's public certification that the company is effectively "damaged goods."[137] Further, most firms operate in markets less efficient than capital markets.[138] As a result, MAC claims not only generate more negative publicity than would otherwise be realized by the adverse change alone, but such negative publicity reaches a broader audience than would have been familiar with the target's performance but-for.[139] In the event MAC provisions are invoked for purposes of renegotiation of deal consideration, it should be noted that the target's negative exposure will flow through to the buyer upon deal close as the target is subsumed into the buyer. In short, when attempt is made to abandon a deal due to a MAC clause, it is "big news in the business world" – manifest as a "doomsday scenario" for targets.[140] A subjective MAC materiality standard lacking in specificity provides broader latitude for buyer's MAC claims, unnecessarily increasing targets' exposure to this system risk.

Additionally, the modern MAC standard may impose systemic change in the acquisition market – as reflected in deal prices and efforts to forum shop . First, buyers' limited ability to abandon transactions by claiming a MAC due to the seller-friendly nature of *Tyson* and other Delaware rulings may drive up the purchase price in certain deals.[141] Further, buyers may forum shop by negotiating for agreements to be governed by the law of jurisdictions more buyer-friendly with regard to MAC provisions, such as Tennessee.[142] Regardless, the externalities observed in response to the modern MAC standard potentially impact parties at both the firm and market level.

---

[134] Chertok, *supra* note 5, at 124.
[135] Miller, *supra* note 1, at 2009.
[136] *Id.*
[137] *Id.*
[138] *Id.* at 2077.
[139] *Id.*
[140] *Id.* at 2077–78.
[141] Chertok, *supra* note 5, at 128.
[142] *See, e.g.*, Genesco, Inc. v. The Finish Line, Inc., No. 07-2137-II(III), slip op. (Tenn. Ch. Dec. 27, 2007) (holding2008) (In *Genesco*, the Tennessee Chancery Court, applying Tennessee law, held that under state law, Genesco's drop in earnings over two consecutive quarters– – predicted to be the worst in the firm's past ten years of operation– – was durationally significant and constituted a MAC).. Despite this determination, the Court compelled the acquirer Finish Line to specifically perform with its acquisition of Genesco, concluding. The Court concluded that though sufficiently material, the drop in target's performance was protected by a carve-out in the MAC provision that exempted MAC realization resulting from changes in "*general economic conditions*.." Thus, *Genesco* represents a finding of sufficient MAC materiality, despite facts insufficient to actually unwind the pending deal..).

C. Consequence – Increased Use of MAC as Tool for Renegotiation

Though the modern MAC standard is seller-friendly with regard to deal invalidation, buyers have increasingly used the subjective standard as leverage to renegotiate deal terms between signing and close. Often, the threat of termination alone is sufficient for buyers to extract additional concessions—independent of whether the buyer actually has a viable claim under the terms of the MAC provision.[143] The modern MAC standard can be criticized on policy grounds for robbing buyers of an essential risk allocation strategy by requiring such a rigorous burden of proof to exercise their termination rights. This is particularly galling considering both parties – buyer and seller – are often sophisticated entities employing informed advisors throughout the transaction process. This trend toward buyer renegotiation of deal consideration via leverage of MAC provisions thus can be viewed as an attempt by buyers to reclaim a risk allocation measure blunted by Delaware's recent MAC jurisprudence. Conversely, sellers could perceive such action as inefficient rent-seeking behavior, whereby buyers exploit sellers' risk-aversion to the collateral damage inherent in public MAC claims – claims often independent of merit (see further discussion in Section IV.B). Such behavior seems to cheapen the value of agreement signing, as closing is treated more like a call option rather than the culmination of a deal consummation. Regardless, current trend is to view MAC provisions not as an "out instrument," but as means of leverage for renegotiation of deal consideration.[144]

Perhaps the most public example of such deal renegotiation through MAC provision occurred during Bank of America's $50 billion acquisition of Merrill Lynch in 2008.[145] Soon after entering into merger agreement in September, Merrill Lynch incurred substantial losses in the following two months – beyond either parties' expectations.[146] Bank of America's CEO Ken Lewis would later testify before a House committee that when the firm became aware of losses at Merrill Lynch, it "strongly considered [claiming a] MAC and thought [they] actually had one."[147] Rather than use the MAC provision to renegotiate the deal, Bank of America used leverage derived from the MAC provision and the importance of the deal to the greater economy amid the throes of recession to exact concessions from the federal government.[148] Ultimately, Bank of America was able to receive $20 billion in additional bailout funds and gain protection against losses on approximately $118 billion in toxic assets – marginal gain extracted after the signing of the initial merger agreement.[149] Though this deal reflects the unique circumstances of the credit crisis, it remains illustrative of the way in which buyers are increasingly using MAC provisions to gain and deploy post-signing leverage in acquisition agreements.[150]

V. Drafting Solutions to Facilitate Efficient MAC Enforceability

---

[143] COMMERCIAL CONTRACTS: STRATEGIES FOR DRAFTING AND NEGOTIATING §9.04[[F], at 2 (Vladimir R. Rossman & Morton Moskin eds., Supp. 2015) (hereinafter COMMERCIAL CONTRACTS, the "*Strategies for Drafting and Negotiating*").

[144] Sherri L. Toub, *"Buyer's Regret" No Longer: Drafting Effective MAC Clauses in a Post-IBP Environment*, 24 CARDOZO L. REV. 849, 888–89-889 (2003).

[145] Chertok, *supra* note 5, at 125.

[146] *Id.*Chertok, *supra* note 5, at 126.

[147] William D. Cohan, *An Offer He Couldn't Refuse*, THE ATLANTIC, (Sept. 2009,), at 62, 65.

[148] *Id.*

[149] Chertok, *supra* note 5, at 126.

[150] For a thorough*Id.* at 127-138 (see discussion of more conventional examples of MAC- induced leverage, including deals between Sallie Mae and J.C. Flowers & Co.,. as well as Home Depot, Inc. and Pro Acquisition Corp., see *id.* at 127–38..).

In light of *Tyson* and its progeny, modern MAC provisions provide buyers with limited means of deal termination . As discussed in Section II.A and II.D, MAC provisions are rational, mutually-beneficial tools for buyers and sellers to both allocate adverse change risk and to internalize that risk through other deal parameters (e.g., deal consideration, etc.). Delaware jurisprudence does transaction parties (and their practitioners) a disservice by imposing a MAC standard that is uncertain (see Section IV.A) and practically impossible to achieve.[151] The elevated burden of proof requirement weakens the utility of MAC provisions as a tool for risk allocation by eliminating deal terminations in practice. And the lack of a clearly delineated judicial standard itself imposes additional systemic risk on parties through haphazard judicial application of MAC doctrine and the usurious externality of deal renegotiation (as discussed in Section IV.B). However, transaction parties are not blameless nor helpless. In light of these inefficient judicial developments, practitioners would benefit from reimagining the conventions of MAC provision drafting. Alternative drafting approaches could help combat these perceived shortcoming in the Delaware case law and enhance MAC provision effectiveness at effectuating the intent of the contracting parties and efficiently allocating deal risk .

A. Background – Intentional Ambiguity in Contracting

Traditionally, practitioners have avoided specificity in the drafting of MAC provisions – to the puzzlement of some commentators.[152] Particularly during recessions, practitioner commentators have predicted movement from vague MAC provision drafting toward greater precision and specificity through quantifiable metrics.[153] Vice Chancellor Strine affirmed as much in *Tyson* with his acknowledgement of risks stemming from "capacious" MAC provisions.[154] Further, due to the fact vague MAC drafting has never provided fodder for deal termination in Delaware[155] and specificity helped substantiate the finding of MAC occurrence in a non-Delaware jurisdiction,[156] such an approach offers more potential for MAC enforcement than current convention . Despite this, parties generally draft MAC provisions vaguely.[157]

As a threshold issue, intentional ambiguity in contracting is not prima facie flawed; however, offers mixed value-add . As downside, vague drafting invites self-interested and conflicting contact interpretations.[158] This may stimulate greater conflict between contracting parties, increasing litigation costs and judicial uncertainty.[159] Added litigation and uncertainty may result in unnecessary gamesmanship between parties, threatening more acrimony and deal

[151] *Hexion*, A.2d 715 at 738.
[152] *2010 Nixon Peabody MAC Survey: A Nixon Peabody Study of Current Negotiation Trends of Material Adverse Change Clauses in M&A Transactions*, NIXON PEABODY LLP, 1, http://www.nixonpeabody.com/linked_media/publications/MAC_Survey_2010.pdf (last visited Nov. 7, 2015).
[153] Peter S. Golden, Arthur Fleischer Jr. and David N. Shine, *Negotiated Cash Acquisitions of Public Companies in Uncertain Times*, M&A LAW,LAW., Feb. 2009, at 6.
[154] *IBP v. Tyson*, 789 A.2d at 65.
[155] *Hexion*, 715 A.2d at 738.
[156] *Nip v. Checkpoint Sys. Inc.*, 154 S.W.3d 767, 769–-70 (Tex. App. 2004) (finding that observed loss was in excess of the $50,000 threshold established contractually as MAC trigger).
[157] Albert Choi and George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 881 (2010).
[158] *Id.* at 854.
[159] *Id.* at 882.

risk than but-for inclusion of the ambiguous provisions.[160] Consequently, vague drafting is viewed as antithetical to efficiency.[161]

With that said, scholars have argued that vagueness may be justified when expected litigation costs are outweighed by perceived lower drafting costs during contract formation.[162] Ambiguity may facilitate deal making generally, for both sides can plausibly sell the resultant agreement back to their constituents as advancing their interests.[163] At least theoretically, this vague drafting insulates buyers from the risk a MAC may fall outside the bounds of a quantifiable MAC definition due to an unforeseen or unanticipated manifestation . Contractual vagueness, depending on the provision, adheres to convention, so avoids the negative signaling (e.g. that litigation is anticipated, etc.) potentially communicated as subtext by advocacy for specificity. Further, one could argue that increased litigation costs associated with vague drafting can have a downward pressure on actual litigation, as parties are incentivized to renegotiate outside the formal legal system in the event later conflicts arise so as to avoid legal fees and distraction.[164] Despite instances when ambiguity may confer strategic value, greater specificity with regard to MAC provisions may help alleviate the structural issues derivative from the modern MAC standard – empowering parties to efficiently allocate deal risk through preemptive contracting.

B. Solution – Include Specific Benchmarks and Quantifiable Thresholds for MAC Materiality

To alleviate concerns attributable to the subjective and uncertain MAC standard in Delaware, practitioners should consider drafting MAC provisions with specificity . In particular, drafters should construct MAC provisions to include objective benchmarks and quantifiable thresholds as definitions for MAC materiality, whereby risk allocation may be reclaimed from the court by contracting parties . Materiality benchmarks and thresholds may take a variety of forms – for example, a predetermined decline in EBITDA over a set time period or the occurrence of a particular class of event (measured objectively by exposure, share price decline, etc.) . Because of the inherent variation in structure and operation between businesses and across industries, a general bright-line test for materiality may be imprudent due to a lack of narrow tailoring . However, the contracting process, by definition, is granular and deal-specific . If materiality meant the same thing in every deal, there would be no need for practitioners to tailor boilerplate contracts to meet the expectations of specific parties.[165] By providing the precision and definition otherwise lacking in Delaware's MAC provision case law, practitioners can reclaim the theoretical intent of MAC provisions as efficient allocators of pre-closing adverse change risk . Absent benchmarks and thresholds, the Delaware court has proven time and again that the MAC materiality standard is too high to trigger deal termination (as discussed in Section III) . Such deal-specific quantifiable standards would rectify this judicial circumvention of contracted terms . Though MAC provisions are a tool for buyers to shift risk to sellers, they are not per se buyer-friendly; rather, they are tools to equitably balance and shift risk, risk that, assuming information symmetry, is ultimately internalized in the final deal consideration. Thus, specificity in MAC provision drafting is efficient, empowering parties by conferring a tool for risk allocation that maximizes its function (plausibly permitting deal termination) while internalizing costs (theoretically reflected in an increase in purchase price).

---

[160] *Id.*
[161] *Id.*
[162] *Id.* 854.
[163] Choi & Triantis, supra note 157, at 884–85.
[164] *Id.* at 891.
[165] Toub, *supra* note 144, at 896–97.

Such an approach is not without downside – as reflected in the industry convention for ambiguously drafted MAC provisions. Bargaining for granular benchmarks and thresholds could lead to significant up-front cost by complicating negotiation – threatening agreement in the most hostile of scenarios. Courts could also read these quantitative guidelines as minimums, which may be too rigid of a baseline for interpretation given that certain benchmarks may be based on firm projections or pro forma that, by definition, are volatile, imprecise, and bound to change . Most troublesome is the risk that courts could read these benchmarks as excluding potential adverse events not falling within quantifiable guidelines, though subjectively impairing similar value in the target. Such criticism is not without merit; however, some issues can be partially ameliorated with thoughtful contract language (for example, the inclusion of "including, without limitation" in conjunction with the latter issue).[166] Critics could also argue that MAC provisions, that by language create a mechanism to terminate deals, in practice and intent, are designed to merely trigger deal renegotiation in the event of MAC allegation (see discussion in Section IV.C). Thus, critics may conclude that the court's failure to find occurrence of a MAC is a red herring, as the true policy concern – negotiated purchase price reduction to account for the intervening event – is preserved by the current standard . Though renegotiation may in fact be efficient in its own right (avoiding costs incurred by deal termination, including productivity losses and unrealized due diligence and negotiation),[167] there is no reason why the viable possibility of deal termination cannot work in tandem with renegotiation . Further, the time and expense expended to negotiate MAC provision would be extraneous if mere renegotiation were the ultimate intent of the provision.

Even if practitioners are ignorant of, or unconcerned by, the lack of MAC provision enforceability (content to merely rely on triggered renegotiation in the event of an adverse development), buyers run the risk of declining renegotiation leverage as MAC provisions are increasingly viewed as unenforceable by the Delaware Chancery Court . Buyers retain some leverage from sellers' aversion to the negative publicity stemming from a MAC claim; however, renegotiation leverage is primarily rooted in the risk of litigation to unwind the deal . Unless buyers draft enforceable provisions, buyers (collectively) run the risk of squandering their leverage to renegotiate as sellers come to view the threat of MAC litigation as baseless – due to the Delaware Chancery Court's elevated MAC materiality standard and the implausibility of buyers' efforts to void a deal . Ultimately, though imperfect, defining MAC provision materiality with specific benchmarks and quantifiable thresholds is prudent relative to the alternative – ambiguously drafted MAC provisions which Delaware courts have never found sufficient to trigger deal termination.[168]

C. Solution – Binding Arbitration by Financial Experts

Central to criticism of the modern MAC standard, aside from rendering MAC provisions ineffective, is the belief that the subjectivity with which Delaware defines materiality empowers judges with too much latitude in allocating deal risk . Imposition of quantifiable thresholds empowers the parties themselves to control materiality definition. However, they are still subject to judges and a court system that are unpredictable and at times unsophisticated with regard to financial minutia (though admittedly, the Delaware Chancery Court is more quantitatively sophisticated than most due to the nature of its docket and the resulting selection bias in judge appointment) . Thus, it would be prudent for practitioners to negotiate dispute resolution clauses

[166] Chertok, *supra* note 5, at 136.
[167] Eric L. Talley, *On Uncertainty, Ambiguity, and Contractual Conditions*, 34 DEL. J. CORP. L. 755, 788 (2009).
[168] *Hexion*, 715 A.2d at 738.

whereby MAC materiality disputes would be arbitrated by a panel of financial experts rather than conventional judges. Such predetermined experts would offer more explicit subject matter expertise and the forum of binding arbitration may be marginally more cost effective than conventional litigation. Arguments for such a structure thematically echo those in favor of quantitative benchmarks for MAC materiality – as binding arbitration with experts is efficient and would facilitate a more transparent allocation of deal risk between parties in business combination agreements.

VI. Conclusion

The modern MAC materiality standard – defined by subjective uncertainty and an onerous burden of proof on buyers – is deficient. However, practitioners are not without recourse. By defining MAC materiality contractually with specific benchmarks and quantifiable thresholds and brokering binding arbitration by financial experts, practitioners may dictate materiality terms in a clear, informed, and objective fashion. In doing so, parties may regain control over a powerful tool for allocating deal risk, while efficiently internalizing related burdens through adjustment to the purchase price. Such clarity with regard to risk allocation in business combination agreements would further the interest of both buyers and sellers.